Oregon Department of Veterans' Affairs

Annual Financial Report
Enterprise Funds
For The Fiscal Years Ended
June 30, 2003 and June 30, 2002

An Agency of the State Of Oregon

Serving Those Who Served

Annual Financial Report

Enterprise Funds of the
Oregon Department of Veterans' Affairs

An Agency of the State of Oregon

For The Fiscal Years Ended
June 30, 2003 and June 30, 2002

Jim Willis
Director

Bruce Shriver, CPA
Chief Financial Officer

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With the assistance of the
Financial Administration Division

Cover Photo:
Veterans marching in the annual Veterans' Day Parade in Albany.

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Jon Mangis, Director of Veterans' Affairs: 1985 to 2003

Left: *Jon in December 1988.*
Below left: *Governor Atiyeh with Jon in July 1984.*
Below right: *Governor Kulongoski with Jon at a reception in Jon's honor in August 2003.*

In August 2003, the Oregon Department of Veterans' Affairs said goodbye to Jon Mangis. After retiring from the Department, Jon accepted a position to serve as the Commissioner of the newly-created Virginia Department of Veterans' Services.

Jon began serving as the Director of Veterans' Affairs following his appointment by Governor Atiyeh in December 1984. Jon was hired as a claims agent by the Department in 1970. He progressed through several managerial positions before being appointed as the Director. During his tenure, Jon reformed the Veterans' Loan program to eliminate significant deficits, thereby establishing stability and sustainability of veterans' programs. He also instituted communication and outreach programs with the veteran community.

People that know Jon find him compassionate, witty and knowledgeable. He is genuinely interested in people's lives. His legacy for the Department is that he taught, by his example, what it is to be an advocate for Oregon's veterans.

We will miss Jon very much.

Oregon
Theodore R. Kulongoski, Governor

Oregon Department of Veterans' Affairs
Oregon Veterans' Building
700 Summer Street NE
Salem, OR 97301-1285

SERVING
OREGON VETERANS
SINCE 1945

December 26, 2003

The Honorable Ted Kulongoski
Governor of the State of Oregon
State Capitol
Salem, Oregon 97301-4047

Citizens of Oregon

We are pleased to provide you with the Annual Financial Report of the Oregon Department of Veterans' Affairs *(the "Department")* Enterprise funds, for the fiscal years ended June 30, 2003, and June 30, 2002. We believe the information presented herein is accurate in all material respects, that it is presented in a manner which fairly sets forth the financial position and results of operations of the Department's Enterprise funds, and that all disclosures necessary to enable the reader to gain an understanding of the Department's Enterprise funds' financial affairs have been included. The Department's Governmental and Fiduciary funds' financial statements are presented in the **Other Supplemental Section** for the purpose of additional analysis. The Department is responsible for both the accuracy of the data presented and the completeness and fairness of the presentation including all disclosures.

This report is organized and presented in three sections. The **Introductory Section** includes this transmittal letter and an organizational chart. The **Financial Section** includes the financial statements and accompanying notes, as well as the independent auditor's report on the financial statements. The **Other Supplemental Section** includes selected financial and programmatic information, much of which is presented on a multi-year basis.

The Department is an agency of the State of Oregon and is identified as the reporting entity of this Annual Financial Report. The Department provides a range of services for veterans such as mortgage and home improvement loans, a skilled care nursing facility, benefits and claims counseling, and other veterans' services.

This report has been prepared in accordance with generally accepted accounting principles as promulgated by the Governmental Accounting Standards Board, the Financial Accounting Standards Board, the American Institute of Certified Public Accountants, and other recognized standard-setting bodies. A summary of significant accounting policies of the Department is found in Note 1 of the financial statements.

OREGON ECONOMY

Recent Trends **–** The second quarter initial estimate of job growth was a very disappointing drop of 3.6 percent at an annual rate. This follows a positive growth of 1.2 percent in the first quarter. This second quarter job loss is slightly higher than the worse quarter of the recession – a 3.5 percent annual loss during the fourth quarter of 2001. Oregon's Office of Economic Analysis *(OEA)* suspects that the first quarter growth was too high due to seasonal factors and this plays into a larger drop in jobs for the second quarter. Regardless of the seasonal factor influences, the drop of this magnitude is disturbing. On a year-over-year *(Y/Y)* basis, jobs declined by 0.8 percent in the second quarter.

For the second quarter, job losses dominated across almost all industries. Total Private Nonfarm employment declined at a 3.0 percent rate during the second quarter. Large declines in private employment included natural resources and mining, construction, wood products, computer and electronic equipment, food, and educational services. Transportation equipment posted a very strong growth rate of 25.7 percent. Besides transportation equipment, the only job gainers were in wholesale trade, professional and business services, and health services. The government sector lost jobs at a rate of 5.2 percent. Most of the job losses in government were concentrated in federal jobs and local education.

The most recent Blue Chip Job Growth rankings place Oregon 42nd in the nation. For Y/Y job growth, between June 2002 and June 2003, jobs decreased by 14,700 or negative 0.92 percent. A year ago, Oregon ranked 38th.

Future Outlook **–** When recessions bottom out and recoveries begin, we generally see business' bottom lines improve along with renewed investments. Job gains typically happen in the latter stages of recovery. Both in the U.S. and Oregon economies, businesses have cut costs and incomes are slowly improving. In the 1991 recession, it took 13 months before we saw the start of sustained positive job gains. The U.S. recession officially ended in November 2001 and the Oregon recession may have ended in January or February 2002, based on job losses appearing to be over at this time. By these measures, we are now counting 20 months for the U.S. and 18 months for Oregon into a recovery with no job gains. In fact, since the first quarter of 2002 to the second quarter of 2003, Oregon has lost almost 10,000 jobs for a 0.6 percent decline.

The signs are out that we are on the road to recovery, as long as we don't break down. Consumer confidence appears to be holding and other surveys and indexes of business activity have improved. Both the federal government and the Federal Reserve have stimulative policies to bolster the economy. The risk is that the weak job markets can reverse the slow recovery in the business sector. OEA projects that the proponents for a U.S. economy recovery that will build strength into 2004 are correct, and Oregon will be pulled along. Growth will be slow in the second half of this year before reaching 2.0 percent growth in the second half of 2004.

OEA forecasts employment to fall by 0.5 percent for 2003, capping the third consecutive year of job losses. The last time the Oregon economy lost jobs for three consecutive years was 1980 to 1982. Job growth in 2004 is projected to be 1.1 percent, reflecting the slower growth in the first half of year. The economy continues to strengthen with 2.0 percent job growth in 2005. Additional OEA forecasts on employment, population growth, and specific sectors of Oregon's economy are discussed in the following paragraphs.

Total private nonfarm employment will decline in 2003, falling by 0.3 percent. The sector will bottom out and start to improve in late 2003. Total private nonfarm employment will grow 1.2 percent in 2004 and 2.2 percent in 2005. Manufacturing will decrease by 3.4 percent in 2003 and 1.2 percent in 2004 before turning the corner to grow 0.8 percent in 2005. Job levels will still be below average job levels in 2000. Private non-manufacturing jobs will slightly increase by 0.3 percent in 2003, increase by 1.6 percent in 2004, and 2.5 percent in 2005.

Wood product manufacturing is projected to be down 3.5 percent in 2003 and further declines of 1.8 percent in 2004. Employment is forecast to be flat in 2005.

The sector that contains semiconductors, computer and electronic products, will have another sharp downturn year of 5.4 percent in 2003 before recovering to a job growth of 2.8 percent in 2004. This subsector is expected to bottom out late this year with stronger job gains into 2004. Jobs are expected to grow 4.6 percent in 2005.

Transportation equipment will increase by 7.6 percent in 2003. Although job gains surged in the second quarter of 2003, a large part of the gain is expected to be temporary. Jobs will rise by 2.3 percent in 2004. Slight loss of jobs will prevail at a 0.3 percent decline in 2005.

Construction is expected to repeat the decline of 2002 with a decrease of 1.9 percent in 2003. Job growth will be a positive 2.0 percent in 2004 and 2.9 percent in 2005.

Trade job growth will remain relatively weak in 2003. Retail trade job growth will be stronger in 2004 at 1.1 percent and in 2005 at 1.6 percent. Wholesale trade will remain flat in 2003 but should see annual job growth of 1.1 percent in 2004 and 0.9 percent in 2005.

Professional and business services and health services will see some of the strongest growth. Professional and business services will grow 3.6 percent in 2004 followed by 5.1 percent growth in 2005, while health services will increase around 2.8 percent on average for the same years.

Leisure and hospitality, which includes accommodations and food services, is expected to grow by 0.6 percent in 2003, 1.1 percent in 2004, and 1.8 percent in 2005.

Government employment is expected to decline by 1.4 percent in 2003 with weak growth of 0.6 percent in 2004 and somewhat stronger growth of 1.2 percent in 2005. State and local government jobs will sag in 2003 as budget balancing will continue to reduce jobs. Slow growth is projected for 2004.

Population growth is expected to be higher than the U.S. average, but slower than the growth experienced in the mid-1990's. Slower growth will prevail over the next three years, with increases of 1.0 percent in 2003, 1.3 percent in 2004 and 1.2 percent in 2005.

MAJOR INITIATIVES

Current Service Efforts and Accomplishments - Article XI-A of the Oregon Constitution outlines the broad duties of the Department. The primary Oregon Revised Statutes governing the Department are Chapters 406 through 408. Following is a brief description of the Department's primary Enterprise funds' programs and activities.

- The ***Veterans' Loan Program*** provides home loans to Oregon veterans at favorable interest rates. Eligibility requirements on who may receive a veterans' home loan are governed by both federal and State laws. As of June 30, 2003, this Program had approximately 13,800 mortgage loans and contracts outstanding, with a principal balance of approximately $465 million.

- The ***Veterans' Home Program*** provides professional medical, nursing, rehabilitative, social and other support services to United States veterans residing in the Oregon Veterans' Home *(OVH)*, located in The Dalles, Oregon. The OVH, which opened in November 1997, has the capacity to serve 151 veterans and had an occupancy of 104 residents at June 30, 2003. The Department owns the OVH and for the fiscal years ended June 30, 2003 and June 30, 2002, had contracted with Healthcare for the Mid-Columbia Region to provide the daily services needed by the veteran residents. As of October 1, 2003, the Department entered into a contract with the non-profit organization, Veterans Care Centers of Oregon, to provide these services.

The major issue related to the Department's client base is that the composition and needs of the veteran population are changing due to the passage of time and external events. As the veteran population ages, it is necessary to be more responsive to the increasing health and disability issues of the elderly.

FINANCIAL INFORMATION

Internal Controls - Management is responsible for establishing and maintaining internal controls designed to ensure the Department's assets are safeguarded against loss from unauthorized use or disposition and that financial transactions are properly executed in accordance with generally accepted accounting principles. These internal controls are designed to provide reasonable, but not absolute, assurance that these objectives are met. Budgetary controls are maintained by the Department of Administrative Services and the Oregon Legislature.

Enterprise Funds - The Veterans' Loan Program and the Veterans' Home Program are enterprise funds and account for the Department's business-type activities. At June 30, 2003, the Veterans' Loan Program had approximately $1.30 billion in assets *(primarily consisting of loan and contract receivables, cash and cash equivalents, and investment securities)* and about $1.16 billion in liabilities *(primarily consisting of general obligation bonds)*. Revenues from the Department's home loan program are generated through interest on loans originated and investment income. These revenues are used to pay interest expense on outstanding debt and related program and administrative expenses. At June 30, 2003, the Veterans' Home Program had assets of approximately $12.2 million consisting primarily of capital assets, receivables and cash and cash equivalents.

Debt Administration - The Department, with the approval of the State Treasurer's office, has authority to issue general obligation bonds to fund the Veterans' Loan Program. The Department's general obligation bonds are generally rated as part of the State of Oregon's general obligation bond program. The Department's most recent general obligation bond ratings are as follows:

Moody's Investor Service	Aa 3
Fitch Investors Service	A+
Standard & Poor's	AA

As of June 30, 2003, the Department had approximately $1.07 billion in outstanding bonds. During fiscal year 2003, the Department did not issue any bonds and retired approximately $159 million.

Cash Management - All monies collected by the Department are turned over to the State Treasurer, who is responsible for the control of cash and the investment of State funds. On June 30, 2003, the Department's Enterprise funds cash, cash equivalents *(excluding securities lending collateral)*, and investments totaled approximately $757 million. The Oregon Investment Council, of which the State Treasurer is a member, establishes investment policy for all State of Oregon funds. To further Oregon's economic growth, the Council's continuing policy has been to invest locally when investments of comparable yield, quality, and maturity can be found in-state without damaging portfolio diversity. Fortunately for Oregonians, State-imposed safeguards minimize the dangers of investing in highly leveraged financial instruments, which have been a cause of national concern. The State Treasurer pools all available cash into the Oregon Short-Term Fund from which investments are made in a variety of instruments.

Risk Management - The Department of Administrative Services, through the Insurance Fund, provides for the State's self-insurance programs and for the administration, investigation, and settlement of claims against the Insurance Fund. In accordance with legislative directives, the Insurance Fund must operate on an actuarially sound basis.

Independent Audit - The Secretary of State, Audits Division, has audited the financial records, books of account, and transactions of the Department's Enterprise funds for the years ended June 30, 2003, and June 30, 2002. The auditors used generally accepted government auditing standards in conducting the engagement. Their opinion on the financial statements is included in the Financial Section of this report.

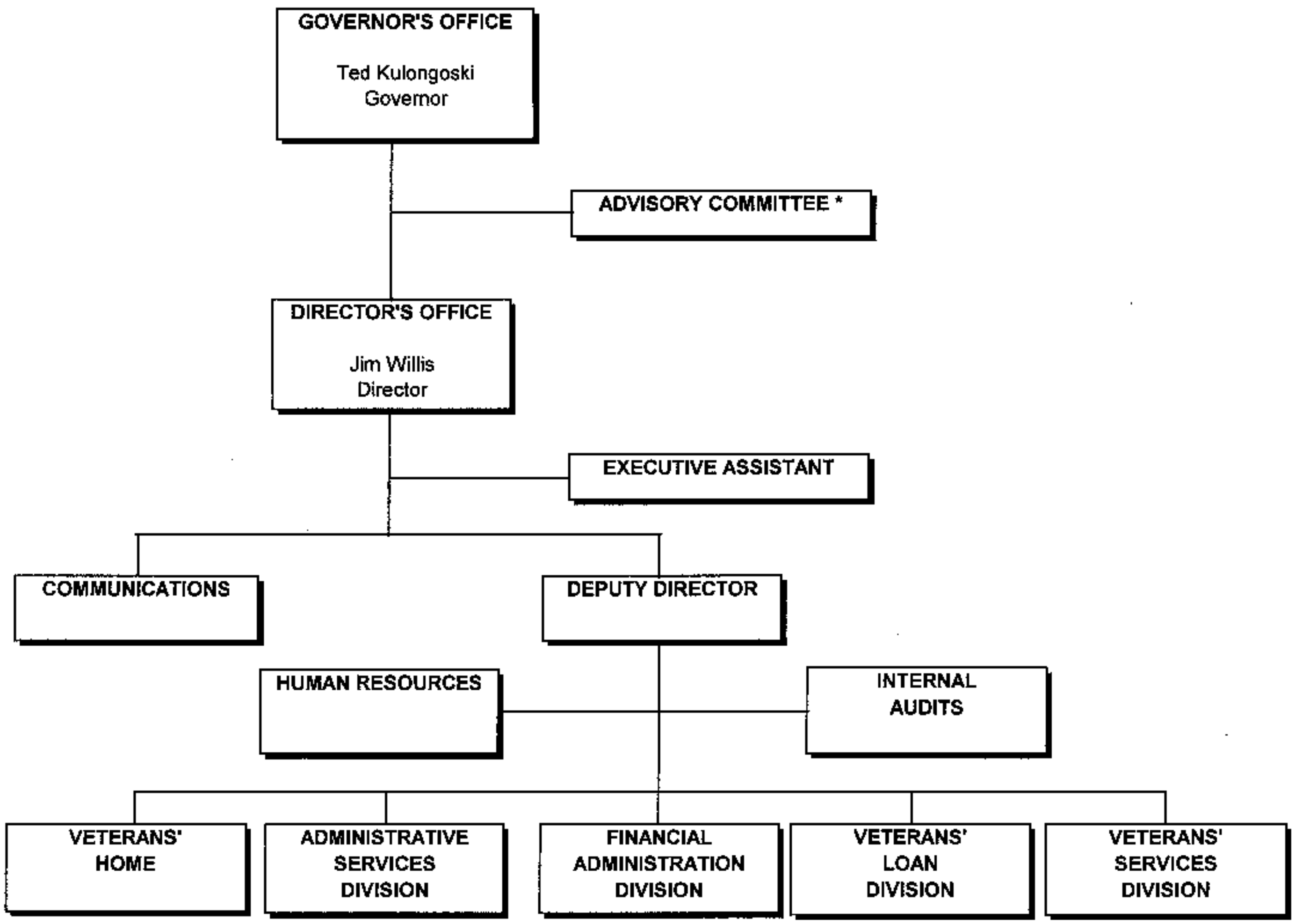
Acknowledgements - The preparation of this report reflects the combined efforts of the Department's staff. The professionalism, commitment, and effort of the individuals involved is very much appreciated.

Respectfully submitted,

Jim Willis
Director

Bruce W. Shriver
Chief Financial Officer

OREGON DEPARTMENT OF VETERANS' AFFAIRS



** The Advisory Committee is a nine-member advisory body appointed by the Governor for four-year terms. The committee advises the Director concerning matters of the operations of the Department and issues affecting veterans and their dependents and survivors who reside in this state.*

Advisory Committee Members	Term Expires	Advisory Committee Members	Term Expires
Evelyn F. Anderson	July 31, 2005	Robert Haltiner	March 15, 2004
Staryl C. Austin, Jr.	March 15, 2004	Harold C. Jordan	December 31, 2006
Robert B. Brown	March 15, 2004	Tino E. Ornelas	September 30, 2007
Furlton M. Burns	March 15, 2004	*vacant position*	
Walter R. Crews	March 15, 2004		

FINANCIAL SECTION

OFFICE OF THE
SECRETARY OF STATE
Bill Bradbury
Secretary of State

AUDITS DIVISION
Cathy Pollino
State Auditor

(503) 986-2255
FAX (503) 378-6767

Auditing for a Better Oregon

The Honorable Theodore R. Kulongoski
Governor of Oregon
254 State Capitol
Salem, Oregon 97301-4047

Jim Willis, Director
Department of Veterans' Affairs
700 Summer Street NE
Salem, Oregon 97301-1285

INDEPENDENT AUDITOR'S REPORT

We have audited the accompanying basic financial statements of the enterprise funds of the state of Oregon, Department of Veterans' Affairs (department), as of and for the years ended June 30, 2003 and 2002, as listed in the table of contents. These financial statements are the responsibility of the department's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

As discussed in Note 1, the basic financial statements present only the department's enterprise funds and do not purport to, and do not, present fairly the financial position of the state of Oregon, as of June 30, 2003 and 2002, and the changes in its financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the enterprise funds of the state of Oregon, Department of Veterans' Affairs, as of June 30, 2003 and 2002, and the changes in financial position

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and cash flows thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming opinions on the basic financial statements that collectively comprise the department's enterprise funds. The other data in this report, designated as the introductory and other supplementary information sections as listed in the table of contents, are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards,* we have also issued our report dated November 28, 2003 on our consideration of the state of Oregon, Department of Veterans' Affairs internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit. That report is separately presented in the other reports section as listed in the table of contents.

OREGON AUDITS DIVISION

Bill Bradbury
Secretary of State

November 28, 2003

STATE OF OREGON
DEPARTMENT OF VETERANS' AFFAIRS
STATEMENT OF NET ASSETS
PROPRIETARY FUNDS
JUNE 30, 2003 AND JUNE 30, 2002

	Enterprise Funds			
	Veterans' Loan Program		Veterans' Home Program	
	June 30, 2003	June 30, 2002	June 30, 2003	June 30, 2002
ASSETS				
Current Assets				
Cash and Cash Equivalents	$ 128,981,842	$ 69,614,585	$ 478,842	$ 492,654
Cash and Cash Equivalents - Restricted	7,130,822	9,172,761	-	-
Securities Lending Cash Collateral	59,557,642	33,442,192	63,195	34,495
Receivables:				
Accrued Interest	8,586,686	8,479,863	-	-
Due from State Treasury	6,000,000	-	-	-
Loan Cancellation Life Insurance Premiums	274,500	332,500	-	-
Federal Per Diem	-	-	390,000	435,000
Other	12,600	10,900	16,794	22,000
Due From Other Funds	163	26,747	-	-
Real Estate Owned	302,563	351,966	-	-
Supplies Inventory and Prepaid Expenses	26,563	45,272	846	793
Total Current Assets	210,873,381	121,476,786	949,677	984,942
Noncurrent Assets				
Cash and Cash Equivalents - Restricted	353,982,441	437,853,753	-	-
Investments - Restricted	266,394,138	288,644,185	-	-
Mortgage Loans and Contracts Receivable (Net)	456,419,543	582,527,538	-	-
Resident related Receivable (Net)	-	-	3,606	-
Deferred Underwriter's Discount	2,209,215	2,413,889	-	-
Capital Assets:				
Building, Property and Equipment	9,955,561	9,726,670	12,501,279	12,507,774
Land	-	-	600,073	593,578
Works of Art and Historical Treasures	85,170	85,170	70,000	70,000
Accumulated Depreciation	(4,647,330)	(4,215,939)	(1,878,984)	(1,525,504)
Total Noncurrent Assets	1,084,398,738	1,317,035,266	11,295,974	11,645,848
TOTAL ASSETS	$ 1,295,272,119	$ 1,438,512,052	$ 12,245,651	$ 12,630,790
LIABILITIES				
Current Liabilities				
Accounts Payable	$ 762,672	$ 410,616	$ 411,023	$ 457,983
Loan Cancellation Life Insurance Premium Payable	455,246	562,197	-	-
Deposit Liabilities	1,910,501	2,154,231	976	7,097
Accrued Interest on Bonds	16,329,000	20,183,563	-	-
Obligations under Securities Lending	59,557,642	33,442,192	63,195	34,495
Compensated Absences Payable	453,859	552,488	13,480	16,746
Bonds Payable-Maturing Within One Year (Net)	104,119,165	114,325,964	-	-
Arbitrage Rebate Payable	-	186,645	-	-
Matured Bonds Payable	7,130,822	9,172,761	-	-
Total Current Liabilities	190,718,907	180,990,657	488,674	516,321
Noncurrent Liabilities				
Bonds Payable-Maturing After One Year (Net)	964,911,356	1,113,899,221	-	-
Arbitrage Rebate Payable	287,175	319,483	-	-
Total Noncurrent Liabilities	965,198,531	1,114,218,704	-	-
TOTAL LIABILITIES	1,155,917,438	1,295,209,361	488,674	516,321
NET ASSETS				
Invested in Capital Assets, net of related debt (restated)	5,393,401	5,595,901	11,292,368	11,645,848
Net Assets, unrestricted	133,961,280	137,706,790	464,609	468,621
TOTAL NET ASSETS	$ 139,354,681	$ 143,302,691	$ 11,756,977	$ 12,114,469

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

Enterprise Funds	
TOTAL	
June 30, 2003	June 30, 2002
$ 129,460,684	$ 70,107,239
7,130,822	9,172,761
59,620,837	33,476,687
8,586,686	8,479,863
6,000,000	-
274,500	332,500
390,000	435,000
29,394	32,900
163	26,747
302,563	351,966
27,409	46,065
211,823,058	122,461,728
353,982,441	437,853,753
266,394,138	288,644,185
456,419,543	582,527,538
3,606	-
2,209,215	2,413,889
22,456,840	22,234,444
600,073	593,578
155,170	155,170
(6,526,314)	(5,741,443)
1,095,694,712	1,328,681,114
$ 1,307,517,770	$ 1,451,142,842
$ 1,173,695	$ 868,599
455,246	562,197
1,911,477	2,161,328
16,329,000	20,183,563
59,620,837	33,476,687
467,339	569,234
104,119,165	114,325,964
-	186,645
7,130,822	9,172,761
191,207,581	181,506,978
964,911,356	1,113,899,221
287,175	319,483
965,198,531	1,114,218,704
1,156,406,112	1,295,725,682
16,685,769	17,241,749
134,425,889	138,175,411
$ 151,111,658	$ 155,417,160

STATE OF OREGON
DEPARTMENT OF VETERANS' AFFAIRS
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS
PROPRIETARY FUNDS
FOR THE FISCAL YEARS ENDED JUNE 30, 2003 AND JUNE 30, 2002

	Enterprise Funds			
	Veterans' Loan Program		Veterans' Home Program	
	June 30, 2003	June 30, 2002	June 30, 2003	June 30, 2002
OPERATING REVENUES				
Interest Income:				
Mortgage Loans	$ 36,742,510	$ 43,749,526	$ -	$ -
Contracts	2,535,147	3,522,372	-	-
Investment Income	24,675,139	35,956,850	8,487	13,983
Loan Cancellation Life Insurance Premiums	3,642,487	-	-	-
Loan Cancellation Life Insurance Processing Fee	425,004	425,004	-	-
Resident related revenue	-	-	5,044,610	5,465,696
Other Fees and Charges	1,189,691	1,447,451	-	-
Conservatorship Fees	364,510	338,136	-	-
Gain on Sale of Foreclosed Property	39,121	172,472	-	-
TOTAL OPERATING REVENUES	69,613,609	85,611,811	5,053,097	5,479,679
OPERATING EXPENSES				
Bond Interest	58,066,877	68,560,732	-	-
Interest on Taxable Line of Credit	7,500	580,883	-	-
Salaries and Other Payroll Expenses	6,838,554	6,974,557	205,262	218,460
Bond Expenses	909,379	868,243	-	-
Securities Lending Investment Expense	630,893	522,316	654	590
Real Estate Owned Expense	80,757	73,308	-	-
Services and Supplies	2,958,497	2,480,268	134,843	54,645
Claims Expense - Loan Cancellation Life Insurance	5,121,239	-	-	-
Veterans' Home Operations	-	-	4,732,459	5,238,567
Depreciation Expense	431,391	538,555	353,480	331,368
Bad Debt Expense	(1,744,700)	(906,906)	1,600	-
Special Payments	51,000	-	-	-
Other Expenses	210,232	180,045	-	-
TOTAL OPERATING EXPENSES	73,561,619	79,872,001	5,428,298	5,843,630
OPERATING INCOME (LOSS)	(3,948,010)	5,739,810	(375,201)	(363,951)
Transfers				
Net Transfers from Veterans' Home Trust Fund	-	-	17,709	1,380
CHANGE IN NET ASSETS	**(3,948,010)**	**5,739,810**	**(357,492)**	**(362,571)**
NET ASSETS - Beginning	143,302,691	94,931,080	12,114,469	11,873,382
Prior Period Adjustment	-	42,556,801	-	563,658
Cumulative Effect of Change in Accounting Principles	-	75,000	-	40,000
NET ASSETS - Beginning, restated	143,302,691	137,562,881	12,114,469	12,477,040
NET ASSETS - Ending	$ 139,354,681	$ 143,302,691	$ 11,756,977	$ 12,114,469

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

Enterprise Funds	
TOTAL	
June 30, 2003	June 30, 2002
$ 36,742,510	$ 43,749,526
2,535,147	3,522,372
24,683,626	35,970,833
3,642,487	-
425,004	425,004
5,044,610	5,465,696
1,189,691	1,447,451
364,510	338,136
39,121	172,472
74,666,706	91,091,490
58,066,877	68,560,732
7,500	580,883
7,043,816	7,193,017
909,379	868,243
631,547	522,906
80,757	73,308
3,093,340	2,534,913
5,121,239	-
4,732,459	5,238,567
784,871	869,923
(1,743,100)	(906,906)
51,000	-
210,232	180,045
78,989,917	85,715,631
(4,323,211)	5,375,859
17,709	1,380
(4,305,502)	**5,377,239**
155,417,160	106,804,462
-	43,120,459
-	115,000
155,417,160	150,039,921
$ 151,111,658	$ 155,417,160

STATE OF OREGON
DEPARTMENT OF VETERANS' AFFAIRS
STATEMENT OF CASH FLOWS
PROPRIETARY FUNDS
FOR THE FISCAL YEARS ENDED JUNE 30, 2003 AND JUNE 30, 2002

	Enterprise Funds	
	Veterans' Loan Program	
	June 30, 2003	June 30, 2002
Cash Flows from Operating Activities:		
Receipts from Customers	$ 5,234,631	$ 1,799,042
Receipts from Other Funds for Services	795,522	621,663
Loan Principal Repayments	169,065,380	165,593,471
Loan Interest Received	39,969,132	48,005,898
Payments to Employees for Services	(6,934,041)	(6,979,943)
Payments to Suppliers	(6,844,187)	(1,775,956)
Payments to Other Funds for Services	(1,090,920)	(1,319,062)
Loans Made	(41,422,613)	(76,205,733)
Other Receipts (Payments)	(243,733)	368,923
Net Cash Provided (Used) in Operating Activities	158,529,171	130,108,303
Cash Flows from Noncapital Financing Activities:		
Proceeds from Bond Sales	-	120,163,188
Loan Proceeds	-	60,000,000
Principal Payments on Bonds	(161,091,939)	(169,974,083)
Principal Payments on Loans	-	(80,000,000)
Interest Payments on Bonds	(62,063,946)	(71,733,255)
Interest Payments on Loans	(7,500)	(580,883)
Bond Issuance Costs	(877,460)	(1,783,618)
Transfers from other funds	-	-
Net Cash Provided (Used) in Noncapital Financing Activities	(224,040,845)	(143,908,651)
Cash Flows from Capital and Related Financing Activities:		
Acquisition of Capital Assets	(228,891)	(295,599)
Proceeds from Sale of Capital Assets	1,555	2,544
Net Cash Provided (Used) in Capital and Related Financing Activities	(227,336)	(293,055)
Cash Flows from Investing Activities:		
Purchases of Investments	(102,781,635)	(66,725,395)
Proceeds from Sales or Maturities of Investments	118,296,208	83,534,265
Interest on Investments and Cash Balances	23,678,443	29,134,042
Investment Income from Securities Lending	630,893	522,316
Investment Expense from Securities Lending	(630,893)	(522,316)
Net Cash Provided (Used) in Investing Activities	39,193,016	45,942,912
Net Increase (Decrease) in Cash and Cash Equivalents	(26,545,994)	31,849,509
Cash and Cash Equivalents - Beginning	516,641,099	442,430,164
Prior Period Adjustments Restating Beginning Cash	-	42,361,426
Cash and Cash Equivalents - Ending	$ 490,095,105	$ 516,641,099
Reconciled to Statement of Net Assets		
Cash and Cash Equivalents - current	$ 128,981,842	$ 69,614,585
Cash and Cash Equivalents - current, restricted	7,130,822	9,172,761
Cash and Cash Equivalents - noncurrent, restricted	353,982,441	437,853,753
Cash and Cash Equivalents - Ending (shown above)	$ 490,095,105	$ 516,641,099

Enterprise Funds		Enterprise Funds	
Veterans' Home Program		Total	
June 30, 2003	June 30, 2002	June 30, 2003	June 30, 2002
$ 5,089,610	$ 5,566,381	$ 10,324,241	$ 7,365,423
-	-	795,522	621,663
-	-	169,065,380	165,593,471
-	-	39,969,132	48,005,898
(208,527)	(216,319)	(7,142,568)	(7,196,262)
(4,912,038)	(5,398,993)	(11,756,225)	(7,174,949)
(2,279)	(4,851)	(1,093,199)	(1,323,913)
-	-	(41,422,613)	(76,205,733)
(6,120)	7,097	(249,853)	376,020
(39,354)	(46,685)	158,489,817	130,061,618
-	-	-	120,163,188
-	-	-	60,000,000
-	-	(161,091,939)	(169,974,083)
-	-	-	(80,000,000)
-	-	(62,063,946)	(71,733,255)
-	-	(7,500)	(580,883)
-	-	(877,460)	(1,763,618)
17,709	1,380	17,709	1,380
17,709	1,380	(224,023,136)	(143,907,271)
-	(11,497)	(228,891)	(307,096)
-	-	1,555	2,544
-	(11,497)	(227,336)	(304,552)
-	-	(102,781,635)	(66,725,395)
-	-	118,296,208	83,534,265
7,833	13,394	23,686,276	29,147,436
654	590	631,547	522,906
(654)	(590)	(631,547)	(522,906)
7,833	13,394	39,200,849	45,956,306
(13,812)	(43,408)	(26,559,806)	31,806,101
492,654	536,062	517,133,753	442,966,226
-	-	-	42,361,426
$ 478,842	$ 492,654	$ 490,573,947	$ 517,133,753
$ 478,842	$ 492,654	$ 129,460,684	$ 70,107,239
-	-	7,130,822	9,172,761
-	-	353,982,441	437,853,753
$ 478,842	$ 492,654	$ 490,573,947	$ 517,133,753

(Continued on next page)

STATE OF OREGON
DEPARTMENT OF VETERANS' AFFAIRS
STATEMENT OF CASH FLOWS
PROPRIETARY FUNDS
FOR THE FISCAL YEARS ENDED JUNE 30, 2003 AND JUNE 30, 2002

(Continued from prior page)

	Enterprise Funds	
	Veterans' Loan Program	
	June 30, 2003	June 30, 2002
Reconciliation of Operating income to Net cash provided (used) by Operating Activities		
Operating Income	$ (3,948,010)	$ 5,739,810
Adjustments to Reconcile Operating Income to Net Cash Provided (Used) by Operating Activities:		
Depreciation and Amortization of capital assets	431,391	538,555
Amortization of Bond Premium, Discount and Underwriter's Discount on called bonds	76,443	28,791
Bad Debt Expense	(1,744,700)	(906,906)
Interest Received on Investments Reported as Operating Revenue	(24,675,139)	(35,956,850)
Investment Expense	630,893	522,316
Interest Payments on Bonds Reported as Operating Expense	58,074,377	69,141,615
Bond Costs	1,003,533	868,243
Net Changes in Assets and Liabilities:		
Accounts and Interest Receivable	792,886	804,118
Prepaid items	18,709	(34,484)
Loans and Contracts Receivable	127,967,598	89,508,522
Accounts Payable	245,105	(347,808)
Deposit Liabilities	(245,285)	193,920
Compensated Absences Payable	(98,630)	8,461
Total Adjustments	162,477,181	124,368,493
Net Cash Provided (Used) by Operating Activities	$ 158,529,171	$ 130,108,303
Noncash Investing and Capital and Related Financing Activities		
Matured investment recorded as "Due From State Treasury"	$ 6,000,000	$ -
Net Change in Fair value of Investments	(735,473)	6,783,131
Foreclosed Property	334,925	433,278
Total Noncash Investing and Capital Related Financing Activities	$ 5,599,452	$ 7,216,409

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

Enterprise Funds		Enterprise Funds	
Veterans' Home Program		Total	
June 30, 2003	June 30, 2002	June 30, 2003	June 30, 2002
$ (375,201)	$ (363,951)	$ (4,323,211)	$ 5,375,859
353,480	331,368	784,871	869,923
-	-	76,443	28,791
1,600	-	(1,743,100)	(906,906)
(8,487)	(13,983)	(24,683,626)	(35,970,833)
654	590	631,547	522,906
-	-	58,074,377	69,141,615
-	-	1,003,533	868,243
45,000	100,685	837,886	904,803
(54)	(524)	18,655	(35,008)
-	-	127,967,598	89,508,522
(46,960)	(110,108)	198,145	(457,916)
(6,121)	7,096	(251,406)	201,016
(3,265)	2,142	(101,895)	10,603
335,847	317,266	162,813,028	124,685,759
$ (39,354)	$ (46,685)	$ 158,489,817	$ 130,061,618
$ -	$ -	$ 6,000,000	$ -
-	-	(735,473)	6,783,131
-	-	334,925	433,278
$ -	$ -	$ 5,599,452	$ 7,216,409

STATE OF OREGON
DEPARTMENT OF VETERANS' AFFAIRS
PROPRIETARY FUNDS
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2003 and 2002

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The Department is a part of the State of Oregon reporting entity. The Department operates under the provisions of the Oregon Constitution article XI-A and primarily Oregon Revised Statutes *(ORS)* chapters 406, 407, 408.010 – 408.090, and 408.360 – 408.490. 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.

In 1944 Oregon voters approved a constitutional amendment that authorized the creation of a Veterans' home and farm loan program. A year later the Department was established to administer this program. The Department's scope of services increased in 1949 when the Oregon Legislative Assembly authorized the Department, acting through the Director, to provide social services and rehabilitative relief by assisting veterans, dependents, and survivors in applying for state and federal benefits. In 1964 the Department's responsibilities were increased again as the Legislative Assembly authorized the Director of the Department to act as a conservator to certain veterans and their survivors through the management of their financial affairs. The most recent expansion of services came in 1993 when the Legislative Assembly authorized the Department to provide skilled nursing care to veterans residing at the Oregon Veterans' Home.

The Department's home loan program *(Veterans' Loan Program)* provides home purchase and home improvement loans at favorable interest rates to eligible veterans, within the limitations set forth in Oregon's Constitution and applicable laws. The Veterans' Loan Program is operated through earnings on program loans, which are financed through the sale of tax-exempt general obligation bonds. These bonds are then retired through principal and interest payments received from borrowers and earnings from invested funds.

The Oregon Veterans' Home *(Veterans' Home Program)* 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.

The Veterans' Loan Program and the Veterans' Home Program are classified as proprietary fund activity. The basic financial statements and notes presented herein include only the proprietary fund activity of the Department. The Department has other programs, namely conservatorship duties and social services to veterans *(claims assistance & counseling)*, which are accounted for in other, non-proprietary funds. The financial activity of these programs have no material impact on proprietary fund activity and are presented in the **Other Supplemental Section.**

Measurement Focus of Accounting and Basis of Presentation

The accounts of the Department are organized on the basis of funds. 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 as Proprietary funds. The focus of Proprietary fund measurement is upon determination of operating income, changes in net assets, financial position, and cash flows, which is similar to private-sector business. Proprietary funds are 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 basic financial statements and notes presented have been prepared in conformity with generally accepted accounting principles *(GAAP)* as prescribed by the Governmental Accounting Standards Board *(GASB)*, the Financial Accounting Standards Board *(FASB)*, and the American Institute of Certified Public Accountants *(AICPA)*. 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. Therefore, private-sector standards of accounting and financial reporting are followed in accompanying proprietary fund financial statements to the extent that those standards do not contradict guidance of the GASB. The Department complies with the State of Oregon guidelines in applying GAAP following GASB Statement No. 20.

Budgetary Process

The Oregon Legislature approves budgets for a biennial period. Operating expenses are subject to limitation and bond related expenses are subject to administrative limitation. Both types of limitations lapse at the end of the biennium. For budgetary purposes, these transactions are recognized when received or paid in cash as opposed to when they are susceptible to accrual.

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)*, cash deposits held by the State's fiscal agent for payment of matured bonds and coupons, and cash deposits held by the agency's loan cancellation life insurance carrier. 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.

Investments and Investment Income

The Department's investments are stated at fair value. Quoted market values were used to value investments except for non-participating interest-earning investments. Non-participating interest-earning investment contracts are exempt from fair value reporting and are shown on the financial statements at amortized cost.

Investment Income includes changes in the fair value of investments and is recognized as a revenue in the Statement of Revenues, Expenses and Changes in Fund Net Assets. Realized gains based on the net increase in fair value of investments are included as a component of Investment Income.

Securities Lending Cash Collateral

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 Statement of Net Assets as Securities Lending Cash Collateral.

Receivables

Receivables are shown net of an allowance for uncollectible accounts. Receivables included are amounts due that represent revenues earned or accrued in the current period. Types included in this classification relate to interest, mortgage loans receivable, loan cancellation life insurance premiums, Federal per diem *(for Veterans' Home residents)* and other miscellaneous receivables.

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 fair market value. Cost is defined as the outstanding principal balance of the mortgage loan or contract on the date of foreclosure.

Supplies Inventories and Prepaid Expenses

Prepaid expenses include prepaid postage on hand at year-end. Supplies inventories represent an estimate of supplies on hand.

Capital Assets

Capital assets are recorded at cost. Depreciation is calculated using the straight-line method. 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. The Veterans' Building and the Oregon Veterans' Home are depreciated over their useful lives *(50 years and 40 years, respectively)*. Building-related assets are capitalized and then depreciated over the remaining estimated life of the building. Furniture, equipment, depreciable works of art, and data processing hardware and software costing $5,000 or more are capitalized and then depreciated over a useful life of five years *(10 years for art work)*.

Compensated Absences Payable

Employees accrue vacation leave at various accrual rates with a maximum accumulation of 350 hours per management employee and 300 hours per classified employee. Employees can be paid 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 non-vesting, accumulated sick pay benefits.

Arbitrage Rebate Payable

The Department discloses a liability to the federal government for excess earnings on tax-exempt bonds. The Department treats excess earnings that are rebateable to the federal government as a reduction of revenue.

Invested in Capital Assets, net of related debt

This is the component of Net Assets *(equity)* net of accumulated depreciation and reduced by any outstanding balances of bonds or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.

Operating Revenues and Expenses

Operating revenues include interest and fees on program loans as well as earnings on cash and investments related to Veterans' Loan and Veterans' Home programs. Administrative expenses, depreciation related to capital assets, and bond program related expenses are considered operating expenses.

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. Amortization of Underwriter's discounts are also included as miscellaneous bond expenses. 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 Standby Bond Purchase Agreement commitment fees and remarketing agent fees *(See Note 7)*. These fees are payable quarterly in arrears.

Comparative data and reclassifications

Certain amounts presented in the prior year data have been reclassified in order to be consistent with the current year's presentation.

2. DEPOSITS AND INVESTMENTS

Deposits

The Veterans' Loan Program book balance of cash and cash equivalents as of June 30, 2003 was $128,981,842 for current, unrestricted cash and cash equivalents; $7,130,822 for current, restricted cash and cash equivalents; and $353,982,441 in restricted, noncurrent cash and cash equivalents *(combined total was $490,095,105)*. The bank balance of these Veterans' Loan Program cash balances was $489,320,062 as of the same date. The Veterans' Home Program book balance of cash and cash equivalents as of June 30, 2003 was $478,842 for current, unrestricted cash and cash equivalents. The bank balance of these Veterans' Home Program cash balances was $478,179 as of the same date. The combined book balance of cash and cash equivalents of all types for both programs was $490,573,947 at June 30, 2003.

A combined total of $456,791,974 *(Veterans' Loan Program with $456,307,795 and the Veterans Home Program with $484,179)* at June 30, 2003 was held in demand accounts with the State Treasurer and invested in the Oregon Short Term Fund *(OSTF)*, which is maintained by the State Treasurer. The OSTF is a cash and investment pool that is available for use by all state funds and eligible local governments. State Treasurer demand deposit accounts and time certificates of deposit investments of the Oregon Short Term Fund held in state banks are insured or collateralized in excess of Federal Deposit Insurance Corporation *(FDIC)* coverage for a minimum of 25 percent in accordance with State statute. Because the pool operates as a demand deposit account, each fund type's portion of this pool is classified on the Statement of Net Assets as Cash and Cash Equivalents.

Earnings on the OSTF are allocated based on daily account balances and a variable interest rate determined periodically by the State Treasurer. Securities in the OSTF are primarily held by the State Treasurer's agent in the name of the State of Oregon. They consist of 47 percent in U.S. government securities; 28 percent in short-term commercial paper; and the remainder in time certificates of deposit and securities lending holdings. A copy of the OSTF audited annual financial report may be obtained by writing to the Oregon State Treasury, 350 Winter St NE Suite 100, Salem, OR 97301-3896.

In addition, the Department held $25,881,445 with an insurance carrier as a reserve for loan cancellation life insurance. These monies are uncollateralized and are not insured under FDIC protection. The Department is required to keep on deposit an amount not less than the annual premium. At June 30, 2003 the Department estimated that required balance to be $3,712,000. That amount is shown as Cash and Cash Equivalents – Noncurrent, restricted. The remainder of the balance at the insurance carrier is disclosed as Cash and Cash Equivalents – Current, unrestricted. For additional information on these monies *(also called the Loan Cancellation Life Insurance Contingency Fund)* see Note 5.

The Department held $7,130,822 at the State's Fiscal Agent for redemption of the Department's bonds and coupons that have matured, but have not yet been redeemed. 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. This money is shown as Cash and Cash Equivalents – Restricted, a current asset. On June 30, 2002, the matured bonds payable balance was $9,172,761.

At June 30, 2002 the Department had a book balance of Cash and Cash Equivalents of $517,133,753, which was composed of $69,614,585 in current, unrestricted cash; $9,172,761 in current, restricted cash; and $437,853,753 in noncurrent, restricted cash. The bank balance for cash at June 30, 2002 was $517,093,346.

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. These funds must be invested, and the investments managed, as a prudent investor would, exercising reasonable care, skill and caution. Under an agreement with the State Treasury, the Department's investments do not include common stock. As of June 30, 2003, the State Treasurer invested the Department's funds primarily in U.S. government securities, international bonds, and corporate bonds.

A portion of the proceeds of Bond Series 75, 76, 77, 79, and 80 are invested in specified accounts called Guaranteed Investment Contracts. These monies are held by institutions outside of the State Treasury. The Guaranteed Investment Contracts feature fixed rates of return over the length of the contracts. The Guaranteed Investment Contract accounts are currently uncollateralized but are subject to collateralization by the providers in the event that the debt rating of a provider falls below a specified level or transfer the agreement to a subsidiary or affiliate of the provider with a higher debt rating. In addition, Guaranteed Investment Contracts evidenced by contracts, rather than by securities, and are uncategorized with regard to credit risk.

A portion of the proceeds of Bond Series 81 and 82 are invested in Repurchase Agreements. These investments are fully collateralized with permitted securities at a current level of 105% of the repurchase price. The Repurchase Agreements have fixed rates of return over the length of the contract. In the event of a rating downgrade of the seller, the collateralization levels may be increased.

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 schedule below presents the credit risk and carrying amount *(fair value)* as of June 30, 2003. The Department's portion of securities lending balances in the OSTF is unclassified with regard to risk and is included in the investment schedule below. The Guaranteed Investment Contracts and the Repurchase Agreements are presented on an amortized cost basis and their reported value is not materially different from fair value. As of June 30, 2003 the carrying value of the other investments below are equal to the fair value.

	Category			Carrying
	1	2	3	Amount
Investments				
Investments held by State Treasurer				
U.S. Government and agency securities	$ 136,149,001	$ -	$ -	$ 136,149,001
International Bonds	36,131,518	-	-	36,131,518
Corporate Bonds	53,742,704	-	-	53,742,704
Total Investments held by State Treasurer	$ 226,023,223	$ -	$ -	$ 226,023,223
Repurchase Agreements	10,276,188	-	-	10,276,188
Total by risk category	$ 236,299,411	$ -	$ -	$ 236,299,411
Investments - Not Categorized				
Guaranteed Investment Contracts				
Investments held by broker-dealers under securities loans with cash collateral:				
U.S. Government and agency securities				57,960,616
Securities Lending Short-Term collateral				
Investment Pool (Oregon Short-Term Fund only):				59,694,122
Less:				
Securities Lending Amounts				(117,654,738)
Total Investments-Restricted				$ 266,394,138

Restricted Assets

Included in Cash and Cash Equivalents and Investments are amounts designated as restricted. Restrictions on the Department's cash and investments are imposed by law through constitutional provision or enabling legislation. As of June 30, 2003, the Department had restricted assets of $627,507,401. As of June 30, 2002, the Department had restricted assets of $735,670,699.

Securities Lending

In accordance with State investment policies, state agencies may participate in securities lending transactions. The Oregon State Treasury has, through a Securities Lending Agreement, authorized its custodian, State Street Bank and Trust Company *("State Street")*, to lend the Department's securities to broker-dealers and banks pursuant to a form of loan agreement. Both Oregon State Treasury and the broker-dealer borrowers maintained the right to terminate all securities lending transactions on demand. There have been no significant violations of the provisions of securities lending agreements.

During the year, State Street lent the Department's fixed income securities and received as collateral U.S. dollar-denominated cash. Borrowers were required to deliver cash collateral for each loan equal to at least 102% of the fair value of the security on loan. Oregon State Treasury did not impose any restrictions during the year on loans of the Department's fixed income securities. The Oregon State Treasury is fully indemnified by State Street against losses due to borrower default, and there were no losses during the year from the failure of borrowers to return securities on loan. However, the Department had no securities on loan as of June 30, 2003, and therefore no cash collateral was invested on the Department's behalf by State Street on that date.

Also, because the Department had no securities on loan as of June 30, 2003, it had no credit risk exposure to borrowers.

The Department's cash balances are invested in the OSTF, a cash and investment pool managed by the Oregon State Treasury which is available for use by all state funds and local governments. State Street is authorized to lend OSTF securities in return for U.S. dollar-denominated cash. State Street is also authorized by the Securities Lending Agreement to invest this cash collateral in a short-term investment pool maintained by State Street. At June 30, 2003 the pool had an average expected maturity of 369 days. Since the securities loans are callable on demand by either the lender or borrower, the life of the loans at June 30, 2003 is effectively one day and consequently does not generally match the life of the investments in the pool. The Department's allocated portion of the OSTF securities on loan and the related collateral is presented in the schedule of investments shown above. As of June 30, 2003, the fair value of the securities on loan from the OSTF and the fair value of securities purchased with the cash collateral were $938,276,842 and $966,339,137, respectively.

Investment Income

The following table details the components of Investment Income for the years ended June 30, 2003 and June 30, 2002:

	June 30, 2003	June 30, 2002
Veterans' Loan Program:		
Investment income: Accrual basis	$ 24,779,719	$ 28,651,402
Securities lending revenue	630,893	522,317
Increase/(Decrease) in fair value of investments	(735,473)	6,783,131
Investment income	$ 24,675,139	$ 35,956,850
Veterans' Home Program:		
Investment income: Accrual basis	$ 7,833	$ 13,393
Securities lending revenue	654	590
Investment income	$ 8,487	$ 13,983

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, 2003 is approximately $465 million. All mortgaged property is located within Oregon. 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 that may affect the ultimate collectibility of the mortgage loans and contracts. In 2003 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, 2003 from $10.35 million to $8.60 million, or approximately 1.85 percent of gross loans and contracts receivable.

The following table details the mortgage loans and contracts receivable and allowance accounts as disclosed on the balance sheet for June 30, 2003 and June 30, 2002.

	June 30, 2003		June 30, 2002	
Loans Receivable	$	439,630,786	$	556,017,331
Contracts Receivable		25,391,757		36,860,207
Total Loans and Contracts Receivable	$	465,022,543	$	592,877,538
Less: Allowance for Principal Losses		(8,603,000)		(10,350,000)
Net Loans and Contracts Receivable	$	456,419,543	$	582,527,538

Included in mortgage loans receivable are loans that will not amortize at their current monthly payment amounts. These loans became non-amortizing 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, 2003, there were approximately 310 non-amortizing accounts with an aggregate principal balance of approximately $28,919,000. This represents 6.3 percent of the total net loans and contracts receivable.

Related Party Transactions: Home Loans to Employees

Department employees are entitled to apply for an ODVA home loan if they meet the eligibility criteria, namely military service and citizenship in the state, and also underwriting standards such as those related to credit history and income level. The interest rate on the home loan and other terms and conditions of these loans are identical to those home loans made to non-employees. During the fiscal year ended June 30, 2003, the department made one new home loan to an eligible veteran employee. At June 30, 2003 the balance of existing home loans was $486,541 based on loans made to seven employees, including two Department managers. This amount represents less than 0.105% of the total loans and contracts receivable.

Troubled Debt Restructurings

The Department makes every reasonable attempt to keep a borrower in the home purchased under the Veterans' Loan Program. In order to avoid foreclosure one method of working with borrowers is to temporarily reduce loan payments for borrowers. This is allowed under ORS 407.095. During the year ended June 30, 2003, the Department provided this relief to some borrowers and deferred loan interest income of approximately $51,300. This interest amount was subsequently capitalized on these loans. In total, $1,785,600 in loans were restructured in this fashion. From these restructured loans the Department received approximately $67,700 in mortgage interest income during the fiscal year.

4. CAPITAL ASSETS

The following table details the net capital assets of the Veterans' Loan and Veterans' Home Programs for the years ended June 30, 2003 and June 30, 2002:

		June 30, 2003		June 30, 2002
Veterans' Loan Program				
Building, Property, and Equipment	$	9,955,561	$	9,726,670
Less: Accumulated Depreciation		(4,647,330)		(4,215,939)
Building, Property and Equipment, carrying value	$	5,308,231	$	5,510,731
Works of Art and Historical Treasures, non-depreciating	$	85,170	$	85,170
Total Capital Assets, net	$	5,393,401	$	5,595,901
Veterans' Home Program				
Building, Property and Equipment	$	12,501,279	$	12,507,774
Works of Art and Historical Treasures, depreciating		30,000		30,000
Less: Accumulated Depreciation		(1,878,984)		(1,525,504)
Depreciable Capital Assets, carrying value	$	10,652,295	$	10,982,270
Works of Art and Historical Treasures, non-depreciating		40,000		40,000
Land		600,073		593,578
Total Capital Assets, net	$	11,292,368	$	11,645,848
Total Capital Assets, net	$	16,685,769	$	17,241,749

The following table provides detail on the balances and activities of the Department's Proprietary fund capital assets for the year ended June 30, 2003:

	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets not being depreciated:				
Land	$ 593,578	$ 6,495	$ -	$ 600,073
Works of Art and Historical Treasures	125,170	-	-	125,170
Total Capital Assets not being depreciated	718,748	6,495	-	725,243
Capital assets being depreciated:				
Buildings	19,601,313	-	6,495	19,594,818
Property and Equipment	2,663,131	1,211,906	983,015	2,892,022
Total Capital Assets being depreciated	22,264,444	1,211,906	989,510	22,486,840
Less accumulated depreciation for:				
Buildings	(4,057,826)	(454,234)	-	(4,512,060)
Property and Equipment	(1,683,617)	(330,637)	-	(2,014,254)
Total accumulated depreciation	(5,741,443)	(784,871)	-	(6,526,314)
Total Capital assets, net	$ 17,241,749	$ 433,530	$ 989,510	$ 16,685,769

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. Historically subsidized from the Oregon War Veterans' Fund *(a dedicated fund of the Department created under Article XI-A of the Oregon Constitution)*, 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 fund consisting of amounts generated by the group policy and interest earned on the fund balance. Monies in the LCLI account are 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 LCLI Contingency Fund is disclosed in Note 2.

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, 2002 and June 30, 2003:

Bonds Payable (Par) at June 30, 2001	$	1,278,305,000
Bonds Issued		120,150,000
Bonds Retired		(169,920,000)
Bonds Payable *(Par)* at June 30, 2002	$	1,228,535,000
Bonds Issued		*none*
Bonds Retired		(159,050,000)
Bonds Payable *(Par)* at June 30, 2003	$	1,069,485,000

Shown below are the components of net bonds payable as disclosed on the balance sheet for June 30, 2003:

		Current		Noncurrent		Total
Bonds Payable (Par)	$	104,015,000	$	965,470,000	$	1,069,485,000
Premium on Bonds Sold		162,784		325,363		488,147
Discount on Bonds Sold		(58,619)		(884,007)		(942,626)
Net Bonds Payable	$	104,119,165	$	964,911,356	$	1,069,030,521

The following schedule summarizes future debt service requirements to maturity as of June 30, 2003:

Fiscal Year	Principal	Interest (1)	Total
2004	$ 104,015,000	$ 50,891,270	$ 154,906,270
2005	84,215,000	43,575,373	127,790,373
2006	64,375,000	37,459,484	101,834,484
2007	64,635,000	32,337,976	96,972,976
2008	64,675,000	27,169,948	91,844,948
2009-2013	92,155,000	89,942,469	182,097,469
2014-2018	209,240,000	77,221,613	286,461,613
2019-2023	222,700,000	53,086,595	275,786,595
2024-2028	53,915,000	37,916,776	91,831,776
2029-2033	42,090,000	23,956,993	66,046,993
2034-2038	31,260,000	14,530,363	45,790,363
2039-2043	36,210,000	5,037,425	41,247,425
TOTAL	$ 1,069,485,000	$ 493,126,285	$ 1,562,611,285

Shown below are the outstanding bond issues and their final maturities *(in fiscal years)* as of June 30, 2003:

Series	Dated	Original Coupon Rates From	To	Issued	Outstanding	Final Maturity
LIX (59)	August 1, 1979	5.600	6.000%	$ 200,000,000	$ 20,000,000	2004
LX (60)	November 1, 1979	6.500	8.000%	200,000,000	40,000,000	2005
LXI (61)	January 1, 1980	7.000	15.000%	300,000,000	120,000,000	2009
LXII (62)	April 1, 1980	8.500	11.250%	300,000,000	110,000,000	2009
LXIII (63)	July 1, 1980	7.300	20.000%	300,000,000	110,000,000	2009
LXIV (64)	October 1, 1980	8.000	19.500%	300,000,000	30,000,000	2010
73 (1)	December 1, 1985	6.875	7.000%	740,000,000	370,000,000	2020
75	October 1, 1995	3.900	6.000%	70,000,000	31,835,000	2027
76A	April 1, 1997	3.950	6.050%	40,000,000	25,025,000	2029
77	April 1, 1998	3.850	5.300%	40,000,000	33,055,000	2030
78A	March 1, 2000	4.000	5.500%	10,000,000	4,835,000	2024
78B	July 6, 2000	5.800	5.800%	10,000,000	5,035,000	2024
79A	March 1, 2000	4.550	6.000%	22,000,000	17,900,000	2032
80A	August 15, 2000	4.300	5.700%	35,000,000	31,650,000	2033
81	September 1, 2001	5.125	5.250%	60,150,000	60,150,000	2042
82	June 1, 2002	5.375	5.500%	60,000,000	60,000,000	2043
Total Bonds Outstanding as of June 30, 2003:					$ 1,069,485,000	

(1) $370,000,000 of Series 73E,F,G and H Variable Demand Rate bonds are included at an assumed interest rate of 1.09%, the rate in effect at June 30, 2003. See Note 7 for further information on these bonds.

Debt Refunding

During the fiscal year ended June 30, 2003 the Department refunded no general obligation bonds. For the prior fiscal year ended June 30, 2002 there were two separate refundings:

- On September 25, 2001, the Department issued $60,150,000 of Series 81 general obligation bonds with an average interest rate of 5.20 percent. These bonds were issued to refund $9,999,937.50 of Series 60, $9,999,937.50 of Series 62, and $9,999,937.50 of Series 64 as well as to refund a taxable line of credit of $30,000,000. The average interest rate of the debt refunded was 6.17 percent. The current refunding of these bonds increases the total debt service payment over the next 40 years *(assuming no bond calls of Series 81 occur)* by approximately $97 million while resulting in an economic gain of approximately $1.8 million.
- On June 19, 2002, the Department issued $60,000,000 of Series 82 general obligation bonds with an average interest rate of 5.45 percent. These bonds were issued to refund $10,000,000 of Series 59, $10,000,000 of Series 61, and $10,000,000 of Series 63 as well as to refund a taxable line of credit of $30,000,000. The average interest rate of the debt refunded was 4.62 percent. The current refunding of these bonds increases the total debt service payment over the next 40 years *(assuming no bond calls of Series 82 occur)* by approximately $60 million while resulting in an economic gain of approximately $277 thousand.

7. DEMAND BONDS

Included in long-term debt at June 30, 2003 is $370,000,000 of State of Oregon, General Obligation, Veterans' Welfare Variable Rate Demand Bonds, Series 73 E, F, G & H. The bonds are general obligations of the State of Oregon and are payable from revenues and reserves of the Veterans' Loan Program. 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 *(J.P. Morgan Securities Inc. and Morgan Stanley)* are authorized to use their best efforts to sell the repurchased bonds at face value by adjusting the interest rate on a weekly basis. The interest rate borne by each series of bonds will be determined by the designated Remarketing Agent for such bonds.

In the event the bonds cannot be remarketed, they will be purchased as specified by the Standby Bond Purchase Agreement *(SBPA)*. Under the SBPA, JPMorgan Chase Bank, formerly known as Morgan Guaranty Trust Company, will commit to purchase any Series 73 E and G unremarketed bonds, and Bayerische Landesbank Girozentrale will commit to purchase any Series 73 F and H unremarketed bonds, in each case subject to certain conditions set forth in the SBPA.

No tender advances or draws have been necessary to purchase any unremarketed bonds under the SBPA. Therefore, no tender advances or draws are outstanding as of June 30, 2003. If a tender advance did occur, it would accrue interest at the bank's base rate *(either a prime lending rate or the federal funds rate plus ½ of 1%, whichever is higher)*. If the tender advance is in default, interest would accrue at the bank's base rate plus 1%. Interest on tender advances must generally be repaid first before the principal portion of a tender advance is repaid. In most cases, tender advances are required to be paid off in approximately two years. Tender advances could be paid off earlier than two years if the Department elected to do so. If repayment of any tender advances does not occur within the specified timeframes contained in the SBPA, a default would have occurred.

Each bank's present purchase commitment consists 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 percent per annum, if any, on the bonds of the applicable series tendered for purchase and not remarketed on the purchase date. The purchase commitment of each bank may be reduced from time to time upon occurrence of certain events specified in the SBPA. As of June 30, 2003, the Department is required to pay a yearly commitment fee which is payable quarterly in arrears, at a rate of .14 percent per annum, applied to the purchase commitment defined above.

The present purchase commitments by the banks will remain in effect to the earlier of *(a)* June 22, 2004 *(scheduled expiration date)*, unless extended at the option of the bank; *(b)* the conversion of all outstanding bonds of a given series to either a variable rate period ending after the scheduled expiration date or a fixed *(or term)* rate; *(c)* the date on which no bonds of a given series are outstanding; *(d)* the date on which the commitment with respect to a particular series has been terminated in accordance with the SBPA.

8. SHORT TERM DEBT

The Department entered into a taxable line of credit agreement on June 20, 2001 to help preserve certain refunding opportunities that may be used to finance veterans' housing loans. The taxable line of credit was with KeyBank National Association and the interest rate was based on a LIBOR index *(London InterBank Offered Rate)* or the bank's prime rate. The borrowing limit on the line of credit can not exceed $30 million. As of June 30, 2003 and June 30, 2002, the Department had no outstanding balance from its taxable line of credit. Accordingly, a final payment of $7,500 on this short term borrowing was made during the fiscal year ended June 30, 2003.

During the fiscal year ended June 30, 2002 the beginning balance of the Department's short-term taxable line of credit financing was $20 million. Additional draws or borrowings of $60 million were made as well as principal repayments of $80 million, leaving no outstanding balance at June 30, 2002.

9. INTERFUND TRANSACTIONS

At June 30, 2003, the Veterans' Loan Program had an outstanding receivable of $163 due from the Department's Conservatorship Trust Fund. This balance is shown as a "Due from Other Funds" on the Statement of Net Assets. In addition, the Department had a single day's accrued receivable at June 30, 2003 of $6,000,000 from the Oregon State Treasury. This balance is shown as a "Due from State Treasury" on the Statement of Net Assets.

At June At June 30, 2002, the Veterans' Loan Program had an outstanding receivable of $26,747 due from the Department's Conservatorship Trust Fund.

10. EMPLOYEE RETIREMENT PLAN

The Department's employees participate in the Oregon Public Employees 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 13 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 by writing to the Fiscal Services Division, PERS, P.O. Box 23700, Tigard, OR 97281-3700.

Covered employees are required by state statute to contribute 6.0 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 9.49 percent of each covered employee's salary. The Veterans' Loan and Home Programs payroll for employees covered by PERS for the years ended June 30, 2003, June 30, 2002, and June 30, 2001 were approximately $4,973,300, $5,118,300, and $5,107,100, respectively. Employer contributions to PERS for these employees for the years ended June 30, 2003, June 30, 2002, and June 30, 2001 were approximately $498,200, $514,900, and $526,000, respectively, and were equal to the required contributions for each year.

11. PRIOR PERIOD ADJUSTMENTS

In the basic financial statements a total of $43,120,459 was presented as prior period adjustments. In accordance with GAAP, these adjustments were presented as adjustments to the earliest year presented -- the fiscal year ended June 30, 2002. The following prior period adjustments are included in the amounts shown in the accompanying financial statements:

- During the fiscal year ended June 30, 2002, the Department recorded a prior period adjustment of $42,361,426 due to clarification of ownership of the Loan Cancellation Life Insurance Contingency Fund. In July 2001 the Oregon Attorney General's office advised the Department on the treatment of monies held in this account and deemed them to be assets of the Oregon War Veterans' Fund. As a result, the Department is recognizing these monies as an asset thus restating beginning Net Assets, as of July 1, 2001. *(For additional information on this account see Note 5.)*
- During the fiscal year ended June 30, 2003, the Department recorded prior period adjustments of $759,033. Of these, $608,658 were capital asset-related adjustments in both the Veterans' Loan Program and the Veterans' Home Program. In addition, an

adjustment was recorded for unamortized bond discount of $150,375 in the Veterans' Loan Program.

12. LEASE COMMITMENT AND RECEIVABLES

Operating leases are rental agreements where payments are chargeable as rent and recorded as services and supplies. The Department leases land under an operating lease. Total cost for the lease for the fiscal year ended June 30, 2003 was $6,508. The future yearly minimum lease payment will remain the same amount until December 31, 2005. At that time it is expected that this lease will be replaced with a lease with a higher rental rate due to inflation.

The Department leases office space to state agency tenants at its headquarters in Salem. The lease agreements for the tenant agencies are for two-year periods, ending on the last day of the biennium. For the biennium ended June 30, 2003, the total rental income received from tenants was $494,208, per fiscal year. Future rental income may increase due to a higher rental rate due to inflation. The approximate historical cost of this office space is $1,954,600 with a carrying value of $1,207,200 *(historical cost less accumulated depreciation)*.

13. RISK FINANCING

The State of Oregon administers property and casualty insurance programs covering State government through its Central Services Fund *(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; worker's compensation; employee dishonesty; and faithful performance coverage for certain key positions required by law to be covered, and other key positions.

As a state agency, the Department participates in the Insurance Fund. The cost of servicing insurance claims and payments is covered by charging an assessment to each 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.

Risk Management Division of the Department of Administrative Services is the State's manager for self-insurance, insurance and risk control. Risk Management Division investigates, evaluates and resolves claims for damage to state property and for loss or injury to the public arising out of state activities. Division staff consult with and advise state agencies on claim related loss control issues. State agencies are responsible for informing Risk Management Division in a timely fashion when they become aware that property or liability damage has occurred.

During the fiscal years ended June 30, 2003 and June 30, 2002 there has been no significant reductions in insurance coverage in any risk category. Also, for the past three fiscal years *(July 1, 2000 through June 30, 2003)* there have been no claims that exceeded the Department's property or liability coverage.

14. CHANGE IN ACCOUNTING PRINCIPLES

During the fiscal year ended June 30, 2003, no accounting adjustments were made for change in accounting principles. However, for the fiscal year ended June 30, 2002 the Department implemented new accounting standards issued by the Governmental Accounting Standards Board. Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, as amended by Statement 37, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus,* establishes new financial reporting standards for state and local governments. These financial statement requirements present a significant change in the financial reporting model. In particular, the Department classified historical treasures and works of art which were specifically addressed for accounting treatment in the new accounting pronouncements. In the Veterans' Loan Program a cumulative effect of change in accounting principle for $75,000 was recorded which restated beginning Net Assets. In the Veterans' Home Program, a similar cumulative effect of change in accounting principle for $40,000 was recorded which also restated beginning Net Assets.

15. SUBSEQUENT EVENTS

The following subsequent events occurred after July 1, 2003:

- The Governor of Oregon named Jim Willis the Acting Director when Director Jon Mangis stepped down from his position on September 1, 2003. The Governor's appointment came after Mr. Willis was approved by the Advisory Committee on August 27, 2003. On November 6, 2003, the Oregon Senate confirmed Mr. Willis' appointment.
- On September 1, 2003, the Department called the following general obligation bonds: $5,515,000 of Series 80, $9,255,000 of Series 81, and $9,530,000 of Series 82 general obligation bonds.
- On October 1, 2003, the Department called the following general obligation bonds: $10,000,000 of Series 64, $5,525,000 of Series 75, $4,195,000 of Series 76A, $1,840,000 of Series 77, $680,000 of Series 78A, $680,000 of Series 78B, and $3,025,000 of Series 79A general obligation bonds.
- As of October 1, 2003, the Department entered into a contract with the non-profit organization, Veterans Care Centers of Oregon, to provide daily skilled nursing care services to residents of the Oregon Veterans' Home.

OTHER SUPPLEMENTAL SECTION

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.

UNAUDITED
STATE OF OREGON
DEPARTMENT OF VETERANS' AFFAIRS
BALANCE SHEET
GENERAL FUND
JUNE 30, 2003 and JUNE 30, 2002

	General Fund	
	June 30, 2003	June 30, 2002
ASSETS		
Current Assets		
Receivables:		
Due from State General Fund	$ -	$ 151,707
Due From Other Funds	-	3,764
Prepaid Items	38	137
Total Current Assets	38	155,608
TOTAL ASSETS	$ 38	$ 155,608
LIABILITIES & FUND BALANCES		
Current Liabilities		
Accounts Payable	$ -	$ 139,097
Compensated Absences Payable	-	16,374
Total Current Liabilities	-	155,471
TOTAL LIABILITIES	$ -	$ 155,471
FUND BALANCES:		
Fund Balances:		
Reserved for Prepaid Items	$ 38	$ 137
Unreserved, undesignated Fund Balance	-	-
TOTAL FUND BALANCES	$ 38	$ 137
TOTAL LIABILITIES AND FUND BALANCES	$ 38	$ 155,608

UNAUDITED

STATE OF OREGON

DEPARTMENT OF VETERANS' AFFAIRS

STATEMENT OF REVENUES, EXPENDITURES

AND CHANGES IN FUND BALANCE

GENERAL FUND

FOR THE FISCAL YEARS ENDED JUNE 30, 2003 AND JUNE 30, 2002

	General Fund	
	June 30, 2003	**June 30, 2002**
Revenues		
	$ -	$ -
Total Revenues	-	-
Expenditures		
Veterans' Services		
Personal Services	$ 475,199	$ 648,139
Services and Supplies	43,535	58,142
Special Payments	343,206	496,776
Total Expenditures	861,940	1,203,057
Excess of Revenues over Expenditures	(861,940)	(1,203,057)
Other Financing Sources		
State appropriations	861,940	1,203,057
Total Other Financing Sources	861,940	1,203,057
Net Change in Fund balance	$ -	$ -
Beginning Fund Balance	137	267
Change in Reserve for Prepaid Items	(99)	(130)
Ending Fund Balance	$ 38	$ 137

UNAUDITED

STATE OF OREGON

DEPARTMENT OF VETERANS' AFFAIRS

SCHEDULE OF LEGISLATIVE AUTHORIZATION (NON-GAAP BUDGETARY BASIS)

COMPARED TO ACTUAL EXPENDITURES SUBJECT TO BUDGET

GENERAL FUND

FOR THE BIENNIUM ENDED JUNE 30, 2003

	General Fund			
	2001-2003 Budget	First Year Actual June 30, 2002	Second Year Actual June 30, 2003	Variance Favorable/ (Unfavorable)
General Fund:				
Veterans' Services Division - Appropriation	$ 2,064,547	$ 1,194,203	$ 861,841	$ 8,503
Total General Fund	$ 2,064,547	$ 1,194,203	$ 861,841	$ 8,503

Fiduciary Funds

Private Purpose Trust Funds, a type of Fiduciary Fund, account for trust arrangements, other than those properly reported in pension trust funds or investment trust funds, under which principal and income benefit individuals, private organizations, or other governments.

Conservatorship Private Purpose Trust Fund

The Department acts as conservator of estates of approximately 260 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' Trust Accounts Private Purpose 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. In addition, the Department maintains various veteran-related trust accounts.

UNAUDITED

STATE OF OREGON

DEPARTMENT OF VETERANS' AFFAIRS

COMBINING STATEMENT OF NET ASSETS

FIDUCIARY FUNDS

Private Purpose Trust Funds

JUNE 30, 2003 and JUNE 30, 2002

	Conservatorship Private-purpose Trust Fund		Veterans' Trust Accounts Private-purpose Trust Fund	
	June 30, 2003	**June 30, 2002**	**June 30, 2003**	**June 30, 2002**
ASSETS				
Current Assets				
Cash and Cash Equivalents	$ 21,533,230	$ 21,134,939	$ 642,058	$ 501,966
Investments	2,475,891	2,532,749	-	-
Security Lending Cash Collateral	2,844,672	1,489,978	84,440	34,961
Receivables:				
Accrued Interest	25,235	35,436	-	-
Contracts	178,249	140,671	-	-
Due from Other Funds	-	-	1,346	1,684
Other	3,751	-	-	-
Total Current Assets	27,061,028	25,333,773	727,844	538,611
Noncurrent Assets				
Conservatorship Real Property	3,787,197	3,790,966	-	-
Conservatorship Personal Property	672,596	767,400	-	-
Total Noncurrent Assets	4,459,793	4,558,366	-	-
TOTAL ASSETS	$ 31,520,821	$ 29,892,139	$ 727,844	$ 538,611
LIABILITIES				
Current Liabilities				
Due to Other Funds	$ 163	$ 30,511	$ -	$ -
Obligations under Securities Lending	2,844,672	1,489,978	84,440	34,961
Total Current Liabilities	2,844,835	1,520,489	84,440	34,961
Noncurrent Liabilities				
Mortgages on Conservatorship Real Property	958,956	1,158,969	-	-
Total Noncurrent Liabilities	958,956	1,158,969	-	-
TOTAL LIABILITIES	3,803,791	2,679,458	84,440	34,961
NET ASSETS				
Net Assets Held in trust for Individuals	27,717,030	27,212,681	643,404	503,650
TOTAL NET ASSETS	$ 27,717,030	$ 27,212,681	$ 643,404	$ 503,650

	Total Fiduciary Funds	
	June 30, 2003	June 30, 2002
	$ 22,175,288	$ 21,636,905
	2,475,891	2,532,749
	2,929,112	1,524,939
	25,235	35,436
	178,249	140,671
	1,346	1,684
	3,751	-
	27,788,872	25,872,384
	3,787,197	3,790,966
	672,596	767,400
	4,459,793	4,558,366
	$ 32,248,665	$ 30,430,750
	$ 163	$ 30,511
	2,929,112	1,524,939
	2,929,275	1,555,450
	958,956	1,158,969
	958,956	1,158,969
	3,888,231	2,714,419
	28,360,434	27,716,331
	$ 28,360,434	$ 27,716,331

UNAUDITED
STATE OF OREGON
DEPARTMENT OF VETERANS' AFFAIRS
COMBINING STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN NET ASSETS
FIDUCIARY FUNDS
Private Purpose Trust Funds
FOR THE FISCAL YEARS ENDED JUNE 30, 2003 AND JUNE 30, 2002

	Conservatorship Private-purpose Trust Fund		Veterans' Trust Accounts Private-purpose Trust Fund	
	June 30, 2003	June 30, 2002	June 30, 2003	June 30, 2002
ADDITIONS				
Contributions				
Veterans' Benefits	$ 8,189,227	$ 7,603,493	$ -	$ -
Donations	-	-	154,264	131,776
Other	-	-	1,000	2,457
Total Contributions	8,189,227	7,603,493	155,264	134,233
Investment Income:				
Interest Income	365,024	471,747	10,509	11,550
TOTAL ADDITIONS	$ 8,554,251	$ 8,075,240	$ 165,773	$ 145,783
DEDUCTIONS				
Securitites Lending Investment Expense	$ 30,807	$ 25,194	$ 810	$ 492
Beneficiary Care	8,019,095	8,475,388	-	-
Other Expenditures	-	-	20,157	21,290
TOTAL DEDUCTIONS	$ 8,049,902	$ 8,500,582	$ 20,967	$ 21,782
Net Increase/ (Decrease) Before Transfers	$ 504,349	$ (425,342)	$ 144,806	$ 124,001
TRANSFERS				
Operating interagency transfers in	$ -	$ -	$ 12,657	$ 10,143
Operating transfers out (to Veterans' Home)	-	-	(17,709)	(1,380)
Change In Net Assets	$ 504,349	$ (425,342)	$ 139,754	$ 132,764
Beginning Net Assets	$ 27,212,681	$ 27,638,023	$ 503,650	$ 370,886
Ending Net Assets	$ 27,717,030	$ 27,212,681	$ 643,404	$ 503,650

Total Fiduciary Funds			
June 30, 2003		June 30, 2002	
$	8,189,227	$	7,603,493
	154,264		131,776
	1,000		2,457
	8,344,491		7,737,726
	375,533		483,297
$	8,720,024	$	8,221,023
$	31,617	$	25,686
	8,019,095		8,475,388
	20,157		21,290
$	8,070,869	$	8,522,364
$	649,155	$	(301,341)
$	12,657	$	10,143
	(17,709)		(1,380)
$	644,103	$	(292,578)
$	27,716,331	$	28,008,909
$	28,360,434	$	27,716,331

STATISTICAL SECTION

STATE OF OREGON
DEPARTMENT OF VETERANS' AFFAIRS
COMPARATIVE STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS
PROPRIETARY FUND - VETERANS' LOAN PROGRAM only
FOR THE FISCAL YEARS 1994 - 2003

	June 30, 2003		June 30, 2002		June 30, 2001		June 30, 2000	
REVENUES								
Mortgage Loan interest income	$ 36,742,510		$ 43,749,526		$ 50,861,579		$ 57,259,424	
Contract interest income	2,535,147		3,522,372		4,562,401		5,648,408	
Investment income	24,675,139	**	35,956,850	**	57,521,901	**	38,492,961	**
Gain on Sale of Foreclosed Property	39,121		172,472		9,052		16,892	
Gain (Loss) on Sale of Investments	-	**	-	**	-	**	-	**
Loan Cancellation Life Insurance Premiums	3,642,487		-		-		-	
Loan Cancellation Life Insurance Processing Fees	425,004		425,004		425,004		399,937	
Other Fees and Charges	1,189,691		1,447,451		1,342,762		1,402,798	
Conservatorship Fees	364,510		338,136		353,417		345,554	
TOTAL REVENUES	$ 69,613,609		$ 85,611,811		$ 115,076,116		$ 103,565,974	
EXPENSES								
Bond Interest Expense	$ 58,066,877		$ 68,560,732		$ 85,455,556		$ 93,957,700	
Interest on Taxable Line of Credit	7,500		580,883		-		-	
Salaries and Other Payroll Expenses	6,838,554		6,974,557		6,932,307		6,886,703	
Bond Expenses	909,379		868,243		925,722		819,421	
Securities Lending Investment Expense	630,893		522,316		1,156,100		2,006,704	
Real Estate Owned Expense	80,757		73,308		57,863		42,230	
Services and Supplies	2,958,497		2,480,268		2,741,678		2,679,295	
Claims Expense - Loan Cancellation Life Insurance	5,121,239		-		-		-	
Depreciation Expense	431,391		538,555		453,159		360,840	
Bad Debt Expense	(1,744,700)		(906,906)		(1,078,111)		(1,227,068)	
Special Payments	51,000		-		-		-	
Other Expenses	210,232		180,045		74,888		42,749	
TOTAL EXPENSES	$ 73,561,619		$ 79,872,001		$ 96,719,162		$ 105,568,574	
Income/ (Loss) before Extraordinary or Special Items	$ (3,948,010)		$ 5,739,810		$ 18,356,954		$ (2,002,600)	
Extraordinary or Special items:								
Loss on Extinguishment of Debt	$ -		$ -		$ (17,231)		$ (11,888)	
Gain from Litigation	-		-		-		-	
CHANGE IN NET ASSETS	$ (3,948,010)		$ 5,739,810		$ 18,339,723		$ (2,014,488)	
NET ASSETS								
Beginning Net Assets *	$ 143,302,691		$ 94,931,080		$ 76,591,357		$ 78,605,845	
Prior Period Adjustment	-		42,556,801		-		-	
Cumulative Effect of Change in Accounting Principle	-		75,000		-		-	
Beginning Net Assets, restated	$ 143,302,691		$ 137,562,881		$ 76,591,357		$ 78,605,845	
Ending Net Assets, restated	$ 139,354,681		$ 143,302,691		$ 94,931,080		$ 76,591,357	

* Prior to the fiscal year ended June 30, 2002, the term "Retained Earnings" was used. It has the same meaning as "Net Assets".

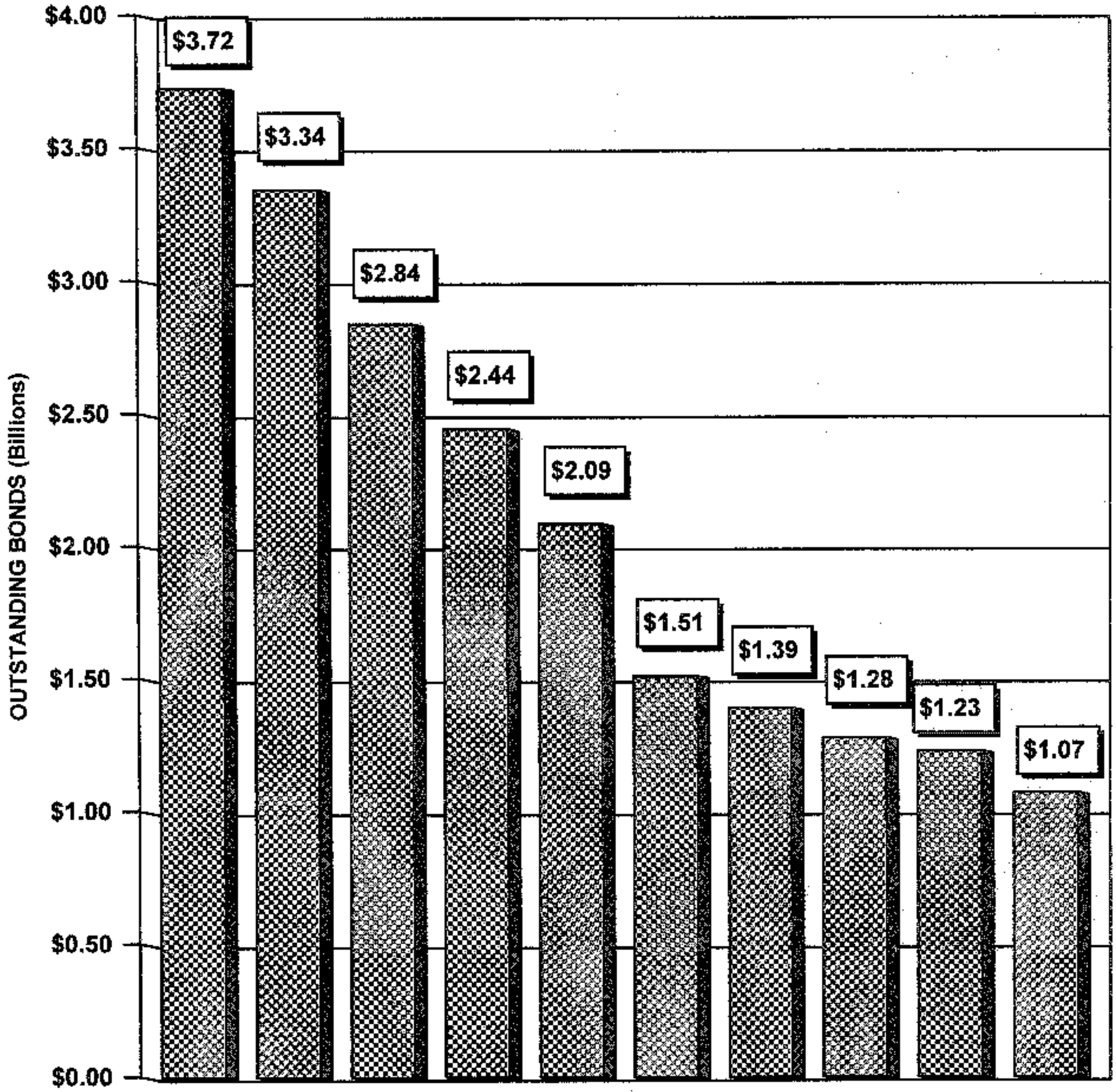
** Investment income includes change in fair value, as required by GASB Statement 31, beginning in the fiscal year ending June 30, 1998. Gain or loss on sale of investments is not reported under GASB Statement 31.

Prepared without audit.

June 30, 1999	June 30, 1998	June 30, 1997	June 30, 1996	June 30, 1995	June 30, 1994
$ 68,967,805	$ 84,739,050	$ 101,149,885	$ 119,299,277	$ 137,627,560	$ 164,565,886
7,603,132	10,413,658	13,302,547	16,741,582	19,925,191	24,434,197
48,834,865 **	80,184,016 **	88,584,123	91,392,885	106,181,662	101,205,742
32,324	106,330	292,921	438,213	354,743	329,949
- **	- **	(771,619)	(1,265,290)	(2,295,346)	29,299,910
-	-	-	-	-	-
327,540	433,763	497,874	561,115	601,875	560,297
1,055,894	932,092	884,689	742,319	459,468	463,561
322,973	334,784	334,328	335,634	325,256	322,367
$ 127,144,533	$ 177,143,693	$ 204,274,748	$ 228,245,735	$ 263,180,409	$ 321,181,909
$ 117,276,619	$ 153,677,775	$ 186,918,415	$ 215,402,978	$ 259,118,354	$ 284,932,969
-	-	-	-	-	-
6,829,801	6,952,431	6,958,822	7,374,399	7,963,439	7,919,633
952,673	1,478,508	1,774,314	2,310,443	2,677,130	2,665,458
1,607,492	1,588,540	4,656,093	-	-	-
49,096	50,806	79,340	170,172	232,218	240,393
3,055,525	3,473,771	3,197,130	3,317,255	3,091,085	3,390,725
-	-	-	-	-	-
317,751	338,820	235,128	417,097	522,733	1,233,864
(3,346,273)	(2,934,825)	(3,217,416)	(3,858,097)	(7,126,322)	-
-	-	-	-	-	-
42,477	53,475	32,406	23,258	20,052	12,800
$ 126,785,161	$ 164,679,301	$ 200,634,232	$ 225,157,505	$ 266,498,689	$ 300,395,842
$ 359,372	$ 12,464,392	$ 3,640,516	$ 3,088,230	$ (3,318,280)	$ 20,786,067
$ (12,271,433)	$ (3,870,466)	$ (5,676,618)	$ (10,519,290)	$ (4,112,981)	$ -
654,385	-	-	-	3,283,024	-
$ (11,257,676)	$ 8,593,926	$ (2,036,102)	$ (7,431,060)	$ (4,148,237)	$ 20,786,067
$ 89,863,521	$ 78,681,347	$ 80,717,449	$ 88,148,509	$ 92,296,746	$ 71,510,679
-	-	-	-	-	-
-	2,588,248	-	-	-	-
$ 89,863,521	$ 81,269,595	$ 80,717,449	$ 88,148,509	$ 92,296,746	$ 71,510,679
$ 78,605,845	$ 89,863,521	$ 78,681,347	$ 80,717,449	$ 88,148,509	$ 92,296,746

OREGON DEPARTMENT OF VETERANS' AFFAIRS

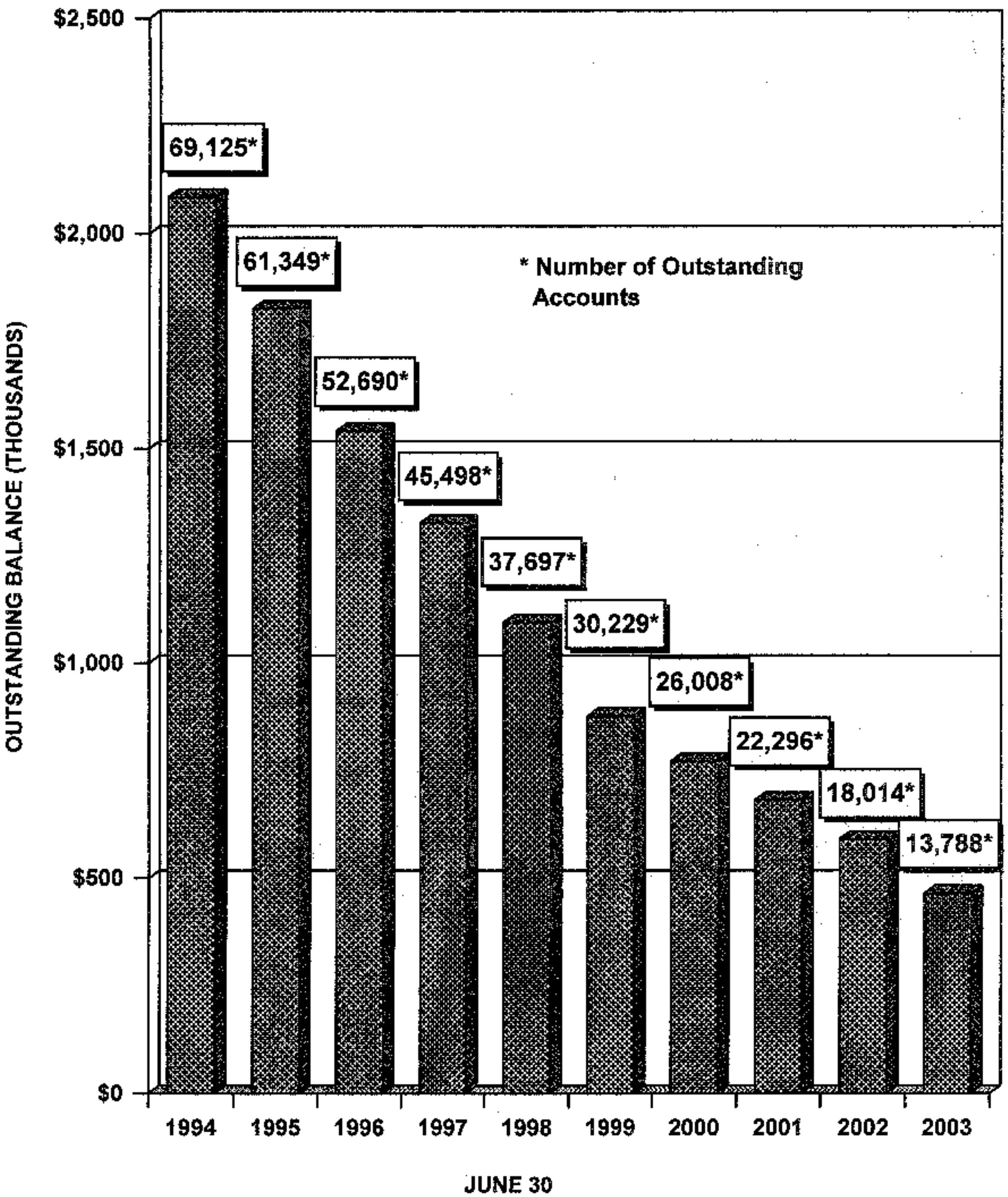
COMPARATIVE SUMMARY OF BONDS OUTSTANDING



Source: Financial Statement of the Oregon Department of Veterans' Affairs. Prepared without audit.

OREGON DEPARTMENT OF VETERANS' AFFAIRS

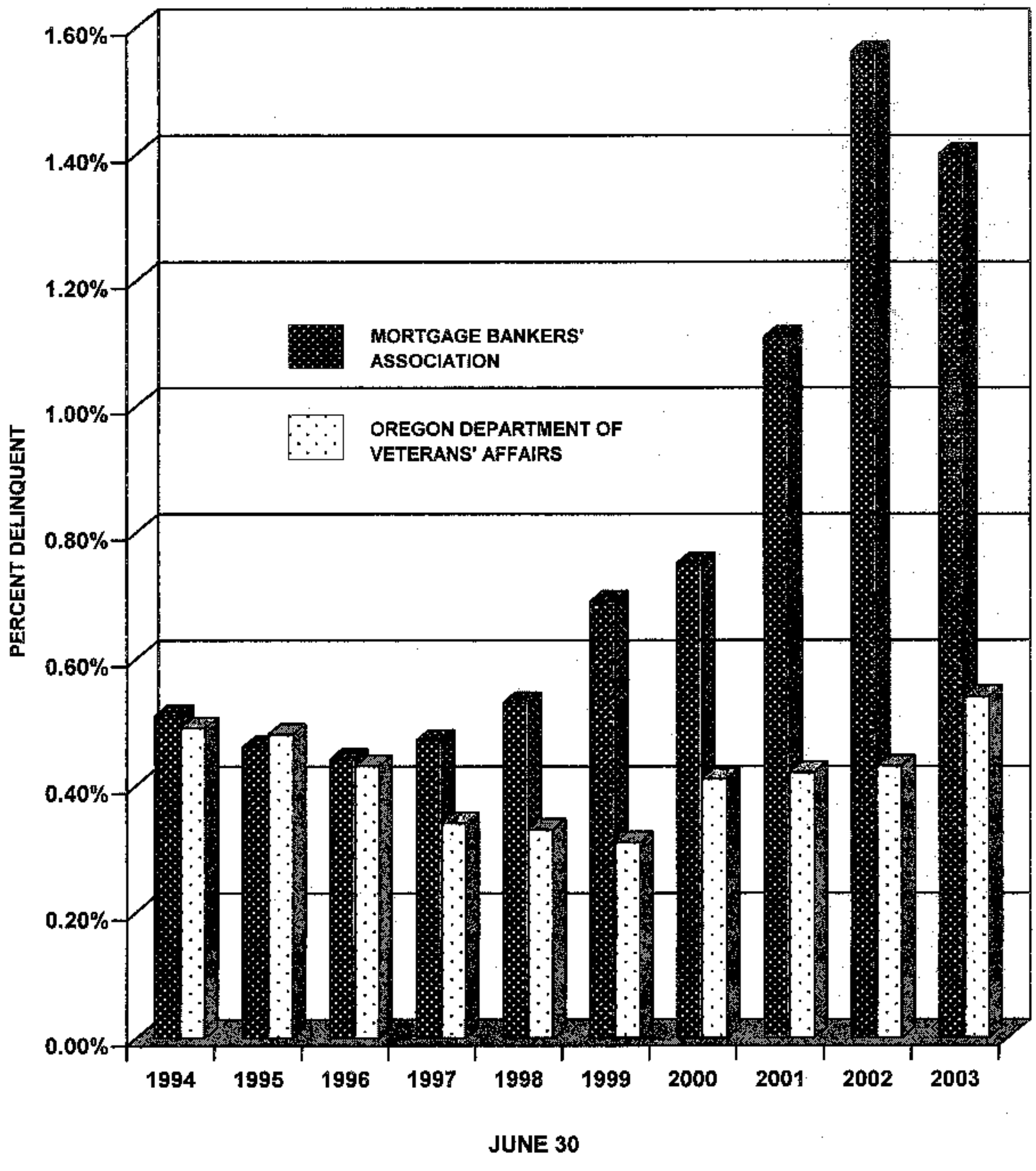
COMPARATIVE SUMMARY OF LOANS AND CONTRACTS OUTSTANDING



Sources: Statistical Reports and Financial Statements of the Oregon Department of Veterans' Affairs.
Prepared without audit.

OREGON DEPARTMENT OF VETERANS' AFFAIRS

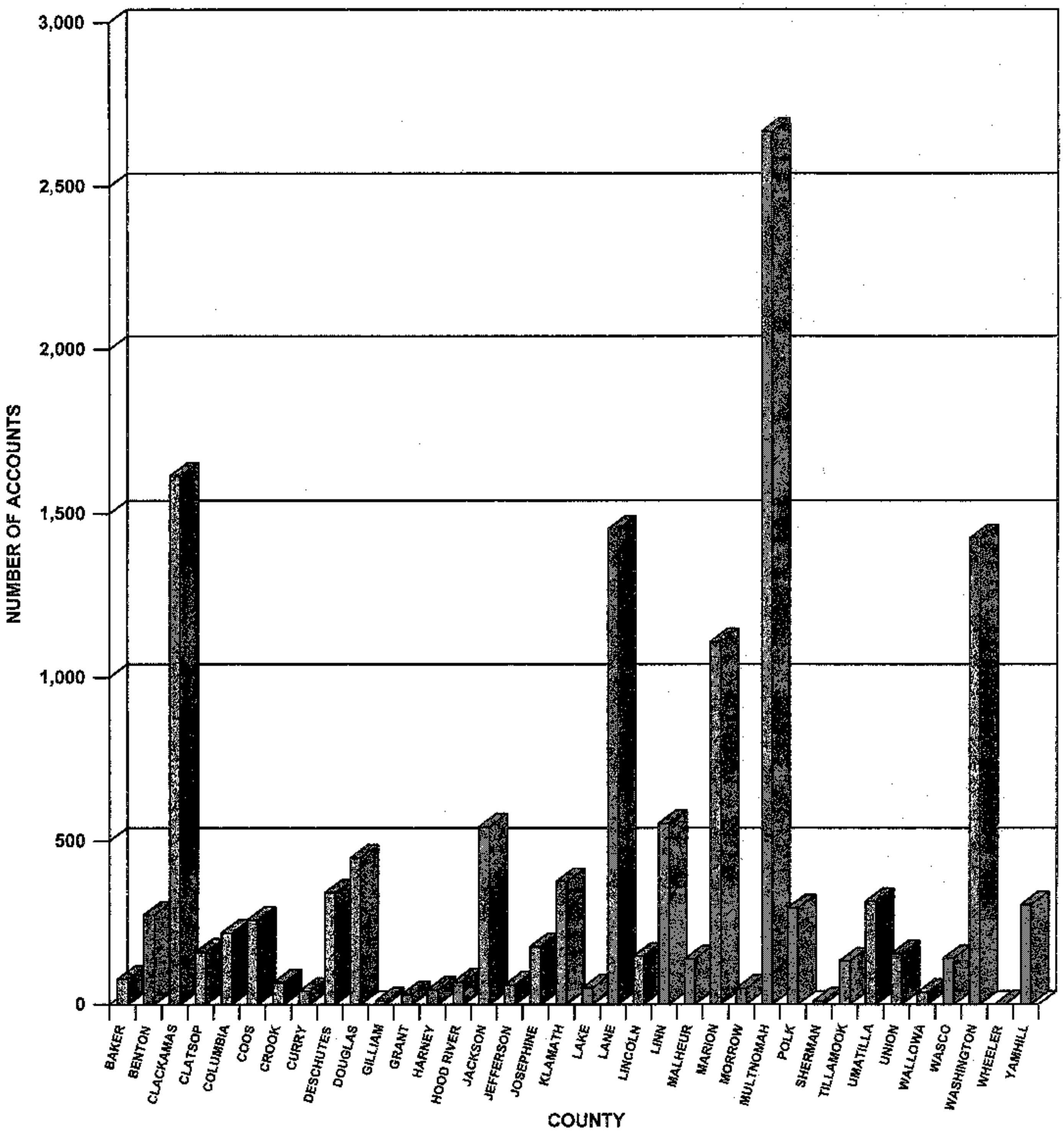
COMPARATIVE SUMMARY OF 90+ DAY DELINQUENCIES



Sources: National Delinquency Survey (Oregon, All Loans) - Mortgage Bankers Association and the Oregon Department of Veterans' Affairs.
Prepared without audit.

OREGON DEPARTMENT OF VETERANS' AFFAIRS

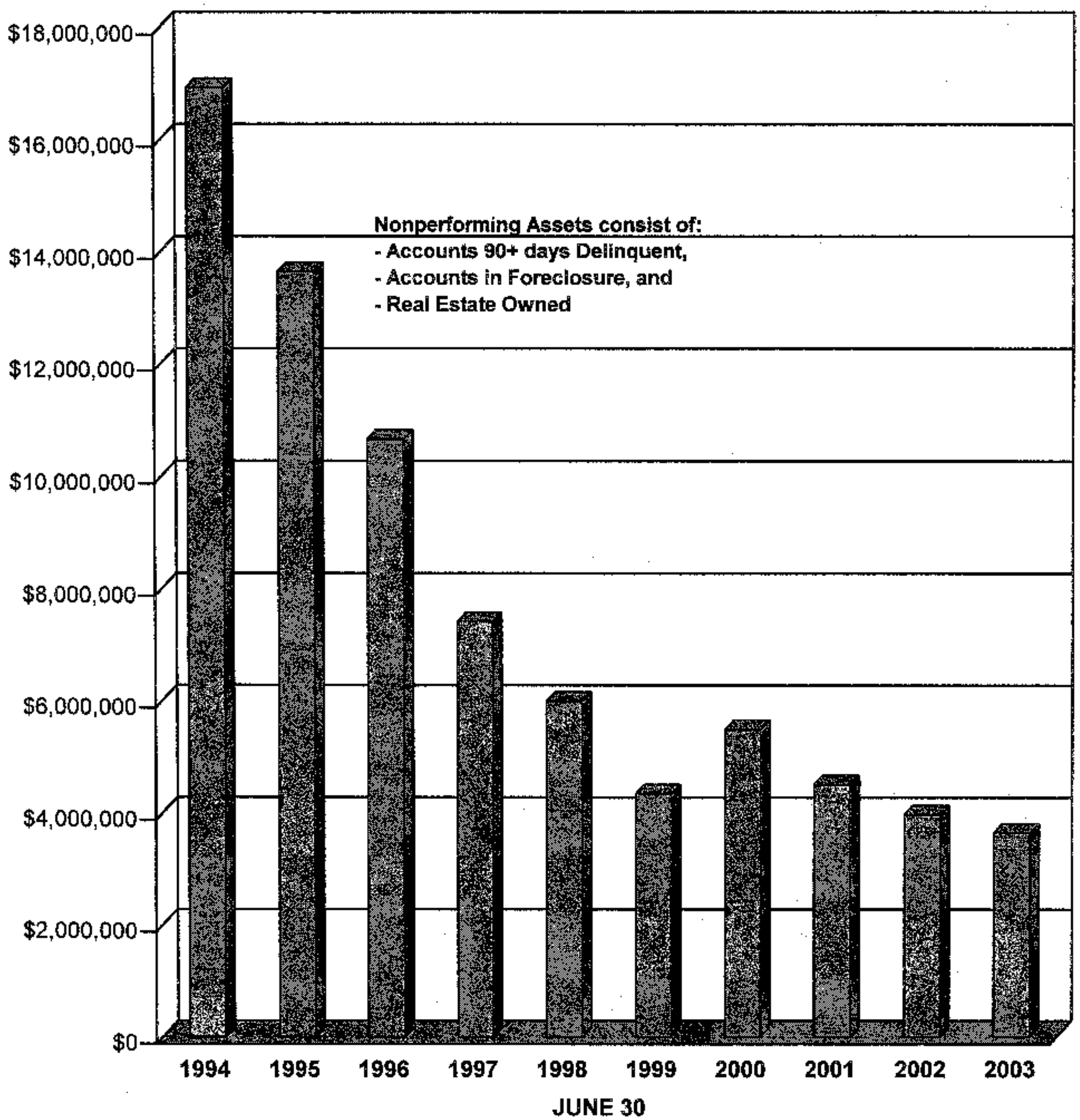
OUTSTANDING LOAN AND CONTRACT ACCOUNTS BY COUNTY AS OF JUNE 30, 2003



Source: Oregon Department of Veterans' Affairs.
Prepared without audit.

OREGON DEPARTMENT OF VETERANS' AFFAIRS

COMPARATIVE SUMMARY OF NONPERFORMING ASSETS



Sources: Statistical Reports and Financial Statements of the Oregon Department of Veterans' Affairs. Prepared without audit.

OTHER REPORTS

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

We have audited the basic financial statements of the enterprise funds of the state of Oregon, Department of Veterans' Affairs (department), as of and for the years ended June 30, 2003 and 2002, and have issued our report thereon dated November 28, 2003. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the department's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the department's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or

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operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements 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 the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the Oregon Department of Veterans' Affairs management, the governor of the state of Oregon and the Oregon Legislative Assembly and is not intended to be and should not be used by anyone other than these specified parties.

OREGON AUDITS DIVISION

Bill Bradbury
Secretary of State

November 28, 2003

The Oregon Department of Veterans' Affairs (ODVA) intends to comply with the Americans with Disabilities Act (The ADA), PL101-336. The ADA provides that no qualified person with a disability shall be kept from participation in (or be denied a benefit of) the services, programs, or activities of ODVA because of that disability. For additional information or how to file a complaint, please contact ODVA's ADA coordinator.

ADA Coordinator 503-373-2380

Oregon Department of Veterans' Affairs

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This information is also available in alternate formats, upon request.