Secretary of State

State of Oregon

OFFICE OF ENERGY

Small Scale Energy Loan Program

July 1, 1995 to June 30, 1996

Audits Division

Secretary of State

State of Oregon

OFFICE OF ENERGY

Small Scale Energy Loan Program

July 1, 1995 to June 30, 1996

Audits Division

No. 97-34

April 10, 1997

Secretary of State Audits Division

Auditing for a Better Oregon

The Honorable John Kitzhaber
Governor of Oregon
State Capitol Building
Salem, Oregon 97310

John Savage, Administrator
Office of Energy
625 Marion Street NE
Salem, Oregon 97310

This audit was conducted for the purpose of reporting on the financial statements of the Office of Energy, Small Scale Energy Loan Program (SELP) as of and for the year ended June 30, 1996. Our opinion on those financial statements is presented in the Financial Section of this report.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

As required by those standards, we reviewed SELP's system of internal control in order to determine the audit procedures necessary to gather sufficient competent evidence in support of our opinion on the financial statements. We also performed tests of SELP's compliance with applicable laws and regulations. Our report includes comments about the need for improvement in SELP's accounting for cash and investments, as well as comments regarding internal control and compliance with legal requirements. Those comments may be found in the Audit Results section of this report.

OREGON AUDITS DIVISION

Don Waggoner, CPA
State Auditor
Fieldwork Completion Date:
January 15, 1997

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

SUMMARY

This audit concludes that the financial statements of the Office of Energy, Small Scale Energy Loan Program (SELP) for the year ended June 30, 1996, which are included in this report, are fairly presented. The report also provides recommendations for improvement in SELP's accounting for cash and investments.

SELP is funded through the sale of general obligation bonds. Bond proceeds are loaned to individuals, businesses, organizations, and local governments in Oregon to finance projects that save otherwise wasted energy or produce renewable energy sources. The bonds are then paid off from the principal and interest payments received from program borrowers and from earnings on invested funds. Besides principal and interest payments, borrowers also pay fees which help fund SELP's operating costs.

SELP did not issue any new bonds during fiscal year 1996. New loans totaling $11.4 million were approved during the same period. As of June 30, 1996, outstanding loans receivable, net of an allowance for uncollectible accounts, were $177.2 million. Bonds payable at that date totaled $206.6 million.

INTRODUCTION

ORGANIZATION AND FUNCTIONS

In May 1980, the voters approved Article XI-J of the Oregon Constitution, authorizing the sale of general obligation bonds to finance small scale, local energy projects within Oregon. The bond program is administered by the Small Scale Energy Loan Program (SELP) within the Office of Energy, which in turn is a part of the Department of Consumer and Business Services. SELP is authorized to issue and have outstanding bonds equal to one-half of one percent of the true cash value of all property in the state.

Oregon Revised Statutes chapter 470 provides for a Small Scale Energy Project Advisory Committee to review loan applications and make recommendations to the administrator of the Office of Energy. The seven committee members are appointed by the administrator to serve two year terms.

The loan program finances energy conservation and renewable resource energy projects to meet local community or regional energy needs in Oregon. Renewable resources include water, wind, geothermal heat, solar radiation, biomass, and waste heat. SELP also funds projects that use alternative fuels, save transportation energy, and make products from recycled material. Program loans are made to individual residents, Oregon businesses, nonprofit organizations, municipal organizations, and state agencies.

FINANCIAL ACTIVITIES

SELP is funded through the sale of general obligation bonds. Bond proceeds are deposited in the Small Scale Local Energy Project Loan Fund, and are used to finance energy projects. Loan repayments and fees from borrowers, as well as earnings on invested assets, are deposited in the Small Scale Local Energy Project Administration and Bond Sinking Fund. Those funds are used to make payments of principal and interest on outstanding bonds and to pay the administrative costs of operating the program.

During fiscal year 1996, SELP did not issue new bonds. New loans totaling $11.4 million were approved during the year. At June 30, 1996, total bonds outstanding were $206.6 million, and net loans receivable were $177.2 million.

AUDIT RESULTS

REPORT ON INTERNAL CONTROL

We have audited the financial statements of the Office of Energy, Small Scale Energy Loan Program (SELP), as of and for the year ended June 30, 1996, and have issued our report thereon dated January 15, 1997.

We conducted our audit in accordance with generally accepted auditing standards and *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.

The management of SELP is responsible for establishing and maintaining a system of internal control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal controls. The objectives of an internal control system are to provide management with reasonable assurance regarding the reliability of financial reporting, the effectiveness and efficiency of operations, and compliance with laws and regulations. Because of inherent limitations in any system of internal control, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of internal control to future periods is subject to the risk that controls may become inadequate because of changes in conditions or that the effectiveness of the design and operation of controls may deteriorate.

In planning and performing our audit of the financial statements of SELP for the year ended June 30, 1996, we obtained an understanding of internal control. With respect to the internal control system, we obtained an understanding of the design of relevant controls and whether they have been placed in operation, and we assessed control risk in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on internal control. Accordingly, we do not express such an opinion.

We noted certain matters involving the internal control system and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal controls that, in our judgment, could adversely affect the entity's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. The matters we consider to be reportable conditions are included in the FINDINGS AND RECOMMENDATIONS section of this report.

A material weakness is a reportable condition in which the design or operation of one or more of the specific internal control components does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving internal controls that we consider to be material weaknesses as defined above.

REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

We have audited the financial statements of the Office of Energy, Small Scale Energy Loan Program (SELP), as of and for the year ended June 30, 1996, and have issued our report thereon dated January 15, 1997.

We conducted our audit in accordance with generally accepted auditing standards and *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.

Compliance with laws, regulations, contracts and trust indentures is the responsibility of the Office of Energy management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of SELP's compliance with certain provisions of laws, regulations, contracts and trust indentures. However, the objective of our audit of the financial statements was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance that are required to be reported herein under *Government Auditing Standards*.

FINDINGS AND RECOMMENDATIONS

ACCOUNTING FOR CASH AND INVESTMENTS

SELP did not have internal controls in place to assure transactions and balances are accurately recorded in the accounting records. In particular, cash and investment transactions and balances were not properly recorded. For example:

- Some investment transactions were not recorded in the general ledger. During the year under audit, $2.5 million in investment purchases and $3 million in investment sales were never recorded to the investment accounts.

- Non-cash transactions were recorded in the cash accounts. Premium and discount amortization totaling $27 thousand for the year, which should have been recorded as increases or decreases to investment book value, were incorrectly recorded as cash receipts. In addition, $2 million in borrower's investment balances were recorded on the books as cash.

- Adjustments were made to the books as net entries, rather than specifically identifying which accounts were not correct and making the appropriate entries. As of June 30, 1996, a general ledger adjustment of $2 million was made to cash and investments to force the investment balances to agree exactly to the balances reported by the State Treasurer. SELP accounting staff made no effort to identify the source of the differences.

In part, these errors occured because SELP accountants did not separately reconcile cash and investments. Although reconciliations to Control Accounting were prepared monthly in a four column format, they only reconciled cash and investments in total. For the June 30, 1996, audit date, SELP prepared a reconciliation to State Treasury as well as to Control Accounting. However, it also combined the cash and investment balances, and it did not include transactions. Monthly reconciliations to Control Accounting were not reviewed and approved by SELP management. Because cash and investments were reconciled only in total, errors that effect both cash and investments were not identified. Further, when errors were identified they were not corrected timely. Some reconciling items at June 30, 1996, had been outstanding for more than one year.

A reliable information system includes controls to assure that all valid transactions are identified and recorded, properly classified, correctly valued, and recorded in the proper period. SELP does not have the controls in place to provide this assurance and as a result, SELP's cash and investment balances on the general ledger are neither accurate nor complete.

Inadequate cash reconciliations expose the agency to a greater risk that assets could be misappropriated without being detected timely. The reconciliation process should enable SELP accountants to identify and correct the errors recorded in the cash and investment balances in the general ledger.

We recommend SELP immediately begin reconciling cash to State Treasury records on a monthly basis. Investments should be separately reconciled to the Treasury records monthly. The reconciliations should be prepared in a four-column format, and should be reviewed by management for accuracy and to determine if reconciling items are properly identified.

AUDITEE'S RESPONSE:

Office of Energy agrees with the recommendation. We will separately reconcile cash and investments to State Treasury records along with the reconciliation we now perform to Control Accounting. We will continue to reconcile to Control Accounting until we convert to the new Statewide Financial Management System.

The separate reconciliation of investments to Treasury records will assure that actual transactions rather than net results are recorded in the general ledger. All non-cash investment transactions such as amortization of bond premium and discount will be recorded in the investment accounts rather than the cash accounts.

We have begun working with other agencies to obtain timely information to implement this recommendation. We will reconcile investments separately to Treasury records on a monthly basis. Our reconciliations will be in a four-column format that includes monthly transactions as well as beginning balances. Use of the four-column format should ensure that non-cash transactions are recorded as investments. Management will review the reconciliations monthly.

These changes should provide the necessary management control of assets. The changes will allow for timely correction of entry errors. They also will provide controls to assure that the general ledger contains accurate cash and investment balances.

We believe these changes will provide proper internal controls.

FOLLOW-UP ON PRIOR AUDIT FINDINGS

This section reports the current status of findings included in our prior audit report issued for the period from July 1, 1994, to June 30, 1995. The scope of the prior audit was to express an opinion on SELP's financial statements.

We had originally planned to complete field work for our prior audit by March 15, 1996. However, SELP's inability to produce financial statements timely delayed that completion until June 5, 1996. That delay may be partially responsible for SELP's not yet implementing our prior audit recommendations.

Prior Audit Findings	Disposition
1. Controls over SELP's accounting records and financial reporting were inadequate. The accounting records contained errors that had not been identified and corrected by accounting staff. Additional errors were made by the accounting staff when preparing the financial statements. Some note disclosures did not agree to supporting documentation.	1. SELP has partially implemented our recommendations. We identified some of the same errors during the current period as were present during our previous audit, as discussed in the FINDINGS AND RECOMMENDATIONS section of this report.
2. SELP's process for reconciling cash and investment balances and transactions did not provide sufficient management control over those assets. Cash and investments were not reconciled separately, but only in total. As a result, errors effecting both cash and investments were not identified and corrected.	2. SELP has not implemented our recommendations. Similar observations and recommendations are contained in our current comments in the FINDINGS AND RECOMMENDATIONS section of this report.

REPORT DISTRIBUTION

This report is a public record and is intended for the information of Office of Energy management, the governor of the state of Oregon, the Oregon Legislative Assembly, and all other interested parties.

COMMENDATION

The courtesies and cooperation extended by officials and employees of the Office of Energy during the course of the audit were very commendable and are sincerely appreciated.

AUDIT TEAM

Joel Leming, CPA, Audit Administrator
Sheila Orton, CPA
William Rodriguez
Janice Richards

FINANCIAL SECTION

The Honorable John Kitzhaber
Governor of Oregon
State Capitol
Salem, Oregon 97310

John Savage, Administrator
Office of Energy
625 Marion Street
Salem, Oregon 97310

INDEPENDENT AUDITOR'S REPORT

We have audited the accompanying balance sheet of the Office of Energy, Small Scale Energy Loan Program, as of June 30, 1996, and the related statements of revenues, expenses and changes in retained earnings, and the statement of cash flows for the year then ended. These financial statements are the responsibility of the management of the Office of Energy. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards* issued by the Comptroller General of the United States. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Small Scale Energy Loan Program, and are not intended to present fairly the financial position of the Office of Energy, and the results of its operations and cash flows of its governmental fund types, fiduciary fund types, and accounting groups in conformity with generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Office of Energy, Small Scale Energy Loan

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Program, as of June 30, 1996, and the results of its operations and cash flows for the year then ended in conformity with generally accepted accounting principles.

Reports in accordance with *Government Auditing Standards* on the Office of Energy, Small Scale Energy Loan Program internal control and compliance with laws and regulations are presented in the Audit Results section of this report.

OREGON AUDITS DIVISION

Don Waggoner, CPA
State Auditor
January 15, 1997

STATE OF OREGON

OREGON OFFICE of ENERGY

SMALL SCALE ENERGY LOAN PROGRAM

BALANCE SHEET

ENTERPRISE FUND

ASSETS

	June 30, 1996	June 30, 1995
Cash	$ 20,753,680	$ 17,483,856
Investments (net)	19,892,415	29,656,868
Investment interest receivable	229,196	215,629
Loan interest receivable	2,649,127	3,238,830
Loan receivable (net)	177,196,396	186,666,423
Total Assets	$ 220,720,814	$ 237,261,606

LIABILITIES AND FUND EQUITY

	1996	1995
Liabilities:		
Accounts payable	$ 40,741	$ 112,679
Matured bonds payable	541,150	895,225
Bond interest payable	6,535,328	7,952,360
Employee vacation payable	30,711	35,470
Arbitrage liability	68,358	-0-
Deferred income	199,051	237,051
Borrowers' reserve funds	2,095,201	4,864,414
Bonds payable	206,593,667	220,545,330
Total Liabilities	216,104,207	234,642,529
Fund Equity:		
Retained earnings	4,616,607	2,619,077
Total Liabilities and Fund Equity	$ 220,720,814	$ 237,261,606

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

STATE OF OREGON

OREGON OFFICE of ENERGY

SMALL SCALE ENERGY LOAN PROGRAM

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN RETAINED EARNINGS

ENTERPRISE FUND

	Year Ended June 30,	
Operating revenue:	1996	1995
Interest on loans	$ 14,002,550	$ 15,348,717
Interest on investments	2,407,233	2,655,269
Application and commitment fees	35,852	44,971
Loan fees	33,629	47,078
Miscellaneous	465,262	37,930
Total operating revenue	16,944,526	18,133,965
Operating expense:		
Bond interest and debt service expense	13,834,763	14,928,874
Personal services	577,665	664,742
Services and supplies	436,279	574,295
Bad debt expense	98,289	683,393
Total operating expenses	14,946,996	16,851,304
Net income	1,997,530	1,282,661
Retained earnings - beginning	2,619,077	1,754,125
Prior period adjustment	-0-	(417,709)
Retained earnings - ending	$ 4,616,607	$ 2,619,077

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

STATE OF OREGON
OREGON OFFICE of ENERGY
SMALL SCALE ENERGY LOAN PROGRAM
STATEMENT OF CASH FLOWS
ENTERPRISE FUND

	Year Ended June 30,	
	1996	1995
Operating income	$ 1,997,530	$ 1,282,661
Adjustments to reconcile operating income to cash provided by operating activities:		
Bad debt expense	98,289	683,393
Arbitrage liability	68,358	-0-
Interest received on investment reported as operating income	(2,407,233)	(2,655,269)
Bond interest and amortization reported as operating income	13,686,931	14,668,139
(Increase)/decrease in loan interest receivable	589,703	(1,013,008)
(Increase)/decrease in loan receivable	9,470,027	(13,837,879)
Increase/(decrease) in accounts payable	(71,938)	75,587
Increase/(decrease) in bond interest payable	(1,417,032)	886,753
Increase/(decrease) in matured bonds payable	(354,075)	561,525
Increase/(decrease) in employee vacation payable	(4,759)	(2,946)
Increase/(decrease) in borrowers' reserve funds	(2,769,213)	1,503,474
Increase/(decrease) in deferred income	(38,000)	(37,000)
	16,851,058	832,769
Net cash provided (used) by operations	$18,848,588	$ 2,115,430

Continued on next page

STATE OF OREGON
OREGON OFFICE of ENERGY
SMALL SCALE ENERGY LOAN PROGRAM
STATEMENT OF CASH FLOWS (continued)
ENTERPRISE FUND

	Year Ended June 30,	
	1996	1995
Net cash provided (used) by operations	$18,848,588	$ 2,115,430
Cash flows from non-capital financing activities:		
Proceeds from bond sales	-0-	22,723,684
Principal payments on bonds	(14,245,000)	(13,090,000)
Payment on bonds refunded	-0-	(5,080,000)
Interest payments on bonds	(14,810,624)	(13,504,362)
Cash expense of refunding bonds	-0-	(94,137)
Net cash provided by non-capital financing activities	(29,055,624)	(9,044,815)
Cash flows from investing activities:		
Purchase of investments	(2,510,690)	(44,405,866)
Proceeds from sale and maturities of investments	12,926,778	24,127,058
Interest received on investments	3,060,772	2,772,579
Net cash provided by investing activities	13,476,860	(17,506,229)
Net increase/(decrease) in cash and cash equivalents	3,269,824	(24,435,614)
Cash and cash equivalents at beginning of period	17,483,856	41,919,470
Cash and cash equivalents at end of period	$ 20,753,680	$ 17,483,856

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

STATE OF OREGON

OREGON OFFICE of ENERGY

SMALL SCALE ENERGY LOAN PROGRAM

NOTES TO THE FINANCIAL STATEMENTS

ENTERPRISE FUND

JUNE 30, 1996

The accompanying financial statements of the Small Scale Energy Loan Program (SELP) have been prepared in conformity with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB), the Financial Accounting Standards Board (FASB), and the American Institute of Certified Public Accountants. Under the auspices of GASB Statement No. 20, SELP does not apply FASB pronouncements issued after November 30, 1989, for proprietary activities, unless GASB amends its pronouncements to specifically adopt FASB pronouncements issued after that date.

(1)

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

SELP was created through the adoption of Article XI-J of the Oregon Constitution in May 1980. The Small Scale Energy Loan Program is a part of the state of Oregon and its Office of Energy. Effective July 1, 1995, the Department of Energy became the Office of Energy in the Department of Consumer and Business Services.

Basis of Presentation

The accounts of the Oregon Office of Energy are organized on the basis of funds and account groups, each of which is considered a separate accounting entity with a self-balancing set of accounts. The state accounts for SELP as an enterprise fund. Enterprise funds are used for operations that are financed and operated in a manner similar to private business enterprises, where the costs of providing goods and services to the general public on a continuing basis are intended to be financed or recovered primarily through user charges.

Basis of Accounting

Enterprise funds use the flow of economic resources measurement focus and financial statements are presented on the accrual basis. Under the accrual basis of accounting, revenues are recognized when they are earned and expenses are recognized when the liabilities are incurred. All assets and liabilities associated with the operations of these funds are included on the balance sheet. Fund equity (i.e., net total assets) is shown as retained earnings.

SELP accounting policies conform to the Oregon Accounting Manual and generally accepted accounting principles as applicable to state governments. SELP general ledger transactions are recorded on a cash basis. These cash basis transactions have been converted to the accrual basis for financial reporting.

Budgets

The Office of Energy's budget is approved by the Legislature biennially. Any increase in the budget that may be necessary during the interim is approved by the Emergency Board of the Legislature. Limitations are financed from revenues of self-supporting activities and lapse at the end of the biennium. Any Legislative limitation established for SELP applies only to administrative costs that are separated in the approved budget.

Cash, Cash Equivalents and Investments

Cash and cash equivalents are defined as cash held in the State Treasury and cash on deposit outside the State Treasury.

Investments are stated at amortized cost and are accounted for using the completed transaction basis. Since it is management's intention to hold investments to maturity, investments are not valued at the lower of cost or market.

Properties acquired through foreclosure proceeding or by acceptance of deeds in lieu of foreclosure are included in investments and are recorded at the lower of cost or fair market value. Cost is defined as the outstanding principal balance of the mortgage loan or contract on the date of foreclosure. Professional appraisers estimate fair market value. The lower of cost or fair market value is then adjusted for estimated selling expenses to arrive at the new realizable value.

Interest Receivable

Interest receivable on investments and loans is recorded at its expected recoverable amount. Therefore, no allowance for doubtful accounts is recorded for accrued interest receivable.

Loans Receivable

Receivables are shown net of uncollectible accounts. The Allowance for Uncollectible Accounts at June 30, 1996, was $1,746,903.

Fixed Assets and Depreciation

Fixed assets are stated at historical cost or estimated historical cost if the original cost is not determinable. Fixed assets costing less than $5,000 or having a useful life of less than two years are not capitalized. SELP has no capitalized assets.

Compensated Absences

Employees accrue vacation leave at various accrual rates and may generally be paid for up to a maximum of 250 hours of accrued vacation leave at termination. Accumulated vacation leave is recorded as an expense and a liability of those funds as the benefits accrue to the employees. No liability is recorded for nonvesting, accumulated sick pay benefits.

Bond Expenses

Bond issuance costs, except for underwriter's discounts, are expensed when incurred. Bond premiums and discounts associated with a particular bond issue are deferred and amortized over the term of the bond issue, using the bonds outstanding method of amortization.

(2)

CASH AND INVESTMENTS

SELP funds are held by the State Treasurer. The State Treasurer is the investment officer for funds on deposit in the State Treasury. The state's investment policies are governed by statute, and are overseen by the Oregon Investment Council. The State Treasurer may invest in any instrument which persons of prudence, discretion, and intelligence would invest in for their own account. State moneys may be deposited in any trust company, savings and loan association, or bank or mutual savings bank or branch office in that capacity within the state. The state is authorized to use demand deposits and certificates of deposit. At June 30, 1996, SELP funds were invested primarily in US government securities and dealer repurchase agreements.

Cash and investments are legally required to be segregated into the Loan Fund and the Sinking Fund. Cash and investments at June 30, 1996, consisted of:

	Cash	Investments
Loan Fund	$(466,467)	$ 9,739,408
Sinking Fund		
Program Account	5,375,950	2,187,298
Bond Reserve		3,448,000
Principal and Interest Account	14,925,370	
Extraordinary Expense Account	377,677	1,959,100
Deferred Account		199,051
Borrower's Account		2,084,558
Held by Fiscal Agent	541,150	
Assets held by agency		275,000
	$ 20,753,680	$ 19,892,415

Cash Deposits

As of June 30, 1996, the book balance of cash was $20,753,680. The Treasury Department and fiscal agent (bond payment account) cash balance was $20,987,459. All moneys received by SELP are required to be deposited with the State Treasurer. All cash held by the State Treasurer is insured or collateralized. The Federal Deposit Insurance Corporation (FDIC) insures up to $100,000. All funds over this amount are included in the statewide collateral pool, a multiple financial institution collateral pool which protects public deposits pursuant to ORS 295.015.

On June 30, 1996, the state's fiscal agent (Chase Manhattan Bank) was holding SELP funds totaling $541,150 for redemption of bonds and coupons which had matured, but had not yet been redeemed. This amount is included in SELP's cash. These funds are not collateralized, but are insured by the FDIC up to $100,000 per bondholder. If a bondholder has other accounts with Chase Manhattan Bank, the combined account balances are insured up to $100,000.

Investments

Governmental Accounting Standards Board Statement No. 3 requires that investments be categorized to give an indication of the level of risk assumed as of year end. The three categories of credit risk are:

1) Insured or registered, or securities held by the state of Oregon or its agent in the state of Oregon's name for the SELP program.

2) Uninsured and unregistered with securities held by the counterparty's trust department or agent in the state of Oregon's name for the SELP program.

3) Uninsured and unregistered with securities held by the counterparty, or by its trust department or agent but not in the state of Oregon's name for the SELP program.

Investments include Treasury bills, commercial paper, certificates of deposit, repurchase agreements, Treasury notes and bonds. All of SELP's investments are in credit risk category 1, insured or registered, and securities are held by the state of Oregon or its agent in the state's name. As of June 30, 1996, the investment portfolio consisted of:

	Book Value	Market Value
US Government Securities	$ 7,608,353	$ 8,200,220
Municipal Bonds	310,554	314,354
Dealer Repurchase Agreement	11,698,508	11,698,508
Preferred Stock	275,000	-0-
Totals	$ 19,892,415	$20,213,082

SELP holds 2,750 shares of WTD, Inc. preferred stock subject to the following rights: $100 per share liquidation preference; limited voting rights; cumulative dividends payable quarterly in advance at the prime rate, with a minimum rate of 6% and a maximum rate of 9%; convertible into WTD, Inc. common stock at $7.50 per share after April 30, 1999; and redeemable at the original issue price plus any accrued dividends at the option of the board of directors, in the form of cash or in exchange for senior unsecured debt with 12% coupon. The holders of the Series A preferred stock will be granted voting control of the WTD, Inc. board of directors in the event the company misses three consecutive quarterly dividend payments, four quarterly dividend payments within twenty-four months or a total of eight quarterly dividend payments. There are no arrearages in the quarterly dividends. This stock was received by court order as part of the settlement in a Chapter 11 bankruptcy reorganization.

Securities Lending Program

The Oregon Investment Council has authorized securities lending agreements whereby securities are loaned to broker-dealers for a fee. Borrowers pledge and maintain collateral. In the event borrowers default on their obligation to return the securities, the entity would bear an economic gain or loss equal to the difference between the collateral and obligation amount plus the fee.

As of June 30, 1996, the State Treasurer, as investment officer, had securities with a par value of $450,000 and a market value of $473,697 on loan to broker-dealers. The market value of collateral pledged pertaining to these outstanding loans was $487,500.

(3)

LOANS RECEIVABLE

The loan and contract receivable portfolio at June 30, 1996, is $177,196,396 (net of allowance for uncollectible accounts of $1,746,903) which includes $20,356,595 from state agencies. All mortgaged property is located within Oregon. SELP is exposed to a statewide concentration of credit risk in the amount of approximately $158,586,704. SELP uses the allowance method to estimate uncollectible mortgage loans and contracts receivable. The allowance for all new loans and contracts is based primarily upon the percent of new loans. The allowance is periodically adjusted by management to accommodate changes in economic conditions, non-performing assets, historical loss experience, and other conditions which may affect the ultimate collectibility of the mortgage loans and contracts. In 1996 SELP management determined that the balance of the allowance account was sufficient to cover projected losses for the loan and contract portfolio.

(4)

BONDS PAYABLE AND DEBT SERVICE

The table below provides a summary of general obligation bond transactions of SELP for the fiscal year ended June 30, 1996:

Bonds Payable (Par) at June 30, 1995	$ 222,785,000
Bonds Retired	(14,245,000)
Bonds Payable (Par) at June 30, 1996	$ 208,540,000

Shown below are the components of net bonds payable as disclosed on the balance sheet for June 30, 1996:

Bonds Payable (Par)	$ 208,540,000
Discount on Bonds Sold	(1,946,333)
Net Bonds Payable	$ 206,593,667

Following is a schedule of future debt service requirements to maturity as of June 30, 1996.

Date	Principal	Interest	Total Debt Service
1997	14,160,000	12,805,006	26,965,006
1998	12,440,000	12,078,012	24,518,012
1999	12,520,000	11,419,227	23,939,227
2000	13,165,000	10,717,844	23,882,844
2001	13,540,000	9,957,314	23,497,314
Thereafter	142,715,000	65,835,744	208,550,744
Total	$208,540,000	$122,813,147	$331,353,147

(5)

DEFEASED DEBT

SELP defeased certain general obligation bonds by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in SELP's financial statements.

On June 30, 1996, $14,795,000 of SELP's bonds are considered defeased.

(6)

BOND CALL

On January 1, 1996, SELP called bonds with coupon rates from 7.7% to 9.5% and an aggregate principal amount of $3,740,000 prior to maturity with proceeds from loan prepayments. SELP recognized a loss of $13,141.

On July 1, 1996 SELP called bonds with coupon rates from 7.2% to 9.25% and an aggregate principal amount of $3,505,000 prior to maturity with proceeds from loan prepayments. SELP recognized a loss of $26,624 during the current fiscal year for this bond call.

(7)

DEFINED BENEFIT RETIREMENT PLAN

SELP employees participate in the Oregon Public Employe's Retirement System (PERS), a cost-sharing multiple employer benefit plan. All SELP employees are eligible to participate in the system after completing six months of service. PERS is administered by the Public Employes Retirement Board under the guidelines of the Oregon Revised Statutes, chapter 238. The PERS retirement allowance, payable monthly for life, may be selected from twelve retirement benefit options. Options include survivorship benefits and lump sum refunds. The basic benefit formula is 1.67 percent of a member's final average salary multiplied by the member's number of years of service. Benefits may also be calculated under either a money match or an annuity-plus-pension computation if a greater benefit results. PERS also provides death and disability benefits. A copy of the Oregon Public Employes Retirement System annual financial report may be obtained from PERS, P. O. Box 73, Portland, Oregon 97207-0073.

Covered employees are required by state statute to contribute 6 percent of their salary to the plan. Current law permits employers to pay employee contributions to the retirement fund. SELP is required by statute to contribute actuarially computed amounts as determined by PERS. Rates are subject to change as a result of subsequent actuarial valuations. Currently the rate is 8.46 percent of each covered employee's salary. The amounts contributed by SELP for the years ending June 30, 1996, 1995, and 1994, were $66,108, $75,865 and $70,959, respectively, equal to the required contributions for each year. No pension liability existed at June 30, 1996, determined in accordance with Statement No. 27 of the Governmental Accounting Standards Board.

(8)

UNEMPLOYMENT BENEFITS

State departments are subject to the Department of Employment Act. State employees who qualify are entitled to benefit payments during periods of unemployment. Each state department is required to reimburse the Employment Department for benefit payments made to their former employees. There is no practical method of estimating the amount of future benefit payments which may be made to former employees for wage credits earned prior to June 30. Consequently, this potential obligation is not included in the accompanying financial statements. There were no charges to SELP for the fiscal year ended June 30, 1996.

(9)

LITIGATION

During the ordinary course of business, SELP becomes involved in litigation regarding its lending activities. The program is represented in these actions by the Attorney General of the state of Oregon. As of June 30, 1996, SELP was not currently a party to litigation that would materially affect the financial position of the program.