Secretary of State

State of Oregon

OFFICE OF ENERGY

Small Scale Energy Loan Program

For the Years Ended June 30, 1997 and 1996

Audits Division

-

Secretary of State

State of Oregon

OFFICE OF ENERGY

Small Scale Energy Loan Program

For the Years Ended June 30, 1997 and 1996

Audits Division

No. 98-16

May 22, 1998

-ii-

OFFICE OF THE
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Auditing for a Better Oregon

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

John Savage, Administrator
Office of Energy
625 Marion Street NE
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This audit was conducted for the purpose of reporting on the Office of Energy, Small Scale Energy Loan Program's (SELP) financial statements as of and for the years ended June 30, 1997, and 1996, and on the internal controls and compliance with applicable laws and regulations.

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 also required by those standards, we reviewed the internal controls of SELP 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 comments regarding internal controls and compliance with legal requirements are presented in the Audit Results section of this report.

OREGON AUDITS DIVISION

John N. Lattimer
Director

Fieldwork Completion Date:
February 13, 1998

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SUMMARY

This audit concludes the financial statements of the Office of Energy, Small Scale Energy Loan Program (SELP) for the years ended June 30, 1997, and 1996, which are included in this report, are fairly presented. The report also provides recommendations for improvement in SELP's internal controls over accounting and financial reporting.

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.

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 loaned to individuals, businesses, organizations, and local governments in Oregon to finance projects that save otherwise wasted energy or produce renewable energy sources. 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 1997, SELP did not issue new bonds. New loans totaling $4.3 million were approved during the year. At June 30, 1997, total bonds outstanding were $192.7 million, and net loans receivable were $169.9 million.

AUDIT RESULTS

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INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL AND COMPLIANCE BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

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, 1997, and have issued our report thereon dated February 13, 1998.

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.

Internal Controls

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 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 procedures 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, 1997, we obtained an understanding of internal control. With respect to the internal control system, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we

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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 internal control 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.

Our consideration of internal control would not necessarily disclose all matters affecting internal control that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of one or more of the 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 control that we consider to be material weaknesses as defined above.

Compliance

Compliance with laws and regulations applicable to SELP is the responsibility of SELP's 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 and regulations. 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*.

OREGON AUDITS DIVISION

Sharron E. Walker, CPA, CFE
Deputy Director

February 13, 1998

FINDINGS AND RECOMMENDATIONS

ACCOUNTING AND FINANCIAL REPORTING

Since our last audit, SELP has improved its controls over accounting and financial reporting. Non-cash transactions are no longer being recorded in the cash accounts, reconciliations separately identify cash and investment transactions, and cash balances and transactions are reconciled to State Treasury balances.

However, SELP's internal controls continue to need improvement. A reliable system of internal control should assure that all valid transactions are identified and recorded, classified properly, valued correctly, and recorded in the proper period.

During our audit, we identified errors and misstatements such as investment income that was not recorded, adjustments recorded in the wrong period, transactions not reported in accordance with generally accepted accounting principles, and unidentified differences between financial statement balances.

In addition, SELP accountants continued to struggle with cash reconciliations after conversion to a new accounting system. As of February 1998, the July 1997 reconciliation of the Sinking Fund account to State Treasury had yet to be successfully completed.

We recommend SELP accountants increase their understanding of the new accounting system. This will assist in identifying errors and misstatements in the general ledger.

General ledger balances of investment income should be reconciled to subsidiary records prepared from Treasury records. At a minimum, this reconciliation should be prepared annually, and all errors identified should be corrected prior to preparation of the annual financial statements.

Cash reconciliations should be brought current, and all errors identified in the reconciliation process corrected. Management should continue to review and approve cash reconciliations.

Management should design and put in operation internal controls to assure that transactions and balances are properly identified, recorded and valued, and are correctly reported in the financial statements. Ideally, those controls should be reduced to writing and management should monitor to assure they are functioning.

AUDITEE'S RESPONSE:

The Office of Energy agrees with the recommendations of the auditors. We have continued to work with the Statewide Financial Management System staff (SFMS) of the Department of Administrative Services and with other state bonding agencies to learn correct procedures and T-codes for recording transactions.

The Office of Energy, including the Small Scale Energy Loan Program, converted to the new SFMS accounting system on May 16,1997. This was a complex and time-consuming conversion that required revising our accounting structure and identifying the appropriate codes for recording transactions. During the conversion process three different SFMS analysts were assigned to help us set up the new system and determine the best way to record transactions. We agree that there were conversion problems, but we have learned much through this process. We have learned new T-codes to record unique transactions. We continue to learn the new system as we work with other agencies and SFMS staff to develop new procedures and T-codes necessary to implement new accounting standards.

We will continue to monitor our methods for recording investment income, although we believe the problems noted by the auditors were conversion problems and are not on-going system problems. We will contact other agencies to help us determine the best method to track and reconcile investment income for financial reporting purposes.

We agree that we have taken a number of months to determine what reports and what method we should use to perform a four-column reconciliation between SFMS and Treasury records. We no longer rely on the reconciliations performed by others, because we have assumed that duty and adjusted the process to meet our needs. We have reconciled seven months (two months in the audit year and five months in the current year) as of the date of this response. We expect to be current with all reconciliations by May 15, 1998. Management will continue to review reconciliations on a monthly basis.

Finally, we will document our internal controls by updating the procedures manual we wrote as part of the conversion process. We recognize that we need to modify the manual to document changes we have implemented as a result of understanding the system better.

FOLLOW UP ON PRIOR AUDIT FINDINGS

This section reports follow-up action taken by SELP management on findings included in our prior audit report issued for the period from July 1, 1995, to June 30, 1996. The scope of the prior audit was to express an opinion on SELP's financial statements.

Prior Audit Finding	Disposition
SELP did not have internal controls in place to assure transactions and balances were accurately recorded in the accounting records, particularly for cash and investment transactions. The accounting records contained errors that had not been identified and corrected by accounting staff. These errors occurred, in part, due to inadequacies in the cash reconciliation process.	SELP has partially implemented our recommendations. In accordance with the plan for conversion to the new accounting system, the Department of Administrative Services prepared cash reconciliations to Treasury for May and June 1997 that included transactions and were reviewed and approved by management. However, we identified some of the same types of accounting and financial reporting errors during the current period as were present during our previous audit, as discussed in the Findings and Recommendations section of this report.

REPORT DISTRIBUTION

This report is a public record and is intended for the information of the 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 management and staff of the Office of Energy during the course of our audit were very commendable and sincerely appreciated.

AUDIT TEAM

Joel Leming, CPA, Audit Administrator
Sheila Orton, CPA
Janice Richards
Stanley Mar

FINANCIAL SECTION

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INDEPENDENT AUDITOR'S REPORT

We have audited the accompanying financial statements of the Office of Energy, Small Scale Energy Loan Program, as of and for the years ended June 30, 1997, and 1996. 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 audits.

We conducted our audits 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. 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 audits provide 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 account 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 Program, as of June 30, 1997, and 1996, and the results of its operations and cash flows for the years then ended in conformity with generally accepted accounting principles.

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In accordance with *Government Auditing Standards,* we also have issued a report dated February 13, 1998, on our consideration of the Office of Energy, Small Scale Energy Loan Program's internal control and its compliance with laws and regulations.

OREGON AUDITS DIVISION

Sharron E. Walker, CPA, CFE
Deputy Director

February 13, 1998

EXHIBIT A

STATE OF OREGON
OFFICE of ENERGY
SMALL SCALE ENERGY LOAN PROGRAM
BALANCE SHEETS
ENTERPRISE FUND
JUNE 30, 1997 AND JUNE 30, 1996

ASSETS

	1997	1996
Cash and cash equivalents	$ 31,135,483	$ 20,753,680
Cash equivalents securities lending collateral	1,685,691	0
Investments (net)	6,463,710	19,892,415
Investment interest receivable	231,934	229,196
Unbilled arbitrage receivable	363,090	0
Loan interest receivable	1,602,751	2,649,127
Loan receivable (net)	169,930,749	177,196,396
Total Assets	$ 211,413,408	$ 220,720,814

LIABILITIES AND FUND EQUITY

	1997	1996
Liabilities:		
Accounts payable	$ 712	$ 40,741
Matured bonds payable	838,325	541,150
Obligations under securities lending	1,685,691	0
Bond interest payable	6,107,354	6,535,328
Employee vacation payable	30,852	30,711
Arbitrage liability	496,458	68,358
Deferred income	162,051	199,051
Borrowers' reserve funds	3,342,346	2,095,201
Bonds payable	192,665,322	206,593,667
Total Liabilities	205,329,111	216,104,207
Fund Equity:		
Retained earnings	6,084,297	4,616,607
Total Liabilities and Fund Equity	$ 211,413,408	$ 220,720,814

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

EXHIBIT B

STATE OF OREGON
OFFICE of ENERGY
SMALL SCALE ENERGY LOAN PROGRAM
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN RETAINED EARNINGS
ENTERPRISE FUND
FOR THE FISCAL YEARS ENDED JUNE 30, 1997 AND JUNE 30, 1996

	1997	1996
Operating revenue:		
Interest on loans	$ 12,985,942	$ 14,002,550
Interest on investments	1,856,858	2,407,233
Application and commitment fees	76,711	35,852
Loan fees	18,719	33,629
Miscellaneous	566,050	465,262
Total operating revenue	15,504,280	16,944,526
Operating expense:		
Bond interest and debt service expense	13,036,805	13,834,763
Personal services	549,654	577,665
Services and supplies	439,944	436,279
Bad debt expense	10,187	98,289
Total operating expense	14,036,590	14,946,996
Net income	1,467,690	1,997,530
Retained earnings – beginning	4,616,607	2,619,077
Retained earnings – ending	$ 6,084,297	$ 4,616,607

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

EXHIBIT C

STATE OF OREGON
OFFICE of ENERGY
SMALL SCALE ENERGY LOAN PROGRAM
STATEMENTS OF CASH FLOWS
ENTERPRISE FUND
FOR THE FISCAL YEARS ENDED JUNE 30, 1997 AND JUNE 30, 1996

	1997	1996
Operating income	$ 1,467,690	$ 1,997,530
Adjustments to reconcile operating income to cash provided by operating activities:		
Expenses not requiring outlay of cash:		
Bad debt	10,187	98,289
Arbitrage liability	428,100	68,358
Interest received on investment reported as operating income	(1,856,858)	(2,407,233)
Bond interest and amortization reported as operating income	12,608,705	13,686,931
(Increase)/decrease in loan interest receivable	1,046,376	589,703
(Increase)/decrease in loan receivable	7,265,647	9,470,027
(Increase)/decrease in unbilled receivable	(365,828)	0
Increase/(decrease) in accounts payable	(40,029)	(71,938)
Increase/(decrease) in bond interest payable	(427,974)	(1,417,032)
Increase/(decrease) in obligation under securities lending	1,685,691	0
Increase/(decrease) in arbitrage payable	428,100	0
Increase/(decrease) in matured bonds payable	297,175	(354,075)
Increase/(decrease) in employee vacation payable	141	(4,759)
Increase/(decrease) in borrowers' reserve funds	1,247,145	(2,769,213)
Increase/(decrease) in deferred income	(37,000)	(38,000)
Total Adjustments	22,289,578	16,851,058
Net cash provided (used) by operations	$23,757,268	$ 18,848,588

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

STATE OF OREGON

OFFICE of ENERGY

SMALL SCALE ENERGY LOAN PROGRAM

STATEMENTS OF CASH FLOWS (continued)

ENTERPRISE FUND

FOR THE FISCAL YEARS ENDED JUNE 30, 1997 AND JUNE 30, 1996

	1997	1996
Net cash provided (used) by operations	$23,757,268	$ 18,848,588
Cash flows from non-capital financing activities:		
Principal payments on bonds	(14,160,000)	(14,245,000)
Interest payments on bonds	(12,805,006)	(14,810,624)
Net cash provided by non-capital financing activities	(26,965,006)	(29,055,624)
Cash flows from investing activities:		
Purchase of investments	-0-	(2,510,690)
Proceeds from sale and maturities of investments	13,381,793	12,926,778
Interest received on investments	1,893,439	3,060,772
Net cash provided by investing activities	15,275,232	13,476,860
Net increase/(decrease) in cash and cash equivalents	12,067,494	3,269,824
Cash and cash equivalents at beginning of period	20,753,680	17,483,856
Cash and cash equivalents at end of period	$ 32,821,174	$ 20,753,680
Cash and cash equivalents in State Treasury	$ 31,135,483	
Cash equivalents securities lending collateral	1,685,691	
Total	$ 32,821,174	

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

STATE OF OREGON
OFFICE of ENERGY
SMALL SCALE ENERGY LOAN PROGRAM
NOTES TO THE FINANCIAL STATEMENTS
ENTERPRISE FUND
JUNE 30, 1997 AND JUNE 30, 1996

(1)

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization
The Small Scale Energy Loan Program (SELP) was created through the adoption of Article XI-J of the Oregon Constitution in May 1980. SELP 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 accompanying financial statements 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 (AICPA).

The accounts of the 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.

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.

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. All SELP moneys are held in the Oregon Short Term Fund (OSTF) and are considered to be cash equivalents, which is a cash and investment pool having characteristics of a demand deposit account. The State Treasurer participates in securities lending with a portion of the OSTF. SELP's share of the cash collateral received from broker-dealers is disclosed in the balance sheet as Cash Equivalents Securities Lending Collateral. In implementing GASB Statement No. 28, SELP has chosen not to restate prior period financial statements for securities lending due to the difficulty of obtaining prior period data.

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 estimated 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, 1997 and 1996, was $1,773,922 and $1,746,903, respectively.

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, 1997 and 1996, SELP funds were invested primarily in US government securities.

Cash and investments are legally required to be segregated into the Loan Fund and the Sinking Fund. Cash and investments at June 30, 1997 and 1996, respectively consisted of:

	June 30, 1997		June 30, 1996	
	Cash	Investments	Cash	Investments
Loan Fund	$4,654,776		$(466,467)	$9,739,408
Sinking Fund				
Program Account	7,879,518	3,759,103	5,375,950	2,187,298
Bond Reserve	2,991,000			3,448,000
Principal & Interest	11,522,348		14,925,370	
Extraordinary Expense	2,336,777		377,677	1,959,100
Deferred Revenue				199,051
Borrowers' Account	$912,739	$2,429,607		$2,084,558
Fiscal Agent	838,325		541,150	
Assets held by agency		275,000		275,000
	$31,135,483	$6,463,710	$20,753,680	$19,892,415

Cash Deposits

At June 30, 1997, the book balance of cash and cash equivalents was $32,821,174 less the $1,685,691 of cash equivalent securities under securities lending agreements for a net book balance of $31,135,483. The bank balance was $32,839,981, of which $32,001,656 was held in demand accounts with the State Treasurer and was invested in the Oregon Short Term Fund (OSTF) and $838,325 was held by the State's fiscal agent. State Treasurer demand deposit accounts and time certificates of deposit investments of the OSTF are held in state banks and insured or collateralized in excess of FDIC coverage for a minimum of 25 percent in accordance with State statute.

At 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.

Securities in the OSTF are held by the State Treasurer’s agent in the name of the State of Oregon. They consist of 40 percent in government securities and 60 percent in time certificates of deposit, bankers acceptances, and other short-term commercial paper. Earnings on the OSTF are allocated on a pro-rata basis of daily account balances.

On June 30, 1997 the State's fiscal agent (Mellon Bank) was holding SELP funds totaling $838,325 for redemption of bonds and coupons which had matured but had not yet been redeemed. On June 30, 1996, the State's fiscal agent (Chase Manhattan Bank) was holding SELP funds totaling $541,150. These amounts are 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 Mellon Bank, the combined account balances are insured up to $100,000.

Investments

SELP’s investments are categorized below to give an indication of the level of risk assumed by SELP at year-end. Category 1 includes investments that are insured or registered, with securities held by SELP or its agent in SELP’s name. Category 2 includes uninsured and unregistered investments, with securities held by the counterpart’s trust department or agent in SELP’s name. Category 3 includes uninsured and unregistered investments, with the securities held by the counterpart or by its trust department or agent but not in SELP’s name.

As of June 30, 1997 the investment portfolio consisted of:

	Risk Category			Carrying	Fair
	1	2	3	Amount	Value
Investments not on securities loan:					
US Government	$5,878,622			$5,878,622	$6,277,299
Municipal Bonds	310,088			310,088	311,073
Preferred stock	275,000			275,000	-0-
Allocated portion of reinvested cash collateral from OSTF:					
US Government			594,598	594,598	595,287
Repurchase agreements			182,310	182,310	182,521
Commercial paper			878,602	878,602	879,621
Subtotal	$6,463,710	$ 0	$1,655,510	8,119,220	8,245,801
Investments held under securities loans with cash collateral:					
US Government				1,638,066	1,647,344
Subtotal				9,757,286	9,893,145
Less:					
Balances treated as cash and cash equivalents on balance sheet				(3,293,576)	(3,304,773)
Total investments				$6,463,710	$6,588,372

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

In accordance with State investment policies, state agencies may participate in securities lending and the State has, through Securities Lending Authorization Agreements, authorized its custodians to lend the State's securities pursuant to a form of loan agreement. There have been no significant violations of the provisions of securities lending agreements during the period of these financial statements.

During the year, the State's custodians lent short-term and fixed income securities and received as collateral US dollar cash, US government and agency securities, or letters of credit. Borrowers were required to deliver collateral for each loan equal to not less than 102% of the market value of the loaned security. The custodians did not have the ability to pledge or sell collateral securities absent a borrower default, and the State did not impose any restrictions during the fiscal year on the amount of the loans the custodians made on its behalf. The State, through its securities lending agreements, is fully indemnified against borrower default. There were no losses during the year from the failure of borrowers to return loaned securities and no recoveries of amounts from prior losses.

The maturities of investments made with cash collateral during the year generally did not match the maturities of their securities loans. On June 30, 1997, the State had no credit risk exposure to borrowers. On June 30, 1997, SELP had no securities on loan.

SELP's cash balances are invested in the OSTF, as is the cash of other state agencies. As of June 30, 1997, the market value of the collateral held and the value of the securities on loan, including accrued income, from the OSTF was $272,531,250 and $266,331,457, respectively. SELP's allocated portion of the securities on loan and the related collateral is presented in the accompanying schedule of investments.

At 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 includes state agency loans. All mortgaged property is located within the state. The loan portfolio value and associated statewide concentration of credit risk is:

	June 30, 1997	June 30, 1996
Loans and contracts	$171,704,671	$178,943,299
State agency loans	(19,246,563)	(20,356,595)
Credit risk exposure	$152,458,108	$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 1997 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 years ended June 30, 1997, and 1996:

	June 30, 1997	June 30, 1996
Bonds payable – beginning	$208,540,000	$222,785,000
Bonds retired	(14,160,000)	(14,245,000)
Bonds payable – ending	194,380,000	208,540,000
Discount on bonds payable	(1,714,678)	(1,946,333)
Net bonds payable	$192,665,322	$206,593,667

Following is a schedule of future debt service requirements to maturity as of June 30, 1997:

Date	Principal	Interest	Total Debt Service
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
2002	13,745,000	9,151,071	22,896,071
Thereafter	128,970,000	56,684,672	185,654,672
Total	$194,380,000	110,008,140	$304,388,140

(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, 1997, none of SELP's bonds were considered defeased. On June 30, 1996, $14,795,000 of SELP's bonds were considered defeased.

(6)

BOND CALL

No bonds were called prior to stated maturity during the fiscal year ended June 30, 1997.

On January 1, 1996, SELP called bonds with coupon rates from 7.7% to 9.5% and recognized a loss of $13,141.

On July 1, 1996, SELP called bonds with coupon rates from 7.2% to 9.25% and recognized a loss of $26,624 during fiscal year 1996.

(7)

DEFINED BENEFIT RETIREMENT PLAN

SELP employees participate in the Oregon Public Employee'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 Employees 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 Employees 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 6.0 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, 1997, 1996, and 1995, were $62,484, $66,108 and $75,865, respectively, equal to the required contributions for each year. No pension liability existed at June 30, 1997, determined in accordance with Statement No. 27 of the Governmental Accounting Standards Board.

(8)

UNEMPLOYMENT BENEFITS

State agencies are subject to the Department of Employment Act. State employees who qualify are entitled to benefit payments during periods of unemployment. Each state agency is required to reimburse the Oregon Employment Department for benefit payments made to 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, 1997.

(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, 1997, SELP was not currently a party to litigation which would materially affect the financial position of the program.

(10)

SUBSEQUENT EVENTS

SELP has issued a draft of a Preliminary Official Statement and intends to issue bonds on March 31, 1998.

Facts About the Secretary of State Audits Division

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

Directory of Key Officials

Director	John N. Lattimer
Deputy Director	Catherine E. Pollino, CGFM
Deputy Director	Sharron E. Walker, CPA, CFE

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