Secretary of State

State of Oregon

DEPARTMENT OF VETERANS' AFFAIRS

July 1, 1997, through June 30, 1998

Audits Division

Secretary of State

State of Oregon

DEPARTMENT OF VETERANS' AFFAIRS

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No. 98-50

December 30, 1998

OFFICE OF THE
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Auditing for a Better Oregon

The Honorable John Kitzhaber
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This audit was performed for the purpose of reporting on the general-purpose financial statements of the Department of Veterans' Affairs (department) as of and for the year ended June 30, 1998. Our opinion on the financial statements is included 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 also required by those standards, we reviewed the department's internal control and compliance with laws and regulations. Our report on the results of those reviews is presented in the Audit Results section of this report.

OREGON AUDITS DIVISION

John N. Lattimer
Director

Fieldwork completion date:
December 1, 1998

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

SUMMARY

BACKGROUND

The Oregon Department of Veterans' Affairs (department) has as its primary operations the veterans' loan program, the veterans' services program, and the veterans' home program. The loan program is financed through the sale of tax-exempt general obligation bonds. These bonds are then retired using borrower repayments and investment earnings. The veterans' services programs are funded by a combination of state General Fund Appropriations and fee income from its conservatorship program. These programs provide counseling assistance, conservatorship services, education aid, and partial funding for county veterans' services offices. The Oregon Veterans' Home at The Dalles, Oregon became operational in November 1997 and is currently about fifty percent occupied. The Home is a 151 bed skilled nursing and Alzheimer's Disease care facility operated by a private long-term care provider under contract with the department. Resident veterans generally pay for the cost of care not paid by the United States Department of Veterans' Affairs.

AUDIT PURPOSE

The audit was conducted for the purpose of reporting on the department's general-purpose financial statements for the year ended June 30, 1998, and on internal control and compliance with laws and regulations.

AUDIT RESULTS

This audit concludes the department's financial statements for the year ended June 30, 1998, are presented fairly. Our review and evaluation of the department's internal control and tests of compliance with laws and regulations disclosed no significant findings.

INTRODUCTION

ORGANIZATION AND FUNCTIONS

The Oregon Department of Veterans' Affairs (department) was created in 1945 to aid veterans in obtaining benefits and to provide home and farm loans to veterans at favorable interest rates. *Oregon Revised Statutes* (ORS) 407.115 provides that the department be headed by a director who is responsible for its administration. ORS 406.210 establishes an Advisory Committee. The director, who must be a war veteran chosen on the basis of executive and administrative ability, is appointed by the governor with written approval of the Advisory Committee, and is subject to confirmation by the Senate. Members of the Advisory Committee must be veterans and are appointed by the governor for four-year terms.

Employing approximately 159 people, the department consists of four main divisions and the director’s senior management group.

The **Administrative Services Division** is responsible for collections, office and business services, and property management for the department.

The **Financial Administration Division** is responsible for accounting, budgeting, financial reporting, records management, and information systems for the department. This division is also responsible for debt management including bond issuance, debt service, and tax and bond covenant compliance.

The **Veterans' Loan Division** is responsible for home and farm loan processing. The department has made about 300,000 home and farm loans since it was created, with a principal amount of over $7 billion. These loans are financed with proceeds of general obligation bonds issued by the department.

The **Veterans' Services Division** is responsible for counseling and claims services to veterans, their dependents and survivors. It assists them in making application for benefits to which they may be entitled. This division is also responsible for the conservatorship program which manages the estates of veterans and their dependents who are considered “protected persons” by various Oregon probate courts and who are unable to manage their own affairs.

The **Administration Group** includes the director, deputy director, internal auditor, personnel unit, and an executive officer and staff responsible for oversight of the new veterans’ home.

The department was directed by the 1993 Oregon Legislative Assembly to develop and administer an Oregon Veterans’ Home, a long term skilled nursing and Alzheimer's Disease care facility for disabled veterans. Construction of the facility, at The Dalles, Oregon, cost some $13 million of which about one third was funded by a Wasco County bond levy and about two thirds was paid by federal funds. The 151 bed facility opened in November 1997 and is currently about fifty percent occupied. Resident veterans generally pay for the cost of care not paid by the United States Department of Veterans' Affairs. The facility is operated by a private long-term care provider under contract with the department.

FINANCIAL ACTIVITIES

The primary source of revenue in the Enterprise Fund is the interest portion of mortgage loan and contract repayments. Another major source of income is investment income derived from Enterprise Fund investments and cash held by the State Treasury. Major expenses of the Enterprise Fund include interest on outstanding bonds and general administrative expenses (e.g., employee salaries and benefits, and services and supplies). The primary source of funds in the Expendable Trust Fund is from veterans' Social Security and pension benefits. The primary expenditure is related to beneficiary care.

The veterans' farm and loan program and the veterans' home program are accounted for as Enterprise Funds. Under generally accepted accounting principles applicable to state and local governmental units, Enterprise Funds are used to account for activities which operate primarily on a self-sustaining basis. The conservatorship program within the Veterans' Services Division is accounted for as an Expendable Trust Fund. Expendable Trust Funds are used to account for the collection and disbursement of assets held in trust for a group of individuals.

The department utilizes the Department of Administrative Services' Statewide Financial Management System to record its financial transactions and account balances.

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 general-purpose financial statements of the Department of Veterans' Affairs (department) as of and for the year ended June 30, 1998, and have issued our report thereon dated December 1, 1998, which was qualified because insufficient audit evidence exists to support the department's disclosures with respect to the year 2000 issue.

Except as discussed in the preceding paragraph, we conducted our audit in accordance with generally accepted auditing standards 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 general-purpose financial statements are free of material misstatement.

Internal Control
The management of the department 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 controls may become inadequate

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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 general-purpose financial statements of the department, for the year ended June 30, 1998, 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 general-purpose financial statements and not to provide an opinion on internal control. Accordingly, we do not express such an opinion.

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 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 general-purpose 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 the Department of Veterans' Affairs is the responsibility of the department's management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the department's compliance with certain provisions of laws and regulations. However, the objective of our audit of the general-purpose 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

December 1, 1998

REPORT DISTRIBUTION

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

COMMENDATION

The courtesies and cooperation extended by the officials and employees of the Oregon Department of Veterans' Affairs during the course of our audit were commendable and are much appreciated.

AUDIT TEAM

Dennis Rose, CPA, Audit Administrator
Bob Jordan, CPA
Ron Forehand
Lorna Christopherson

FINANCIAL SECTION

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INDEPENDENT AUDITOR'S REPORT

We have audited the accompanying general-purpose financial statements of the state of Oregon Department of Veterans' Affairs (department) as of and for the years ended June 30, 1998, and June 30, 1997. These general-purpose financial statements are the responsibility of the department's management. Our responsibility is to express an opinion on these general-purpose financial statements based on our audits.

Except as discussed in the following paragraph, we conducted our audits in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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.

Govermental Accounting Standards Board Technical Bulletin 98-1, *Disclosures About Year 2000 Issues*, requires disclosure of certain matters regarding the year 2000 issue. The Department of Veterans' Affairs has included such disclosures in Note 13. Because of the unprecedented nature of the year 2000 issue, its effects and the success of related remediation efforts will not be fully determinable until the year 2000 and thereafter. Accordingly, insufficient audit evidence exists to support the department's disclosures with respect to the year 2000 issue made in Note 13. Further, we do not provide assurance that the department is or will be year 2000 ready, that the department's year 2000 remediation

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efforts will be successful in whole or in part, or that parties with which the department does business will be year 2000 ready.

As discussed in Note 1, the general-purpose financial statements of the Department of Veterans' Affairs, state of Oregon, are intended to present the financial position and results of operations and the cash flows of the proprietary fund type of only that portion of the financial reporting entity of the state of Oregon that is attributable to the transactions of the department.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to examine evidence regarding the year 2000 disclosures, the general-purpose financial statements referred to above present fairly, in all material respects, the financial position of the Department of Veterans' Affairs as of June 30, 1998, and June 30, 1997, and the results of its operations and the cash flows of its proprietary fund type for the years then ended in conformity with generally accepted accounting principles.

Our audits were performed for the purpose of forming an opinion on the general-purpose financial statements taken as a whole. The combining financial statements and schedule are presented for purposes of additional analysis and are not a required part of the general-purpose financial statements. Such information has been subjected to the auditing procedures applied in the audit of the general-purpose financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the general-purpose financial statements taken as a whole.

A report in accordance with *Government Auditing Standards* on the department's internal control and its compliance with laws and regulations is separately presented in the AUDIT RESULTS section of this report.

OREGON AUDITS DIVISION

Sharron E. Walker, CPA, CFE
Deputy Director

December 1, 1998

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

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STATE OF OREGON
DEPARTMENT OF VETERANS' AFFAIRS
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 1998

(1)
SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

REPORTING ENTITY

The Department of Veterans' Affairs (the "Department") is a department of the State of Oregon. The Department's director is appointed by the Governor with input from the Advisory Committee and is subject to confirmation by the Oregon Senate. The director must be a war veteran chosen on the basis of his or her executive and administrative ability. The Advisory Committee is a nine-member board, appointed by the Governor, that acts in an advisory capacity to the director concerning all matters upon which the director requests counsel. The State Legislature has significant ability to influence funding, approve the Department's budget, and pass laws governing the Department.

The Department was created in 1945 to help veterans in obtaining benefits under federal, state, and local programs and to undertake the Veterans' Loan Program to provide home and farm loans to veterans at favorable interest rates. The Veterans' Loan Program is operated through earnings of the program itself, which is financed through the sale of tax-exempt general obligation bonds. These bonds are then retired through regular principal and interest payments from borrowers and earnings from invested funds.

The Department also acts as conservator of estates for approximately 290 veterans, survivors, and minor or helpless children of veterans who the court has determined are unable to manage their own financial affairs.

The Oregon Veterans' Home provides skilled nursing and Alzheimer's disease care to some of Oregon's most vulnerable veterans. The single-story, 75,000 square foot facility offers care in a home-like environment, complementing the philosophy of personal independence.

BASIS OF ACCOUNTING

The accompanying financial statements of the Department have been prepared in conformity with generally accepted accounting principles (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB). Under the auspices of GASB Statement No. 20, the Department does not apply Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989 for proprietary activities unless GASB amends its pronouncements to specifically adopt FASB pronouncements issued after that date. The Department complies with the State of Oregon guidelines in applying GAAP following GASB Statement No. 20.

The accounts of the Department are organized on the basis of funds and account groups. A fund is defined as a fiscal and accounting entity with a self-balancing set of accounts recording assets, liabilities, and equities which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations or restrictions.

The Veterans' Loan Program and the Veterans' Home Program are accounted for within the Enterprise Fund. The Enterprise Fund is presented using the accrual basis of accounting and the flow of economic resources measurement focus. Under the accrual basis of accounting, revenues are recognized when they are earned and expenses are recognized when the liabilities are incurred.

The Conservatorship Program and donations for the Veterans' Home Program are accounted for within the Expendable Trust Fund. A trust fund is established to account for assets received and held by an agency acting in the capacity of trustee or custodian. The Expendable Trust Fund is presented using the modified accrual basis of accounting and the flow of current financial resources measurement focus. Under this method, revenues are recognized when they become measurable and available and expenditures are recognized when the liabilities are incurred. Veterans' benefits, which are the primary revenue sources, are susceptible to accrual.

The Veterans' Services Division is accounted for within the General Fund. It is presented using the modified accrual basis of accounting and the flow of current financial resources measurement focus. Revenues and expenditures are recognized in essentially the same manner as the Expendable Trust Fund described above.

The General long-term Debt Account Group consists of a long-term liability for compensated absences payable. The liability was incurred by the Veterans' Services Division and is an obligation of the General Fund.

BUDGETARY PROCESS

The Department's budget for all funds is approved biennially by the Oregon Legislature. Any increase in the budget that may be necessary during the interim is approved by the Emergency Board of the Legislature. Appropriations are financed from general governmental revenues of the State General Fund. Limitations, which represent an authority to spend as approved by the Executive and the Legislative branches, are financed from general governmental revenues or revenues of self-supporting activities. Appropriations and limitations are treated identically for budgetary and accounting purposes. Both lapse at the end of the biennium.

The appropriated budget is prepared by fund, function and department. Within the Department, the Director may make transfers of appropriations without legislative approval. The legal level of budgetary control is at the department level.

The budgetary basis of accounting is materially consistent with the GAAP basis of accounting, except for transactions related to long-term receivables and payables, debt service, and the acquisition and depreciation of fixed assets. For budgetary purposes, these transactions may or may not be treated as revenues and expenditures. Encumbrance accounting is allowed during the biennium. However, encumbrances are not allowed at the end of a biennium except those related to capital construction, capital improvement, continuing contracts, and contested claims, which are continuously appropriated.

CASH AND CASH EQUIVALENTS

Cash and Cash Equivalents include: cash on hand, cash and investments held by the State Treasury in the Oregon Short-Term Fund (OSTF), and cash deposits held by the State's fiscal agent for payment of matured bonds and coupons. All monies held in the OSTF 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. The Department's share of the cash collateral received from broker-dealers is disclosed in the balance sheet as Cash and Cash Equivalents – Securities Lending Collateral.

INVESTMENTS AND INVESTMENT INCOME

The Department's investments are stated at fair value. The Department implemented GASB Statement 31 for the fiscal year ended June 30, 1998. The Department has chosen not to restate prior period financial statements for fair value due to the cost of assembling the information.

Quoted market values were used to value investments with the following exceptions: nonparticipating interest-earning investment contracts and certain conservatorship investments. Nonparticipating interest-earning investment contracts are exempt from fair value reporting and are shown on the financial statements at amortized cost. Conservatorship investments include U.S. Savings bonds which were valued at current redemption values as a substitute for quoted market value. In addition, equity securities in privately held entities were valued at estimated market value.

Investment Income includes changes in the fair value of investments and is recognized as a revenue in the operating statement (or statement of changes in fund balance). Realized gains based on the net increase in fair value of investments are included as a component of Investment Income.

REAL ESTATE OWNED

Properties acquired through foreclosure proceedings or by acceptance of deeds in lieu of foreclosure are recorded at the lower of cost or net realizable 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 adjusted, if necessary, for estimated selling expenses to arrive at the net realizable value shown on the financial statements.

CONSERVATORSHIP ASSETS

Conservatorship personal property with an estimated value less than $1,000 is presented at a nominal value of one dollar to maintain accountability. Conservatorship real property is shown at cost. Cost is defined as the original cost of the real property to the protected person or the tax assessed value of the real property at the time the Department became conservator.

FIXED ASSETS AND DEPRECIATION

Fixed assets are recorded at cost. Depreciation is calculated using the straight-line method. Furniture and equipment are depreciated over a period of five years. The Veterans' Building and the Oregon Veterans' Home are depreciated over their useful life (50 years and 40 years, respectively). Gain or loss on the sale of an asset is determined by taking the difference between the carrying value (cost less depreciation) and the sale price.

COMPENSATED ABSENCES PAYABLE

Employees accrue vacation leave at various accrual rates with a maximum accumulation of 350 hours per management employee and 250 hours per classified employee. Accumulated vacation leave that is expected to be paid with expendable available financial resources, generally within 90 days, is reported as an expenditure and a fund liability of the governmental fund type that will pay for it. Accumulated vacation leave of proprietary fund types is recorded as an expense and a liability of those funds as the benefits accrue to the employees.

SUPPLIES INVENTORIES

Supplies inventories, which consist primarily of operating supplies, are stated at cost utilizing the first-in, first-out cost valuation method. Supplies inventories include prepaid postage on hand at year end. In both governmental and proprietary fund types, inventories are recorded as expenditures when used (consumption method).

BOND EXPENSES

Bond premiums and discounts associated with a particular bond issue are amortized over the life of the bond issue using the bonds outstanding method of amortization. These expenses are charged or credited to interest expense.

Miscellaneous bond expenses are primarily recorded as expenses when incurred. Underwriter's discounts are among miscellaneous bond expenses and are amortized over the life of the bond issue. Included in bond expenses are fees related to Series 73 variable-rate bonds, amortization of prepaid remarketing fees from fixed-rate conversions, expenses of the matured bond and coupon account with the State's Fiscal Agent, and bond attorney fees.

Expenses of Series 73 variable rate bonds include letter of credit commitment fees, agent bank fees, and remarketing agent fees (See Note 7). These fees are payable quarterly in arrears.

TOTAL COLUMN

The Total column on the Combined Balance Sheet is captioned "memorandum only" to indicate that they are presented only for use in financial analysis. Data in this column do not present financial position in conformity with generally accepted accounting principles. Furthermore, this information is not comparable to a consolidation of funds, as interfund balances have not been eliminated.

(2)
DEPOSITS AND INVESTMENTS

DEPOSITS

At June 30, 1998 the book balance of Cash and Cash Equivalents was $449,337,336. This is shown in the balance sheet as $430,763,512 in Enterprise funds and $18,573,824 in Expendable Trust funds. The bank balance of cash was $447,735,877, of which $429,015,487 was for Enterprise funds and $18,720,390 in Expendable Trust funds. These amounts were on deposit with the State Treasurer and the State's Fiscal Agent (Bank of New York) on June 30, 1998. According to the Governmental Accounting Standards Board, deposits are classified in three categories of credit risk assumed by the Department:

- Category 1 includes deposits that are insured or collateralized with securities held by the Department or its agent in the Department's name.

- Category 2 includes deposits collateralized with securities held by the pledging financial institution's trust department or agent in the Department's name.
- Category 3 includes deposits which are uncollateralized. This category may include any bank balance that is collateralized with securities held by the pledging financial institution, or by its trust department or agent but not in the Department's name.

Deposit balances at June 30, 1998 consisted of the following:

	Category			Bank	Carrying
Form of Deposit	1	2	3	Balance	Amount
Enterprise funds:					
Oregon Short-Term fund	$ 416,716,376	-	-	$ 414,968,351	$ 416,716,376
Cash with Fiscal Agent	14,047,136	-	-	14,047,136	14,047,136
Subtotal	**$** 430,763,512			$ 429,015,487	**$** 430,763,512
Expendable Trust funds:					
Oregon Short-Term fund	18,573,824	-	-	18,720,390	18,573,824
Total Deposits	$ 449,337,336	-	-	$ 447,735,877	$ 449,337,336

Deposits in the State Treasury's OSTF are insured or collateralized in excess of FDIC coverage for a minimum of 25 percent in accordance with State statute. All funds over FDIC coverage of $100,000 are included in the statewide collateral pool, a multiple financial institution collateral pool which protects public deposits pursuant to Oregon Revised Statutes (ORS) 295.015.

Securities in the OSTF are held by the State Treasurer's agent in the name of the State of Oregon. They consist of 39 percent in U.S. government securities; 41 percent in short-term commercial paper; and the remainder in bankers acceptances, time certificates of deposit, and repurchase agreements.

The funds held by the State's Fiscal Agent are restricted for payment of matured bonds and interest payable. These funds are deposited at the Bank of New York and are backed by the full faith and credit of the Bank of New York. Further, these funds, while not collateralized, are insured up to $100,000 per bondholder as specified by FDIC regulations. On June 30, 1998, the State's Fiscal Agent was holding $14,047,136 for redemption of Oregon War Veterans' bonds and coupons that have matured, but have not yet been redeemed. On June 30, 1997, the matured bonds payable balance was $17,804,843.

At June 30, 1997 the Department had a book balance of Cash and Cash Equivalents of $395,092,486, which was composed of $376,980,074 in Enterprise funds and $18,112,412 in Expendable Trust funds. The bank balance of cash at June 30, 1997 was $393,754,201, composed of $375,322,066 in Enterprise funds and $18,432,135 in Expendable Trust funds.

INVESTMENTS

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. The State Treasurer is prohibited from investing in common stock pursuant to ORS 293.736. As of June 30, 1998, the State Treasurer invested the Department's funds primarily in U.S. government securities, international securities, and corporate bonds.

A portion of the proceeds of Bond Series 75, Series 76, and Series 77 was invested in specified accounts called Guaranteed Investment Contracts. The State Treasurer named a securities custodian to oversee these deposits, which are held in institutions (providers) outside of the State Treasury. The Guaranteed Investment Contracts feature fixed rates of return over the length of the contracts. The accounts require collateralization by the providers as specified by the State and contain default provisions in the event that the debt rating of a provider falls below a specified level. Guaranteed Investment Contracts are investments evidenced by contracts, rather than by securities, and are uncategorized with regard to credit risk.

Investments in Expendable Trust funds include holdings of protected persons whose funds are managed by the Department under the conservatorship laws of the State. Those investments are, in effect, held in the Department's name. These items are presented in the schedule below as "Other Investments".

There are three categories of credit risk that apply to investments:

- Category 1 includes investments that are insured or registered, or for which the securities are held by the Department or its agent in the Department's name.
- Category 2 includes uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent in the Department's name.
- Category 3 includes uninsured and unregistered investments for which the securities are held by the counterparty or by its trust department or agent but not in the Department's name.

The State Treasurer maintains the OSTF, a cash and investment pool that is available for use by all funds and local governments. Because the pool operates as a demand deposit account, each fund type's portion of this pool is classified on the Combined Balance Sheet as Cash and Cash Equivalents. However, OSTF investments are classified by risk and included in the investment schedule below. Investments in the OSTF with remaining maturities of up to ninety days are carried at amortized cost, which approximates fair value. For this reason, the carrying value of these short-term investments is different than their fair value.

The schedule below presents the credit risk, carrying amount, and fair value of the Department's investments as of June 30, 1998:

	Category 1	Category 2	Category 3	Carrying Amount	Fair Value
Investments					
Investments held by State Treasurer					
U.S. Government and agency securities	$ 273,482,693	$ -	$ –	$ 273,482,693	$ 273,482,693
International Bonds	83,003,842	-	–	83,003,842	83,003,842
Corporate Bonds	274,954,185	-	–	274,954,185	274,954,185
Total Investments held by State Treasurer	$ 631,440,720	$ -	$ –	$ 631,440,720	$ 631,440,720
Other Investments					
U.S. Savings Bonds	$ 1,742,026	$ -	$ –	$ 1,742,026	$ 1,742,026
Stocks and other equity	160,931	-	–	160,931	160,931
Total Other Investments	$ 1,902,957	$ -	$ –	$ 1,902,957	$ 1,902,957
Investments on Securities Loan for Securities					
Agreement Collateral (Oregon Short Term Fund only):					
U.S. Government and agency securities	$ –	$ –	$ 6,389,958	$ 6,389,958	$ 6,394,339
Commercial paper	–	–	12,903,793	12,903,793	12,925,153
Corporate Bonds	–	–	2,859,029	2,859,029	2,859,029
Asset-backed Securities	–	–	1,209,552	1,209,552	1,209,552
Repurchase agreements	–	–	14,002,387	14,002,387	14,002,387
Total Investments on Securities Loan	$ –	$ –	$ 37,364,719	$ 37,364,719	$ 37,390,460
Investments - Not Categorized					
Guaranteed Investment Contracts				$ 60,416,518	$ 60,416,518
Investments held by broker-dealers under securities loans with cash collateral:					
U.S. Government and agency securities				$ 36,681,110	$ 36,681,110
Less:					
Balances treated as Cash and Cash Equivalents on Balance Sheet				$ (74,045,829)	$ (74,071,570)
Total Investments				$ 693,760,195	$ 693,760,195

At June 30, 1997, the Department had investments with a carrying value of $ 870,332,890, composed of $869,680,465 in Enterprise funds and $652,425 in Expendable Trust funds. The fair value of the Department's investments at June 30, 1997 was $825,385,008, composed of $824,569,141 in Enterprise funds and $ 815,867 in Expendable Trust funds.

RESTRICTED ASSETS

Included in Cash and Cash Equivalents and Investments are amounts recorded in the Department's Debt Service Reserve Account. Funds in the Debt Service Reserve Account are restricted for retirement of future bond principal and interest. The Debt Service Reserve Account was established to provide a reserve which is to be maintained at a level equal to the maximum annual debt service of the program. As of June 30, 1998, the Debt Service Reserve Account has a balance of $338,853,911, which includes $5,860,825 in cash and $332,993,086 in net investments (fair value). The balance of the Debt Service Reserve Account at June 30, 1997 was $447,556,585, which included $48,896,351 in cash and $398,660,234 in net investments.

SECURITIES LENDING

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

During the year, the State's custodian lent fixed income securities and received as collateral United States cash or securities issued or guaranteed by the United States government. Borrowers were required to deliver collateral for each loan equal to not less than 102% of the market value of the loaned security. The custodian 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 year on the amount of the loans the custodian made on its behalf. The State, through its Securities Lending Agreement, 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.

Because the loans were terminable at will their maturities did not generally match the maturities of the investments made with cash collateral. On June 30, 1998 the State had no credit risk exposure to borrowers. On June 30, 1998, the Department had no securities on loan.

The Department's cash balances are invested in the OSTF, as is the cash of other state agencies. As of June 30, 1998, the fair value of the collateral held and the securities on loan from the OSTF was $460,796,000 and $452,054,000, respectively. The Department's allocated portion of the securities on loan and the related collateral is presented in the schedule of investments shown above.

INVESTMENT INCOME

Investment income for the fiscal year ended June 30, 1998 included the change in fair value of investments. The Department recognized the cumulative effect of a change in accounting principle as a result of GASB Statement 31. In the Enterprise funds, the effect was to increase beginning retained earnings by $2,588,248. In the Expendable Trust funds, the effect was to increased beginning fund balance by $1,612,246.

The following table details the components of Investment Income for the year ended June 30, 1998 and June 30, 1997:

		June 30, 1998		June 30, 1997*
Enterprise funds:				
Investment income: Cash and Accrual basis	$	67,070,749	$	84,118,936
Securities lending revenue		1,593,386		4,690,999
Increase in fair value of investments		11,568,659		n/a
Investment income		80,232,794		
	$		$	88,809,935
Expendable trust funds:				
Investment income: Cash and Accrual basis	$	1,068,379	$	1,009,511
Securities lending revenue		84,176		173,033
Net decrease in fair value of investments		(223,263)		n/a
Investment income	$	929,292	$	1,182,544

* Investment Income for fiscal year ended June 30, 1997 includes amortization of investment discount and premium.

(3)
MORTGAGE LOANS AND CONTRACTS RECEIVABLE

Mortgage loans and contracts receivable are secured by real property, which is repossessed if the receivable becomes uncollectible. Most new loan and contract agreements made during the period from May 1971 through December 1991 contain a provision authorizing the Department to adjust the interest rate. Loan agreements (excluding contracts) made subsequent to December 1991 have fixed interest rates.

The loan and contract receivable portfolio at June 30, 1998 is approximately $1.1 billion. All mortgaged property is located within Oregon. The Department is exposed to a statewide concentration of credit risk in the amount of approximately $1.1 billion.

The Department uses the allowance method to estimate uncollectible mortgage loans and contracts receivable. The allowance is periodically adjusted by management to accommodate changes in economic conditions, nonperforming assets, historical loss experience, and other conditions which may affect the ultimate collectibility of the mortgage loans and contracts. In 1998 the Department determined the balance of the allowance account to be in excess of projected losses for the remaining loan and contract portfolio. Accordingly, the account balance was reduced at June 30, 1998 from $20 million to $17 million, or approximately 1½ percent of gross loans and contracts receivable.

The Department recognizes the net amount of certain nonrefundable loan fees and costs associated with its lending activities over the life of the loan. The unamortized balance of these net loan fees and costs are included on the balance sheet as part of the net mortgage loan and contract balances. The following table details the mortgage loans and contracts receivable, unamortized loan fees and costs, and allowance accounts as disclosed on the balance sheets for June 30, 1998 and June 30, 1997.

		June 30, 1998		June 30, 1997
Loans Receivable	$	987,304,672	$	1,184,758,393
Contracts Receivable		107,054,200		142,256,012
Total Loans and Contracts Receivable	$	1,094,358,872	$	1,327,014,405
Less: Unamortized Loan Fees/Costs		745,204		1,109,972
Less: Allowance for Principal Losses		16,962,647		19,903,760
Net Loans and Contracts Receivable	$	1,076,651,021	$	1,306,000,673

Included in mortgage loans receivable are loans that will not amortize at their current monthly payment amounts. These loans became nonamortizing primarily through borrowers' choosing to extend the repayment term of their loans in lieu of accepting increased monthly principal and interest installments resulting from loan interest rate increases.

The option to allow a borrower to extend the repayment life of the loan rather than accept an increase in the monthly principal and interest installment amount was the result of legal action brought against the Department by the Associated Oregon Veterans in 1985.

As of June 30, 1998, there were approximately 600 nonamortizing accounts with an aggregate principal balance of approximately $59,000,000. This represents 5.5 percent of the total net loans and contracts receivable.

(4)
FIXED ASSETS AND CONSTRUCTION IN PROCESS

Furniture and equipment assets costing $5,000 or more are capitalized and then depreciated over a useful life of five years. Building-related assets are capitalized and then depreciated over the remaining estimated life of the building.

The table below details the composition of the Department's net fixed assets (Proprietary fund Type) at June 30, 1998 and June 30, 1997:

		June 30, 1998		June 30, 1997
Veterans' Loan Program				
Building	$	7,232,201	$	7,232,201
Less: Accumulated Depreciation		2,041,156		1,896,331
Carrying Value, Building		5,191,045		5,335,870
Furniture and Equipment	$	3,429,746	$	3,404,988
Less: Accumulated Depreciation		2,826,373		2,646,889
Carrying Value, Furniture and Equipment		603,373		758,099
Net Fixed Assets, Loan Program	$	5,794,418	$	6,093,969
Veterans' Home Program				
Building	$	12,369,112	$	—
Less: Accumulated Depreciation		200,653		—
Carrying Value, Building		12,168,459		—
Furniture and Equipment	$	98,507	$	—
Less: Accumulated Depreciation		7,195		—
Carrying Value, Furniture and Equipment		91,312	$	—
Land	$	89,500	$	89,500
Net Fixed Assets, Home Program	$	12,349,271	$	89,500
Total Net Fixed Assets	$	18,143,689	$	6,183,469

(5)
LOAN CANCELLATION LIFE INSURANCE

The Department offers Loan Cancellation Life Insurance (LCLI) to approved borrowers and their spouses through a contract with a private insurance company. The Department collects the premiums from borrowers and remits collected premiums, less an administrative fee, to the private insurance company. Upon the death of an insured person, either the account balance will be paid in full, or the amount of insurance in force will be paid and applied toward the account balance.

The Loan Cancellation Life Insurance Contingency Fund is a special reserve fund consisting of amounts generated by the group policy and interest earned on the fund balance. The money is held and controlled by the insurance carrier during the contract period. The fund stabilizes rate experience developed under the group loan cancellation life insurance policy. Annual accounting of premiums, claims, administrative costs, and interest earnings are provided by the insurance carrier for the fund once a year, at August 31. The balance of the fund at August 31, 1998 and August 31, 1997 was approximately $38 million and $37 million, respectively.

(6)
BONDS PAYABLE AND DEBT SERVICE

The table below provides a summary of general obligation bond transactions of the Department for the fiscal years ended June 30, 1997 and June 30, 1998:

Bonds Payable (Par) at June 30, 1996	$	2,837,010,000
Bonds Issued		80,000,000
Bonds Retired		(473,815,000)
Bonds Payable (Par) at June 30, 1997	$	2,443,195,000
Bonds Issued		40,000,000
Bonds Retired		(397,435,000)
Bonds Payable (Par) at June 30, 1998	$	2,085,760,000

Shown below are the components of net bonds payable as disclosed on the balance sheet for June 30, 1998:

		Short Term		Long Term		Total
Bonds Payable (Par)	$	181,500,000	$	1,904,260,000	$	2,085,760,000
Premium on Bonds Sold		417,232		1,633,428		2,050,660
Discount on Bonds Sold		(140,631)		(2,361,421)		(2,502,052)
Net Bonds Payable	$	181,776,601	$	1,903,532,007	$	2,085,308,608

Shown below are the remaining bond issues outstanding and their final maturities (in fiscal years) as of June 30, 1998:

Series	Dated	Issued	Outstanding	Final Maturity
LVIII (58)	May 1, 1979	150,000,000	20,000,000	1999
LIX (59)	August 1, 1979	200,000,000	120,000,000	2004
LX (60)	November 1, 1979	200,000,000	140,000,000	2005
LXI (61)	January 1, 1980	300,000,000	220,000,000	2009
LXII (62)	April 1, 1980	300,000,000	240,000,000	2009
LXIII (63)	July 1, 1980	300,000,000	210,000,000	2009
LXIV (64)	October 1, 1980	300,000,000	160,000,000	2010
LXVI (66)	June 1, 1981	240,000,000	90,000,000	2003
73	December 1, 1985	740,000,000	740,000,000	2020
75	October 1, 1995	70,000,000	65,760,000	2027
76A	April 1, 1997	40,000,000	40,000,000	2028
77	April 1, 1998	40,000,000	40,000,000	2030
Total Bonds Outstanding as of June 30, 1998:		$	2,085,760,000	

The following schedule summarizes future debt service requirements to maturity as of June 30, 1998:

Fiscal Year	Principal	Interest*	Total
1999	$ 181,500,000	$ 147,948,806	$ 329,448,806
2000	142,165,000	134,350,921	276,515,921
2001	122,575,000	123,885,033	246,460,033
2002	122,700,000	114,275,669	236,975,669
2003	112,835,000	104,692,400	217,527,400
2004	122,970,000	96,202,123	219,172,123
2005	103,115,000	87,139,958	190,254,958
2006	83,260,000	79,250,385	162,510,385
2007	83,445,000	72,339,628	155,784,628
2008	83,630,000	65,420,703	149,050,703
2009	63,775,000	58,520,739	122,295,739
2010	13,880,000	54,743,523	68,623,523
2011	3,765,000	54,138,694	57,903,694
2012	96,470,000	50,691,738	147,161,738
2013	4,200,000	47,227,774	51,427,774
2014	96,950,000	43,807,605	140,757,605
2015	97,220,000	37,191,548	134,411,548
2016	97,495,000	30,501,531	127,996,531
2017	97,800,000	26,974,576	124,774,576
2018	98,110,000	23,892,358	122,002,358
2019	98,420,000	18,015,097	116,435,097
2020	98,725,000	12,116,901	110,841,901
2021	6,610,000	6,197,854	12,807,854
2022	7,015,000	3,031,063	10,046,063
2023	7,440,000	2,614,946	10,054,946
2024	7,765,000	2,175,271	9,940,271
2025	7,875,000	1,717,765	9,592,765
2026	7,220,000	1,268,898	8,488,898
2027	6,660,000	847,095	7,507,095
2028	5,015,000	498,941	5,513,941
2029	3,870,000	209,149	4,079,149
2030	1,285,000	34,053	1,319,053
	$ 2,085,760,000	$ 1,501,922,745	$ 3,587,682,745

* $370,000,000 of the Series 73E, F, G, and H Variable Rate Bonds are included at an assumed interest rate of 6.0 percent. For each change of 1 percent in Series 73 interest rates, annual interest requirements would change by approximately $3,700,000.

(7)
DEMAND BONDS

Included in long-term debt at June 30, 1998, is $370,000,000 of State of Oregon, General Obligation, Veterans' Welfare Variable Rate Demand Bonds, Series 73 E, F, G & H. These bonds may be tendered by the bondholder on specified dates at a price equal to principal plus accrued interest.

The Department's Remarketing Agents are authorized to use their best efforts to sell the repurchased bonds at face value by periodically adjusting the interest rate.

In the event the bonds cannot be remarketed, they will be purchased with funds from irrevocable letters of credit issued by Morgan Guaranty Trust Company. The State's Fiscal Agent is entitled to draw an amount sufficient to pay the principal amount of the bonds delivered to it and up to 210 days of interest.

The principal amount of drawings made to pay the purchase price of tendered bonds that have not been remarketed is required to be repaid on or before the earliest of: (a) the second anniversary of the termination of such bank's letter of credit; or (b) the date on which a Letter of Credit Event of Default has occurred.

The Department is required to pay a commitment fee which is payable quarterly in arrears, at a rate of .16 percent per annum, applied to the par value of the bonds ($370,000,000), plus 210 days of interest at an interest rate of 14 percent.

On July 1, 1998 a Standby Bond Purchase Agreement takes effect. This agreement replaces the irrevocable letters of credit described above. Under the Standby Bond Purchase Agreement, Morgan Guaranty Trust Company will commit to purchase any Series 73 E and G unremarketed bonds, and Bayerische Landesbank will commit to purchase any Series 73 F and H unremarketed bonds, in each case subject to certain conditions set forth in the Standby Bond Purchase Agreement. Each bank's purchase commitment will consist of the payment of the purchase price equal to the principal of and up to 40 days' of accrued interest calculated at a rate of 14% per annum, if any, on the bonds of the applicable series tendered for purchase and not remarketed on the purchase date. The commitments by the banks will remain in effect from July 1, 1998 to the earlier of (a) June 30, 1999 (scheduled expiration date), unless extended at the option of the bank; (b) the conversion of all outstanding Series 73 E-H bonds to a variable rate period ending after the scheduled expiration date; (c) the date on which no Series 73 E-H bonds are outstanding; (d) the date on which the commitment with respect to a particular series has been terminated in accordance with the Standby Purchase Agreement.

(8)
FUND EQUITY

DEFICIT RETAINED EARNINGS

The Enterprise fund – Veterans' Home Program had deficit unreserved retained earnings as of June 30, 1998. The deficit is $1,248,443 and is primarily the result of start-up expenses incurred to equip and begin operation at the Oregon Veterans' Home.

CONTRIBUTED CAPITAL

Contributed capital represents contributions and federal grant monies restricted to capital acquisition and construction of the Oregon Veterans' Home in Wasco County. The table below summarizes changes to the Department's contributed capital account for its proprietary fund type for the fiscal years ended June 30, 1998 and June 30, 1997:

Balance, June 30, 1996	$	6,202,507
Other grants		161,000
Federal grant		5,950,886
Balance, June 30, 1997	$	12,314,393
Other grants		15,000
Federal grant		1,322,151
Less: Depreciation		(207,848)
Balance, June 30, 1998	$	13,443,696

(9)
INTERFUND TRANSACTIONS

The following schedule summarizes interfund receivables and payables for the years ended June 30, 1998 and June 30, 1997:

Description	Receivables	Payables	June 30, 1998	June 30, 1997
Conservatorship fees	Veterans' Loan Program	Conservatorship Trust Fund	$ 26,627	$ 28,539

(10)
BUDGETARY COMPLIANCE

A comparison of General Fund expenditures to budget authorization is presented in the Schedule of Legislative Authorization (Non-GAAP Budgetary Basis) Compared to Actual Expenditures Subject to Budget for the biennium ended June 30, 1999 (Schedule 6). The following table reconciles General Fund budgetary expenditures with operating expenditures. Other adjustments include an adjustment to prepaid postage (supplies) and prior biennium transactions included in operating expenditures.

	Fiscal Year Ending 6/30/98	Fiscal Year Ending 6/30/97
Total Budgetary Expenditures	$ 1,191,238	$ 1,151,298
Changes (Nonbudgeted Expenditures):		
Change in Compensated Absences	(9,533)	(911)
Other adjustments	(384)	(14,337)
Total Operating Expenditures	$ 1,181,321	$ 1,136,050

In January 1998, the Emergency Board of the Legislature approved appropriation and limitation changes resulting from a compensation plan. All state agencies were affected. The changes increased the Department's general fund appropriation by $45,004. The Department's other fund limitation also increased by $1,206,018. The other fund category includes Veterans' Loan Program, Veterans' Home Program, and partial funding of Veterans' Services Division.

In September 1996, the Emergency Board approved the following Oregon Veterans' Home limitation changes:

- Combined the original federal fund/other fund limitation into one other fund limitation for $12,925,400.
- Increased the combined limitation by $1,851,151 for a new total limitation of $14,776,551.

(11)
DEFINED BENEFIT RETIREMENT PLAN

The Department participates in the Oregon Public Employee's Retirement System (PERS), a cost-sharing multiple-employer public employee defined benefit pension plan. All Department 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 ORS Chapter 238. The PERS retirement allowance, payable monthly for life, may be selected from 12 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, which are established by state statutes. A copy of the PERS annual financial report may be obtained from PERS, P.O. Box 23700, Tigard, Oregon 97281-3700.

Covered employees are required by state statute to contribute 6 percent of their salaries to the plan. Current law permits employers to pay employee contributions to the Retirement Fund. The Department 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 payroll for Department employees covered by the PERS for the years ended June 30, 1998, June 30, 1997, and June 30, 1996 was $5,595,801, $5,663,654, and $6,010,093, respectively. The employer contributions to PERS for the years ended June 30, 1998, 1997, and 1996 were approximately $486 thousand, $508 thousand, $538 thousand, respectively, and were equal to the required contributions for those years. No pension liability existed at June 30, 1997, determined in accordance with GASB Statement No. 27.

(12)
SEGMENT INFORMATION

The Department maintains two enterprise funds. The Veterans' Loan Program provides home and farm loans to veterans at favorable interest rates. The Veterans' Home Program provides skilled nursing and Alzheimer's disease care to some of Oregon's most vulnerable veterans. Selected segment information for the year ended June 30, 1998 is as follows:

SEGMENT INFORMATION	**Veterans' Loan Program**	**Veterans' Home Program**
Operating revenues	$ 177,143,693	$ 574,750
Depreciation	338,820	207,848
Net income before operating transfers	12,464,392	(1,889,763)
Operating transfers	–	28,218
Net income or (loss)	8,593,926	(1,861,545)
Capital contributions	–	1,337,151
Fixed asset additions	39,269	12,467,620
Net working capital	906,282,564	(40,400)
Total assets	2,264,956,045	12,731,494
Bonds payable	2,085,308,608	–
Total fund equity	89,863,521	12,195,253

(13)
(Unaudited)

YEAR 2000 READINESS DISCLOSURE

The following disclosure is required by the Governmental Accounting Standards Board and is provided under the provisions of the Year 2000 Information and Readiness Disclosure Act, Public Law 105-271.

The year 2000 issue is the result of shortcomings in many electronic data systems and other electronic equipment that may adversely affect the Department's operations as early as fiscal year 1999. The Department is completing an inventory of its primary internal computer systems and other electronic equipment that may be affected by the year 2000 issue and that are necessary to conducting the Department's operations.

The Government Accounting Standards Board has identified the following stages as necessary to implement a Year 2000-compliant system.

- Awareness stage – Establishing a budget and project plan for dealing with the year 2000 issue.
- Assessment stage – Identifying the systems and components for which year 2000 compliance work is needed.
- Remediation stage – Making changes to systems and equipment.
- Validation/testing stage – Validating and testing the changes that were made during the remediation stage.

The Department has identified the following systems requiring year 2000 remediation:

System	Awareness Stage	Assessment Stage	Remediation Stage	Validation & Testing Stage
Loan Servicing and Accounting Systems	Completed *	Completed *		
Mortgage Origination System	Completed *	Completed *		
Remittance Processing System	Completed *	Completed *		
Microfilm Records Indexing System	Completed *	In Progress		
Conservatorship Accounting System	Completed *	In Progress		
Cash Flow Forecasting Model	Completed *	Completed *		

* The Department's disclosure that a particular stage is "completed" is based upon the facts and circumstances available to the Department at the time of this disclosure, including its current plan for remediation and information provided to the Department by third parties involved in its remediation process. Subsequent knowledge of new facts and circumstances or modification of known facts and circumstances may require the Department to reassess its statement of completion.

In addition, the Department processes accounting transactions using the State's Statewide Financial Management System. The Department also uses the State's Investment and Banking System. Other departments of the State are responsible for the remediation of these systems. The Department has no first hand knowledge of these systems. The Department expects to replace or rewrite its primary application systems intended to address the year 2000 issue; however, no contracts specifically related to year 2000 remediation are outstanding as of June 30, 1998.

Because of the unprecedented nature of the year 2000 issue, its effect and the success of related remediation efforts will not be fully determinable until the year 2000 and thereafter. The Department cannot assure that it is or will be year 2000 ready, that the Department's remediation efforts will be completely successful, or that parties with whom the Department does business will be year 2000 ready.

(14)
PRIOR PERIOD ADJUSTMENT

Veterans' Home Program – Enterprise Fund – An adjustment of $12,272 to the Statement of Revenues, Expenses, and Changes in Fund Equity for the year ended June 30, 1997 was made and reported as a prior period adjustment. The adjustment was due to a change in construction in process based on expenses recorded in a prior fiscal year.

(15)
EXTRAORDINARY ITEMS

LOSSES FROM EARLY EXTINGUISHMENT OF DEBT

During the period from July 1, 1997 through June 30, 1998, the Department called (redeemed early) a total of $124,800,000 of its Series 64, Series 69, and Series 75 general obligation bonds. As a result of these early bond redemptions, the Department recognized a net loss of approximately $3.9 million due to the bond call premium and accelerated amortization of issue premium and discount. This net loss is shown in the Proprietary Fund operating statements as an extraordinary item from early extinguishment of debt.

During the period from July 1, 1996 through June 30, 1997, the Department called (redeemed early) a total of $232,180,000 of its Series 64 and Series 74 general obligation bonds. A net loss of approximately $5.7 million was recognized as a result of these early bond redemptions due to bond call premium and accelerated amortization of issue premium and discount.

(16)
RISK FINANCING

The State of Oregon administers property and casualty insurance 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; and employees, elected officials, and members of commissions and boards for honesty and faithful performance.

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 State entity based on its share of services provided in a prior period. The total statewide assessment of each coverage is based on independent biennial actuarial forecasts and administrative expenses, less any available fund balance in the Insurance Fund from the prior biennium.

(17)
SUBSEQUENT EVENTS

DEMAND BOND PURCHASE AGREEMENT (July 1, 1998)

On July 1, 1998 the Department negotiated a Standby Bond Purchase Agreement for the commitment to purchase any outstanding Series 73 E,F,G & H variable rate, general obligation demand bonds. (See Note 7:Demand Bonds.)

SERIES 64 and 75 BOND CALL (October 1, 1998)

On October 1, 1998, the Department called $10,000,000 of its Series 64 general obligation bonds and $3,900,000 of its Series 75 general obligation bonds. No call premium was required with the bond call.

SERIES 73 BOND CALL (December 1, 1998)

On December 1, 1998 the Department called $370,000,000 of its Series 73 A, B, C & D (fixed rate) general obligation bonds. A call premium of $7,400,000 was paid in connection with the bond call.

Enterprise Funds

Enterprise Funds account for goods and services that are financed and operated in a manner similar to private business enterprises — where the intent of the governing body is that the costs of providing goods and services to the general public on a continuing basis be financed or recovered primarily from user charges or when periodic measurement of the results of operations is appropriate for management control, accountability, or other purposes.

Veterans' Loan Program

The Veterans' Loan Program was authorized by a constitutional amendment approved by the voters in 1944. This program quickly became, and remains today, the largest program administered by the Department, with the purpose of providing funds to finance owner-occupied, single-family residential housing for qualified eligible veterans of the State of Oregon.

The program's first loan was made in 1945. Since that time, over 300 thousand loans have been granted, primarily to eligible veterans who served during World War II, the Korean War, and the Vietnam War, with a total original principal amount exceeding $7.2 billion.

The primary revenues for the Veterans' Loan Program consist of interest income from the mortgage portfolio and investment income from program investments. Funds for lending are provided through the issuance of State of Oregon, General Obligation, Veterans' Welfare Bonds, which currently represent over 70% of the outstanding general obligation debt of the State of Oregon.

Veterans' Home Program

The Oregon Veterans' Home provides skilled nursing and Alzheimer's disease care to some of Oregon's most vulnerable veterans. The single-story, 75,000 square foot facility offers care in a home-like environment, complementing the philosophy of personal independence.

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Expendable Trust Funds

Expendable Trust Funds account for assets held by the Department in a trustee capacity when the principal and income may be expended in the course of the fund's designated operations.

Conservatorship Trust Fund
The Department acts as conservator of estates of approximately 290 veterans, survivors, and minor or helpless children of veterans who the court has determined are unable to manage their own financial affairs. Revenue sources include Social Security monies, U.S. Department of Veterans' Affairs benefits, investment income, and other sources of income.

Veterans' Home Trust Fund
The Department accepts donations that can be used to operate the Oregon Veterans' Home in Wasco County, Oregon, and to provide its residents with amenities to enhance their quality of life. The fund is composed of donations and interest earnings.

General Fund

The General Fund accounts for general governmental operations that are financed by legislatively approved appropriations funded from general revenues. For the Department, general government activities are related to services to veterans. Specifically, these activities include counseling and other services to veterans and partial funding of the Department's conservatorship responsibilities. In addition, the General Fund makes available educational aid to certain veterans, as well as financial assistance and training to County Veterans' Service Offices and Veterans' Organizations.

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

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the best possible management of public resources.

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