Common School Fund

Annual Financial Report

For the Fiscal Year Ended June 30, 2016

Oregon Department of State Lands

An Agency of the State of Oregon

James T. Paul
Director

Cynthia Wickham
Deputy Director, Administration Division

Report Prepared by:

Vena McCoy, CPA, Fiscal Manager
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FINANCIAL SECTION

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FINANCIAL SECTION

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MERINA
& COMPANY, LLP
Certified Public Accountants and Consultants

CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS

PARTNERS
KAMALA K. AUSTIN, CPA • TONYA M. MOFFITT, CPA

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, 2016, 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 from 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.

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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 respective financial position of the Common School Fund, as of June 30, 2016, and the respective changes in financial position thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Change in Accounting Principle

As discussed in Note 1 I Change in Accounting Principle to the financial statements, the Common School Fund adopted new accounting guidance, GASB Statement No. 72, *Fair Value Measurement and Application.* Our opinion is not modified with respect to this matter.

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, 2016, 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 November 17, 2016 on our consideration of the 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 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 the Common School Fund's internal control over financial reporting and compliance.

Merina & Company

Merina & Company, LLP
West Linn, Oregon
November 17, 2016

BASIC FINANCIAL STATEMENTS

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Balance Sheet

ASSETS	
Cash and Cash Equivalents	$ 52,821,970
Investments	1,369,484,934
Custodial Assets	15,918,116
Securities Lending Collateral	31,277,287
Accounts and Interest Receivables (net)	26,288,014
Due from Other Funds	299,093
Advances to Other Funds	300,000
Net Contracts, Notes, and Other Receivables	55,128
Total Assets	$ 1,496,444,542
LIABILITIES AND FUND BALANCES	
Liabilities:	
Accounts Payable	$ 34,127,226
Obligations Under Securities Lending	31,277,287
Due to Other Funds	548,957
Custodial Liabilities	255,858,740
Total Liabilities	321,812,210
DEFERRED INFLOWS OF RESOURCES	
Unavailable revenue - contracts	55,128
Total Deferred Inflows of Resources	55,128
Fund Balances:	
Restricted by:	
Oregon Constitution	846,067,726
Enabling Legislation	328,509,478
Total Fund Balances	1,174,577,204
Total Liabilities, Deferred Inflows of Resources, and Fund Balances	$ 1,496,444,542

The notes to the financial statements are an integral part of this statement.

Statement of Revenues, Expenditures, and Changes in Fund Balances

REVENUES	
Licenses and fees	$ 995,297
Charges for Services	206,019
Rebates and Recoveries	14,474
Fines, Forfeitures, and Penalties	48,694
Rents and Royalties	5,712,323
Investment (Loss)	(5,086,670)
Sales	468,703
Unclaimed and Escheat Property Revenue	13,628,642
Other	1,145,045
Total Revenues	17,132,527
EXPENDITURES	
Personal Services	8,205,265
Services and Supplies	11,431,071
Capital Improvements	199,681
Investment Expenditures	5,675,959
Total Expenditures	25,511,976
Excess (Deficiency) of Revenues Over (Under) Expenditures	(8,379,449)
OTHER FINANCING SOURCES (USES)	
Transfers From Other Funds	6,521,195
Transfers to Other Funds	(71,285,556)
Insurance Recoveries	3,635,847
Total Other Financing Sources (Uses)	(61,128,514)
Net Change in Fund Balances	(69,507,963)
Fund Balances - Beginning	1,193,802,791
Prior Period Adjustments	85,184
Cummulative Effect of a Change in Accounting Principles	50,197,192
Fund Balances - Beginning - As Restated	1,244,085,167
Fund Balances - Ending	$ 1,174,577,204

The notes to the financial statements are an integral part of this statement.

NOTE 1 – SUMMARY OF SIGNIFICANT ANNOUNTING 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 fund financial statements consist of a balance sheet and a statement of revenues, expenditures and changes in fund balances. The statement of revenues, expenditures, and changes in fund balances reports revenues by type and expenditures by natural classification. Other financing sources and other financing uses are reported in the last section of the statement.

C – MEASUREMENT FOCUS, 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 or soon enough thereafter to pay liabilities existing at the end of the year. For this purpose, revenues are considered available if they are collected within 90 days of the end of the current fiscal year. Expenditures generally are recognized when a liability is incurred, as under accrual accounting. 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.

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 value except for 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 value of investments are recognized as investment income (loss) in the current year.

The fair value of publicly traded debt and equity securities in active markets is determined by the custodian's pricing agent using nationally recognized pricing services. The custodian's pricing agent values equity securities traded on a national or international exchange at the last reported sales price and generally values debt securities by using evaluated bid prices. The fair value of publicly traded real estate investment trust (REIT) securities is determined by the custodian's pricing agent using recognized pricing services.

Derivatives

In accordance with State investment policies, the Office of the State Treasurer participates in contracts that have derivative characteristics. Derivative instruments are used to lower the cost of borrowing, to hedge against fluctuations in foreign currency rates, and to manage the overall risk of investment portfolios. The fair value of all derivative instruments within the Common School Fund are reported on the 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 statement of revenues, expenditures, and changes in fund balances.

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

F – INTERFUND TRANSACTIONS

Inter-fund transactions are transactions between the Common School Fund and other funds included in the Oregon Comprehensive Annual Financial Report. Inter-fund balances (due to/from other funds and advances to/from other funds) result from the time lag between the dates that (1) inter-fund 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 in inter-fund transactions.

G – RESTRICTED ASSETS

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

H – FUND EQUITY

The difference between assets and liabilities plus deferred inflows of resources is labeled "Fund Balance" on the fund financial statements. Fund balance is reported in five components: (1) Non-spendable, (2) Restricted, (3) Committed, (4) Assigned, and (5) Unassigned.

Restricted fund balances are the result of constraints imposed by the 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 all 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. Ending fund balances, therefore, are the result of that spending.

I – CHANGES IN ACCOUNTING PRINCIPLE

For the fiscal year ended June 30, 2016, the Department implemented GASB Statement No. 72, *Fair Value Measurement and Application*, which establishes general principles for measuring fair value and standards of accounting and financial reporting for assets and liabilities measured at fair value. Additional information can be found in Note 2 – Deposits and Investments and Note 10 – Fund Equity.

NOTE 2 – DEPOSITS AND INVESTMENTS

Common School Fund Investment Portfolio held at Treasury

Investments of the Common School Fund held by the State Treasurer (Treasurer) require the exercise of prudent and reasonable care in the context of the Common School Fund's investment portfolio and as part of an overall investment strategy. The Treasurer is required 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 Treasurer is the investment officer for the Council and is responsible for the funds on deposit with the Oregon State Treasury (Treasury). The Treasurer works with the State Land Board to ensure implementation of the asset allocation policy that meets the business needs of the Common School 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 an 70 percent equity and a 30 percent fixed income target with a range of plus or minus 5 percent, 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.

Asset Class	Benchmark	Target Allocation	Range
Domestic Equities	Russell 3000 Index	30%	25% - 35%
International Equities	MSCI ACWI ex-US	30%	25% - 35%
Private Equities	Russell 3000 + 300 bps	10%	0% - 12%
	Total Equities	70%	65% - 75%
US Fixed Income	Barclays Capital Universal Bond Inde	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 Oregon Short-Term Fund (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. Additional information about the OSTF can be found in the OSTF financial statements at:

http://www.oregon.gov/treasury/Divisions/Investment/Pages/Oregon-Short-Term-Fund-(OSTF).aspx

Common School Fund Investments Held Outside Treasury

Statutes govern the placement of investments of the Common School Fund held outside Treasury as part of trust agreements or mandatory asset holdings by regulatory agencies. The Common School Fund investment portfolio includes $15,718,116 held outside Treasury and included in the $15,918,116 identified as custodial assets 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 depository financial institution 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. 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 depository 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 Treasury uses an internally-developed web application to administer the PFCP and facilitate depository, custodian, and public official compliance with ORS Chapter 295. Under the PFCP, depositories are required to report quarterly to Treasury, providing quarter-end public fund balances in excess of Federal Deposit Insurance Corporation (FDIC) or National Credit Union Administration (NCUA) limits. Depositories are also required to report their net worth and capitalization information. The FDIC or NCUA assigns each bank or credit union a capitalization category quarterly: well capitalized, adequately capitalized, or undercapitalized. Based on this information, the depository's minimum collateral required to be pledged with the custodian and the maximum liability in the pool of all depositories is calculated for the next quarter. The maximum liability is reported to the depository, Treasury, and the custodian.

Barring any exceptions, a depository is required to pledge collateral valued at no less than 10 percent of its last reported uninsured public fund deposits if the depository is well capitalized and as much as 110 percent if the depository 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 depository may not accept public fund deposits from one depositor in excess of the depository's net worth. If the depository has a drop in net worth that takes it out of compliance, the depository is required to post 100 percent collateral on any amount the depositor has in excess of the depository's net worth while working to eliminate that excess.
2. A depository may not hold aggregate public funds in excess of a percentage of the depository's net worth based on its capitalization category (100 percent for undercapitalization, 150 percent for adequately capitalized, 200 percent for well capitalized) unless approved for a period of 90 days or less by Treasury.

3. A depository may hold in excess of 30 percent of all aggregate public funds reported by all depositories holding Oregon public funds, only if the excess is collateralized at 100 percent.

Where interest bearing balances within the OSTF exceed the FDIC or NCUA amount of $250,000 the balances were covered by collateral held in the PFCP.

As of June 30, 2016 $776,446 in other depository 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 (SIPC) which provides protection up to $500,000, of which $250,000 applies to cash credit balances. Consequently, the entire depository balance of uninvested 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 counterparty 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 the securities by a custodian or counter party. For the year ended June 30, 2016 no investment holdings of the Common School Fund held at Treasury were exposed to custodial credit risk.

At June 30, 2016 the Common School Fund held $14,941,669 in investments outside Treasury. These investments were held with Wedbush and Xerox investment firms. The firms are members 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 provided 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 for 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 the accounts. No investment holdings of the Common School Fund held outside 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 31 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 plus or minus 20 percent of the Barclays Capital Universal Index. No more than 30 percent of the total fixed income portfolio at market value, may be maintained in securities rated less than Baa3. No more than 10 percent of the total fixed income portfolio, at market value, may be maintained in Rule 144A securities. No more than 25 percent 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).

Interest Rate Sensitive Investments

The Common School Fund held approximately $49.7 million in debt instruments backed by pooled mortgages, TBAs (to-be-announced federal agency-issued mortgage pools), collateralized mortgage obligations (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 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 $10.9 million of asset-backed securities backed primarily by student loan and manufactured housing loan receivables.

The credit rating of the Common School Fund's investments held at Treasury and using the segmented time distribution method at June 30, 2016 follows.

		Investment Maturities (in years)				
Investment Type	Credit Rating[1]	Less than 1	1 to 5	6 to 10	More than 10 or none	Total Market Value
U.S. Treasury Obligations	Exempt	$ -	$ 14,094,915	$ 2,031,557	$ 15,958,754	$ 32,085,225
U.S. Treasury TIPS	Exempt	1,854,642	-	3,633,406	4,560,147	10,048,194
U.S. Federal Agency Debt	AA	-	-	-	137,045	137,045
U.S. Federal Agency Mortgages	Not Rated	5,575,103	45,332	336,784	27,802,169	33,759,388
		7,429,745	14,140,247	6,001,746	48,458,114	76,029,852
Corporate Bonds	AA	-	251,018	480,720	33,835	765,572
	A	149,910	4,120,570	5,964,494	4,450,230	14,685,204
	BBB	1,865,644	5,325,587	8,735,261	9,748,150	25,674,642
	BB	128,363	759,743	1,248,415	3,346,630	5,483,151
	B	-	207,012	376,859	-	583,871
	CCC	-	17,800	49,400	-	67,200
	Not Rated	-	41	-	20	61
		2,143,916	10,681,772	16,855,149	17,578,864	47,259,701
Non-US Government Debt	AA	-	-	297,186	-	297,186
	A	-	2,488	2,444,381	1,314,802	3,761,670
	BBB	-	-	1,990,127	1,954,325	3,944,452
	BB	392,212	-	1,921,556	562,600	2,876,368
	B	-	170,640	599,675	470,000	1,240,315
	CCC	-	246,125	-	-	246,125
	Not Rated	-	-	589,936	-	589,936
		392,212	419,253	7,842,862	4,301,727	12,956,053
International Debt Securities	AA	-	409,611	-	-	409,611
	A	202,586	1,632,261	2,061,115	574,153	4,470,114
	BBB	189,000	1,410,658	2,411,127	1,587,392	5,598,176
	BB	-	572,292	1,091,145	489,186	2,152,623
	B	-	727,495	391,845	152,000	1,271,340
	CCC	-	-	205,680	-	205,680
		391,586	4,752,316	6,160,912	2,802,731	14,107,544

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		Investment Maturities (in years)				
Investment Type	Credit Rating[1]	Less than 1	1 to 5	6 to 10	More than 10 or none	Total Market Value
Asset Backed Securities	AAA	546,712	-	-	7,443	554,155
	AA	3,035,337	-	-	259,041	3,294,378
	A	1,512,251	1,536	-	-	1,513,787
	BB	1,468,770	-	-	-	1,468,770
	B	317,136	-	-	-	317,136
	CCC	1,468,240	-	-	-	1,468,240
	CC	1,160,536	-	-	-	1,160,536
	C	811,138	-	-	-	811,138
	Not Rated	80,416	-	-	185,716	266,132
		10,400,538	1,536	-	452,199	10,854,273
Collateralized Mortgage Obligations	AAA	9,248	-	-	-	9,248
	AA	458,227	-	-	-	458,227
	A	2,105,447	-	-	-	2,105,447
	BBB	1,639,245	-	-	-	1,639,245
	BB	1,050,692	-	-	-	1,050,692
	B	577,499	-	-	-	577,499
	CCC	388,597	-	-	-	388,597
	D	284,759	-	-	-	284,759
		6,513,713	-	-	-	6,513,713
Collateralized Mortgage Backed Securities	AAA	402,164	-	-	965,544	1,367,708
	AA	575,626	-	104,138	774,433	1,454,196
	A	64,174	-	-	69,990	134,164
	BBB	57,024	-	-	-	57,024
	B	851,946	-	-	716,929	1,568,875
	CCC	2,560,765	233,264	-	189,887	2,983,916
	Not Rated	1,729,662	-	179,770	-	1,909,432
		6,241,360	233,264	283,907	2,716,783	9,475,315
Municipals	AAA	194,817	-	-	-	194,817
Mutual Funds, Domestic Fixed Income	Not Rated	235,507,500	-	-	-	235,507,500
Mutual Funds, International Fixed	Not Rated	3,748,256	-	-	-	3,748,256
Total Debt Investments		$ 272,963,643	$ 30,228,387	$ 37,144,576	$ 76,310,418	416,647,025
Equity - Domestic						295,570,712
Equity - International						307,396,867
Equity - Mutual Funds						169,080,609
Private Equity - Domestic						158,412,436
Real Estate - Domestic						13,697,563
Real Estate - International						4,141,853
Rights/Warrants - International						37,869
Investments Held at Treasury						1,364,984,934
Investments Not Held at Treasury, Real Estate						4,500,000
Total Investments						$ 1,369,484,934

[1] Investments of $32,085,225 in U.S. Treasury obligations, $10,048,194 in U.S. Treasury Inflation Protected Securities (TIPS) , and $4,908,025 in Government National Mortgage Association (GNMA), which are reported within U.S. Federal agency mortgages, are explicitly guaranteed by the U.S. government, and therefore, are exempt from credit risk disclosure requirements.

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 exposed to foreign currency risk for the Common School Fund as of June 30, 2016 follow:

	Deposits and Investments (U.S. Dollars)						
Foreign Currency Denominations	**Deposits**	**International Equity Securities**	**Non-US Government Debt**	**International Real Estate**	**Real Estate**	**Rights and Warrants**	**Total**
Australian Dollar	$ 13,317	$ 14,217,298	$ -	$ 832,782	$ -	$ -	$ 15,063,397
Brazil Real	-	-	182,808	-	-	-	182,808
Canadian Dollar	69,262	19,636,585	-	1,861,316	242,994	-	21,810,157
Swiss Franc	59,574	22,502,922	-	-	-	-	22,562,496
Chinese Yuan	20,226	-	887,123	-	-	-	907,349
Danish Krone	55,700	4,455,473	-	-	-	-	4,511,173
Euro	186,584	81,560,092	-	35,067	-	25,308	81,807,051
British Pound	16,012	36,756,895	-	-	-	-	36,772,907
Hong Kong Dollar	160,234	4,532,495	-	615,634	-	-	5,308,363
Israeli Shekel	34,861	1,339,836	-	330,870	-	12,561	1,718,128
Japanese Yen	372,746	54,092,497	-	185,944	-	-	54,651,187
Mexican Peso	274,720	-	3,761,670	-	-	-	4,036,390
Norwegian Krona	58,133	2,809,217	-	-	-	-	2,867,350
New Zealand Dollar	6,736	76,411	-	280,240	-	-	363,387
Swedish Krona	13,993	10,378,581	-	-	-	-	10,392,574
Singapore Dollar	11,829	1,310,298	-	-	-	-	1,322,127
Total	$1,353,927	$253,668,600	$4,831,601	$4,141,853	$ 242,994	$ 37,869	$264,276,844

Investments Held Outside Treasury

Some custodial assets held outside Treasury are not investments. The following table shows the credit rating and segmented time distribution for Investments held outside Oregon State Treasury at June 30, 2016.

Investment Type	Credit Rating	Investment Maturities (in years) Less than 1	1 to 5	6 to 10	Total Market Value
U.S. Treasury Strips [1]	AAA	$ 3,944	$ -	$ -	$ 3,944
U.S. Agency Strips [1]	AAA	966	-	-	966
Municipal Bonds [1]	AAA	37,842	-	4	37,846
Corporate Bonds [1]	AAA	44,283	-	-	44,283
Debt Investments		$ 87,035	$ -	$ 4	87,039
Alternative Equities [1]					4,516
Mutual Funds [1]					8,513,148
Domestic Equity Securities [1]					6,268,537
International Equity Securities [1]					68,429
Total					$ 14,941,669

[1] Some investments (along with certain cash deposits) are reported as part of custodial assets on the balance sheet.

C – FAIR VALUE MEASUREMENTS

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Observable inputs are developed based on market data obtained from sources independent of the reporting entity. Unobservable inputs are developed based on the best information available about the assumptions market participants would use in pricing the asset. The classification of investments within the fair value hierarchy is based upon the activity level in the market for the security type and the inputs used to determine their fair value, as follows:

- Level 1 – Unadjusted quoted prices for identical instruments in active markets.
- Level 2 – Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs are observable.
- Level 3 – Valuations derived from valuation techniques in which significant inputs are unobservable.

Inputs used to measure fair value might fall in different levels of the fair value hierarchy. Categorization within the hierarchy is based on the lowest level input that is significant to the fair value measurement.

The following table shows the fair value classification hierarchy for investments at June 30, 2016.

Investments	Fair Value Classification Heirarchy Level 1	Level 2	Level 3	Total Investments
U.S. Treasury Obligations	$ -	$ 32,085,225	$ -	$ 32,085,225
U.S. Treasury TIPS	-	10,048,194	-	10,048,194
U.S. Federal Agency Debt	-	137,045	-	137,045
U.S. Federal Agency Mortgages	-	33,759,388	-	33,759,388
Corporate Bonds	-	47,259,701	-	47,259,701
International Debt Securities	-	14,107,544	-	14,107,544
Non-US Government Debt	-	12,956,053	-	12,956,053
Asset Backed Securities	-	10,854,273	-	10,854,273
Collateralized Mortgage Obligations	-	6,513,713	-	6,513,713
Collateralized Mortgage Backed Securities	-	9,475,315	-	9,475,315
Municipals	-	194,818	-	194,818
Mutual Funds, Domestic Fixed Income	9,414,025	226,093,475	-	235,507,500
Mutual Funds, International Fixed Income	-	3,748,256	-	3,748,256
Total Debt Investments	9,414,025	407,233,000	-	416,647,025
Equity	602,963,928	-	3,651	602,967,579
Equity - Mutual Funds	106,876,909	62,203,700	-	169,080,609
Rights/Warrants - International	37,869	-	-	37,869
Private Equity - Domestic	-	-	158,412,436	158,412,436
Real Estate Investment Trust	17,839,416	-	-	17,839,416
Investments Held at Treasury	737,132,147	469,436,700	158,416,087	1,364,984,934
Investments Not Held at Treasury, Real Estate	-	-	4,500,000	4,500,000
Total Investments	$737,132,147	$469,436,700	$162,916,087	$1,369,484,934

Fair value classification hierarchy for investments reported in custodial assets at June 30, 2016 is shown on the following table:

Investments Reported in Custodial Assets	Fair Value Classification Heirarchy Level 1	Level 2	Level 3	Total
U.S. Treasury Strips [1]	$ 3,944	$ -	$ -	$ 3,944
U.S. Agency Strips [1]	966	-	-	966
Municipal Bonds [1]	-	37,842	4	37,846
Corporate Bonds [1]	-	44,283	-	44,283
Alternative Equities [1]	-	-	4,516	4,516
Mutual Funds [1]	8,511,332	1,816	-	8,513,148
Domestic Equity Securities [1]	6,268,537	-	-	6,268,537
International Equity Securities [1]	68,425	-	4	68,429
Total	$14,853,204	$ 83,941	$ 4,524	$ 14,941,669

[1] Some investments (along with certain cash deposits) are reported as part of custodial assets on the balance sheet.

Equity securities, including exchange-traded derivatives, are generally valued based on quoted prices from an active market and are therefore categorized in level 1. In the absence of quoted market prices, such as equity securities that trade infrequently or not at all, valuations are based on the last traded price or prices provided by investment managers and are generally categorized in level 3.

Debt securities classified as level 2 are valued using the latest bid prices or evaluated quotes from independent pricing vendors. The third-party vendors use a variety of methods when pricing these securities that incorporate relevant observable market data to arrive at an estimate of what a buyer in the marketplace would pay for a security under current market conditions. When independent price sources are not available, debt securities are priced based on the last traded price or a valuation provided by the investment manager and are categorized in level 3.

Funds priced using a net asset value ("NAV") that is published daily and validated with a sufficient level of observable activity are categorized in level 1. If observable activity is limited, yet supports that the NAV represents an exit value of the security at the measurement date, the securities are categorized in level 2. Investments that are measured at NAV as a practical expedient, such as private equity, are excluded from the fair value hierarchy if the NAV per share (or its equivalent) was calculated in a manner consistent with the Financial Accounting Standards Board's measurement principles for investment companies. Funds not meeting this criterion are categorized in level 3.

Investments in real estate, which consist of investments in real estate investment trusts, are generally valued based on an active market price and are categorized in level 1. Real estate property investments held outside of the Oregon State Treasury are valued by appraisals using market sales approach and income approach.

Private equity consists of 13 funds, organized as limited partnerships and limited liability companies, participating in diversified strategies including leveraged-buyouts, venture capital, growth equity, fund of funds, co-investments and special situations. The fair values of the private equity investments have been determined using the NAV per share (or its equivalent) as provided by the general partner or managing member. These investments can never be redeemed with the fund. Distributions will be received as the underlying investments of the funds are liquidated, which is expected to occur over the next 12-14 years.

D – SECURITIES LENDING

CSF participates in securities lending transactions in accordance with State investment policies. The Oregon State Treasury has, through a Securities Lending Agreement, authorized State Street Bank and Trust Company (State Street) to lend the CSF securities pursuant to a form of loan agreement. Both the State and borrowers maintain the right to terminate all securities lending transactions on demand. There were no significant violations of the provisions of securities lending agreements during the year ended June 30, 2016.

During the year State Street had the authority to loan short-term, fixed income, and equity securities and to receive as collateral U.S. dollar and foreign currency cash, U.S. government and agency securities, and foreign sovereign debt of Organization of Economic Cooperation and Development countries. Borrowers were required to deliver collateral for each loan equal to not less than 102 percent of the market value of the loaned U.S. securities, international fixed income securities, or 105 percent in the case of international equity. The custodian did not have the ability to pledge or sell collateral securities absent a borrower default, and during the fiscal year the State did impose restrictions on the amount of loans the custodian made on its behalf. The State is fully indemnified against losses due to borrower default by its custodian. There were no losses during the year from the failure of borrowers to return loaned securities and no recoveries of amounts from prior losses.

As of June 30, 2016, the fair value of cash and non-cash collateral received was $33.9 million and invested cash collateral was $30.8 million for CSF. There were no significant violations of the provisions of securities lending agreements during the period of these financial statements.

State Street, as a lending agent, has created a fund to reinvest cash collateral received on behalf of the OSTF. CSF receives an allocated portion of this activity based on its deposits in OSTF. As of June 30, 2016, CSF's allocated portion of cash collateral received and invested cash collateral were $0.5 million and $0.5 million respectively. Securities on loan from OSTF in total included U.S. Treasury securities (78.39%), U.S. Agency securities (13.11%), and domestic fixed income securities (8.50%).

As permitted under the fund's Declaration of Trust (Declaration), participant purchases and redemptions are transacted at $1 per unit ("constant value") based on the amortized cost of the fund's investments. Accordingly, the securities lending collateral held and the obligation to the lending agent are both stated at constant value on the balance sheet and statement of net position.

The fair value of investments held by the fund is based upon valuations provided by a recognized pricing service. These funds are not registered with the Securities and Exchange Commission, but the custodial agent is subject to the oversight of the Federal Reserve Board and the Massachusetts Commissioner of Banks. No income from the funds was assigned to any other funds.

The maturities of investments made with cash collateral did not generally match the maturities of the securities loaned. Since the securities loaned are callable on demand by either the lender of borrower, the life of the loans at June 30, 2016 is effectively one day. On June 30, 2016, the CSF had no credit risk exposure to borrowers because the amounts the State owes to borrowers exceed the amounts borrowers owe the State. The following table shows the combined balances of the securities on loan, cash and securities collateral received, and investments of cash collateral held.

Securities Lending as of June 30, 2016

Investment Type	Cash and Securities Collateral Received	Securities on Loan at Fair Value	Investments of Cash Collateral at Fair Value
U.S. Treasury Securities	$ 75,425	$ 73,547	$ 75,449
U.S. Agency Securities	1,821,700	1,795,546	-
Domestic Equity Securities	12,265,551	12,225,894	11,958,444
Domestic Debt Securities	2,339,983	2,292,776	3,372,767
International Equity Securities	17,390,506	16,600,220	15,397,197
	33,893,165	32,987,983	30,803,857
Allocation from Oregon Short Term Fund	668,916	655,369	483,564
Total	$ 34,562,081	$ 33,643,352	$ 31,287,421

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 of 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.

The following table shows the foreign currency exchange contracts subject to foreign currency risk within the Common School Fund as of June 30, 2016:

Currency	Options	Currency Forward Contracts Net Receivables	Currency Forward Contracts Net Payables	Total Exposure
Australian Dollar	$ -	$ 166,239	$ (39,743)	126,496
Brazilian Real	-	-	(23,807)	(23,807)
Canadian Dollar	-	(84,585)	67,161	(17,424)
Swiss Franc	-	(13,126)	16,471	3,345
Yuan Renminbi	-	-	18,476	18,476
Danish Krone	-	(200,901)	-	(200,901)
Euro Currency	25,308	(11,600)	436,540	450,248
Pound Sterling	-	(387,157)	198,631	(188,526)
Hong Kong Dollar	-	367	(8,284)	(7,917)
New Israeli Sheqel	12,561	37	26,771	39,369
Japanese Yen	-	15,387	(223,461)	(208,074)
Norwegian Krone	-	(2,868)	13,312	10,444
New Zealand Dollar	-	196,655	(587)	196,068
Swedish Krona	-	(120,951)	306,966	186,015
Singapore Dollar	-	877	(20,623)	(19,746)
Total	$ 37,869	$ (441,626)	$ 767,823	$ 364,066

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 specific 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.

The following table shows the related net appreciation/ (depreciation) in fair value amounts and the notional amounts of derivative instruments outstanding within the Common School Fund as of June 30, 2016:

Investment Derivatives	Net Appreciation/ (Depreciation) in in Fair Value [1, 3]	Classification	Fair Value	Notional Value [2]
Foreign Exchange Forwards	$ (2,565,285)	Long Term Instruments	$ 326,196	$ 124,934,886
Rights	22,476	Common Stock	25,308	55,680
Warrants	(6,611)	Common Stock	12,561	23,675
Total	$ (2,549,420)		$ 364,065	$ 125,014,241

[1] Negative values (in brackets) refer to losses

[2] Notional may be a dollar amount or size of underlying for futures and options

[3] Excludes futures margin payments

The fair value of derivative instruments is reported on the balance sheet as investments, accounts and interest receivables, and accounts payable. Changes in fair value of derivative instruments during the fiscal year are reported on the statement of revenues, expenditures, and changes in fund balance as investment income.

NOTE 4 – RECEIVABLES AND PAYABLES

A – RECEIVABLES

The following table disaggregates receivable balances reported in the financial statements as accounts and interest receivable (net) and net contracts. Contracts are not expected to be collected within one year of the date of the financial statements. Receivable reported for governmental activities at June 30, 2016.

Governmental activities	Total
General accounts	$ 15,990
Interest	2,117,999
Investment broker receivable	24,154,025
Contracts	101,138
Other Noncurrent Receivables	4,559
Gross receivables	26,393,711
Allowance for doubtful accounts	(50,569)
Total receivables, net	$ 26,343,142

B – PAYABLES

The following table disaggregates accounts payable reported in the financial statements as general accounts payable and broker payable. Payables reported for governmental activities at June 30, 2016.

Governmental activities	Total
General accounts payable	$ 1,366,189
Investment broker payable	32,761,037
Total payables	$ 34,127,226

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 approximately 42% 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, 2016 was $584,372,890. The accumulated annual adjustment as of June 30, 2016 was $328,514,150.

NOTE 5 – LEASES

A – 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 expense and reported in services and supplies. Rental costs for operating leases for the year ended June 30, 2016 were $114,744. The following table shows future minimum rental payments for operating leases in effect as of June 30, 2016.

Year ending June 30,	Payments
2017	$ 126,953
2018	127,340
2019	129,039
2020	109,771
Total future minimum rental payments	$ 493,103

B – LEASE RECEIVABLES

The Department receives rental income from land and property leased to non-state entities. For the year ended June 30, 2016 the Department received rental income of $159,987 on leased assets with a fair market value of $4,500,000. The leased assets are considered investments of the Department of which the fair market value includes net depreciation of $325,046 over the cost of the leased assets. Future minimum lease revenues for non-cancelable operating leases as of June 30, 2016:

Year ending June 30,	Amount
2017	$ 159,614
2018	126,842
2019	74,612
2020	58,223
2021	29,542
Total future minimum rental revenues	$ 448,833

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, cleanup activities, governmental 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, 2016 the Department 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 12.

NOTE 7 – INTERFUND TRANSACTIONS

Inter-fund balances reported in the financial statements as of June 30, 2016:

	Due from Other Funds		
Due to Other Funds	**General**	**Environmental Management**	**Common School**
Capital Projects	$ -	$ -	$ 1,040
Environmental Management	-	-	547,917
Common School	20,663	278,430	-
Total	$ 20,663	$ 278,430	$ 548,957

	Advances to Other Funds		
Advances from Other Funds			**Common School**
Environmental Management	$ -	$ -	$ 300,000

Inter-fund balances result from the time lag between the date a transaction for inter-fund goods and services or reimbursable expenditures is recorded and the date the payment between funds is made. Advances to other funds are not expected to be repaid within one year.

NOTE 8 – RELATED PARTY TRANSACTIONS

The Oregon State Treasurer (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 (Treasury). Treasury acts as the central bank for all state agencies and is the largest financial institution in the state. 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, Secretary of State and 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 Treasurer is the investment officer for the Investment Council. During the year ended June 30, 2016 the Common School Fund paid Treasury $333,545 in fees for the management of the Common School Fund investment portfolio.

NOTE 9 – 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' 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 10 – FUND EQUITY

As of June 30, 2016, the beginning fund balance was restated by $50,282,376 as follows:

Beginning Balance	$	1,193,802,791
Prior Period Adjustments		85,184
Accounting Changes		50,197,192
Beginning Balance - Restated	$	1,244,085,167

An adjustment of $85,184 was made to correct revenue that was recognized in the incorrect period.

Accounting changes of $50,197,192 are the result of implementing GASB Statement Number 72. This statement established standards for defining and measuring investments at fair value. An adjustment of $45,181,492 was made to reflect the change in valuation method to fair value from cost basis for reporting private equity investments. An adjustment of $5,015,700 was made to classify real property as investments, of which $4,701,437 was attributed to reclassifying the cost of real property net of depreciation reported as a capital asset in the State of Oregon Government-wide Financial Statements to other investments in the Common School Fund.

NOTE 11 – 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, 2016 the Common School Fund had approximately $93 million in commitments to purchase private equity investments. These amounts are unfunded and are not recorded in the financial statements.

NOTE 12 – CONTINGENCIES

A – PORTLAND HARBOR SUPERFUND SITE

The Department 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 has listed as a Superfund site under the federal Superfund law (CERCLA). The Department 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.

The Department has received General Notice Letters from the EPA informing it is a potentially responsible party (PRP) under CERCLA for cleanup costs at the site. It is too early in the process to estimate the total amount of the cleanup costs that will be shared by liable parties. A proposed cleanup plan identifies the EPA's preferred option ranging in cost from $746 million to $811 million. It is also too early to estimate proportionate share of the liability for cleanup costs, if any, that may ultimately be assessed against the Common School Fund. When the mediation will end is not known, but it could be as late as 2019.

The Portland Harbor Superfund will also involve a separate allocation of liability for injuries to natural resources caused by contamination at the site, which is an additional type of recovery under the Superfund law known as natural resource damages (NRD). The NRD claim will be asserted against all PRPs, including the Department, by the Portland Harbor natural resource trustees, a group composed of five tribes, two federal agencies, and the State. The trustees have initiated a cooperative injury assessment process funded by thirty parties including the State. The NRD process will result in an allocation of liability for NRD damages at the same time as the allocation of liability for remedial costs, although parties may alternatively elect to seek an earlier settlement with trustees. It is too early to estimate what, if any, share of the liability the Common School Fund may ultimately bear for natural resource damages.

The Department is pursuing claims for insurance coverage of its Portland Harbor defense costs and any future liabilities for cleanup costs and natural resource damages. These claims are based on insurance policies held from 1968 to 1972 that listed the Department as an additional insured. These insurance carriers have agreed to participate in funding the Department's defense in Portland Harbor proceedings, but have reserved their rights to deny indemnity coverage. The Department plans to pursue its rights to indemnity coverage under these policies.

OTHER REPORTS

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PARTNERS
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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, 2016, and the related notes to the financial statements, which collectively comprise the Common School Fund's basic financial statements, and have issued our report thereon dated November 17, 2016.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, 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 Fund's internal control. Accordingly, we do not express an opinion on the effectiveness of the Common School Fund's 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. Given these limitations, during our audit we did

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not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Common School Fund's financial statements are free from 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*.

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

Merina & Company, LLP
West Linn, Oregon
November 17, 2016