Oregon Department of Veterans' Affairs

Annual Financial Report
Enterprise Funds
For The Fiscal Years Ended
June 30, 2004 and June 30, 2003

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, 2004 and June 30, 2003

Jim Willis
Director

Bruce Shriver, CPA
Chief Financial Officer

<u>Report Prepared By</u>

Carol Clevenberg
Ron Weisser, CPA

With the assistance of the
Financial Administration Division,
Administrative Services Division,
and Public Information Section

<u>Cover Photo:</u>
Dedication of the Medal of Honor Memorial
on the Oregon State Capitol grounds September 2004

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Jim Willis, Director of The Oregon Department of Veterans' Affairs
Governor Ted Kulongoski
Paula Brown, Deputy Director of The Oregon Department of Veterans' Affairs

Oregon Governor Ted Kulongoski appointed Jim Willis Director of the Oregon Department of Veterans' Affairs effective September 1, 2003. Since 1989, Jim has served as an administrator in state executive service under four Oregon governors. Director Willis, a native Oregonian and decorated Vietnam veteran, was born in Portland and raised in Albany. Following his military service and as a law enforcement professional, Jim worked for over thirty years in various assignments from patrol officer to his final assignment as a major with the Oregon State Police, a position he held for over ten years. A long time advocate for veterans, Jim served as the State Legislative Commission Chairman for the American Legion. Former Governor John Kitzhaber appointed Jim to the Governor's Advisory Committee to the Director of the Oregon Department of Veterans' Affairs in 2000. In 2002, Jim was elected Vice-Chair of the Committee and in 2003 was elected Chair of the full committee.

Oregon Department of Veterans' Affairs Director Jim Willis appointed Paula Brown as the Deputy Director in September 2003. Prior to this appointment, Paula served as the Acting Deputy Director under the previous Director. Paula was born in Buckhannon, a small town in West Virginia. Upon graduating from high school, she enlisted in the U.S. Army in November 1985. In April 1986, she was assigned to the 902d Military Intelligence Battalion, Fort Meade, Maryland, where she served in the Counterespionage Unit until the end of her enlistment. She attended Anne Arundel Community College in Maryland with studies focused on business communications. She and her family came to Oregon upon her husband's retirement from the military. In August 1998, Paula went to work for the Department of Veterans' Affairs in the Veterans' Services Division. She went on to be the Public Information Manager until her appointment as the Deputy Director.

Director Jim Willis, Deputy Paula Brown, and the employees of the Oregon Department of Veterans' Affairs are deeply committed to providing quality services to veterans, their families and survivors.

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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

November 19, 2004

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, 2004, and June 30, 2003. 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 four 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 **Other Reports Section** includes the Independent Auditor's report on compliance and internal control over financial reporting.

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 strong increase of 3.8 percent at an annual rate. This is the third consecutive quarterly growth in jobs above 2.0 percent. The last quarter to turn in a stronger performance was the first quarter of 1997. On a year-over-year *(Y/Y)* basis, jobs increased in the second quarter by 2.2 percent. The last time that Y/Y growth came in above 2.0 percent was the second quarter of 2000. This strong Y/Y growth is due in part to the large drop in jobs in the second quarter of 2003 coupled with the strong job growth in the second quarter of this year.

During the second quarter of 2004, job gains dominated across almost all industries. Total private nonfarm employment increased at a 4.3 percent rate. Large increases in private employment included natural resources and mining, construction, durable goods manufacturing (except wood products), retail and wholesale trade, and professional and business services. While the largest growth increase was posted by transportation equipment at 23.5 percent, the sector with the largest growth decline was private educational services at negative 28.7 percent. Other private sector losses occurred in wood products, food processing, transportation, warehousing, and utilities, and information. The government sector gained jobs at a rate of 2.4 percent. While mild job losses occurred at the federal and state levels, local government jobs grew 3.6 percent.

The most recent Blue Chip Job Growth rankings place Oregon 2nd in the nation. For Y/Y job growth, between June 2003 and June 2004, jobs increased by 39,200 or 2.50 percent. A year ago, Oregon ranked 42nd.

Future Outlook – With the second quarter of 2004 ushering in the fourth consecutive quarter of job growth, the evidence points to a recovery in the job market. The Employment Department reports that we have regained two-thirds of Oregon's lost jobs as of June of this year. The national economy is projected to continue its growth path into 2005 and the Oregon economy will be pulled along for the ride. The questions of uncertainty that now loom are: How strong and for how long?

The Federal Reserve raised interest rates this June for the first time in four years. Tax breaks at the national level have provided their stimulus and may not be extended in the next year. The government stimulus is meant to jump-start the economy, and then the economy should be able to run on its own. The engine took longer to turn over than anyone expected, but appears to be running fine. As always, there are risks down the road such as energy costs, especially oil, and geopolitical events.

Oregon's Office of Economic Analysis (OEA) projects that the U.S. economic recovery will hold up through 2005 and Oregon will be pulled along. Growth will be solid the second half of this year and continue above 2.0 percent into the first half of 2005.

OEA forecasts Oregon's employment to rise by 2.0 percent for 2004, ending the three year string of job losses. Job growth in 2005 is projected to be 2.3 percent, reflecting the solid growth in the first half of the year. Oregon's economy is projected to expand with 1.9 percent job growth in 2006.

Total private nonfarm employment is projected to increase in 2004, growing by 2.2 percent. The sector will continue to improve through 2005. Total private nonfarm employment will grow 2.6 percent in 2005 and 2.0 percent in 2006. Manufacturing will increase by 2.4 percent in 2004 and then soften with growth of 1.5 percent in 2005 and 0.4 percent in 2006. Job levels will still be below average job levels in 2000. Private non-manufacturing jobs will increase by 2.2 percent in 2004, 2.8 percent in 2005, and 2.3 percent in 2006.

Wood product manufacturing is projected to be up 1.3 percent in 2004 and then decline by 2.6 percent in 2005 and 4.1 percent in 2006.

The sector that contains semiconductors, computer and electronic products, will improve in 2004 but is expected to show job losses of 0.5 percent for 2004. Job recovery will take hold with a 3.4 percent gain in 2005. This subsector is expected to continue with job gains into 2006 with a growth of 2.4 percent.

Transportation equipment employment will increase by 9.8 percent in 2004. Job gains will not be as strong but continue to be solid in 2005 with growth of 4.7 percent. Employment will remain flat with a gain of 0.1 percent in 2006.

Construction jobs are expected to reverse the decline of 2003 with an increase of 5.7 percent in 2004. Job growth will be a positive 2.7 percent in 2005 and 2.6 percent in 2006.

Trade job growth will improve in the next few years. Retail trade job growth will be stronger in 2005 at 1.8 percent and in 2006 at 1.9 percent. Wholesale trade will be positive in 2004 with annual job growth of 1.4 percent in 2005 and 1.6 percent in 2006.

Professional and business services and health services will see some of the strongest job growth. Professional and business services will grow 6.0 percent in 2005 followed by 4.0 percent growth in 2006 while health services will increase 2.7 percent and 3.0 percent on average for the same years.

Leisure and hospitality employment, which includes accommodations and food services, is expected to grow by 2.7 percent in 2004, 3.4 percent in 2005, and 1.8 percent in 2006.

Government employment is expected to increase by 1.0 percent in 2004 followed by growth of 1.1 percent for 2005 and 2006. State and local government jobs will slowly improve as tax revenues improve with the stronger economy.

Oregon's population growth is expected to be higher than the U.S. average, but slower than the growth experienced in the mid-1990s. Slower growth will prevail over the next three years, with increases of 1.1 percent for 2004 and 1.2 percent each year for 2005 and 2006.

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. Both federal and State laws govern eligibility requirements on who may receive a veterans' home loan. As of June 30, 2004, this Program had approximately 10,100 mortgage loans and contracts outstanding, with a principal balance of approximately $346 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 107 residents at June 30, 2004. The Department owns the OVH and for the fiscal year ended June 30, 2003, 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 three year 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, 2004, the Veterans' Loan Program had approximately $1.29 billion in assets *(primarily consisting of loan and contract receivables, cash and cash equivalents, and investment securities)* and about $1.17 billion in liabilities *(primarily consisting of general obligation bonds)*. Revenues from the Department's home loan program are primarily 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, 2004, the Veterans' Home Program had assets of approximately $12.8 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	Aa3
Fitch Investors Service	A+
Standard & Poor's	AA

As of June 30, 2004, the Department had approximately $882 million in outstanding bonds. During fiscal year 2004, the Department did not issue any bonds and retired approximately $187 million.

Cash Management - 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, 2004, the Department's Enterprise funds cash, cash equivalents *(excluding securities lending collateral)*, and investments totaled approximately $677 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, 2004, and June 30, 2003. 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.

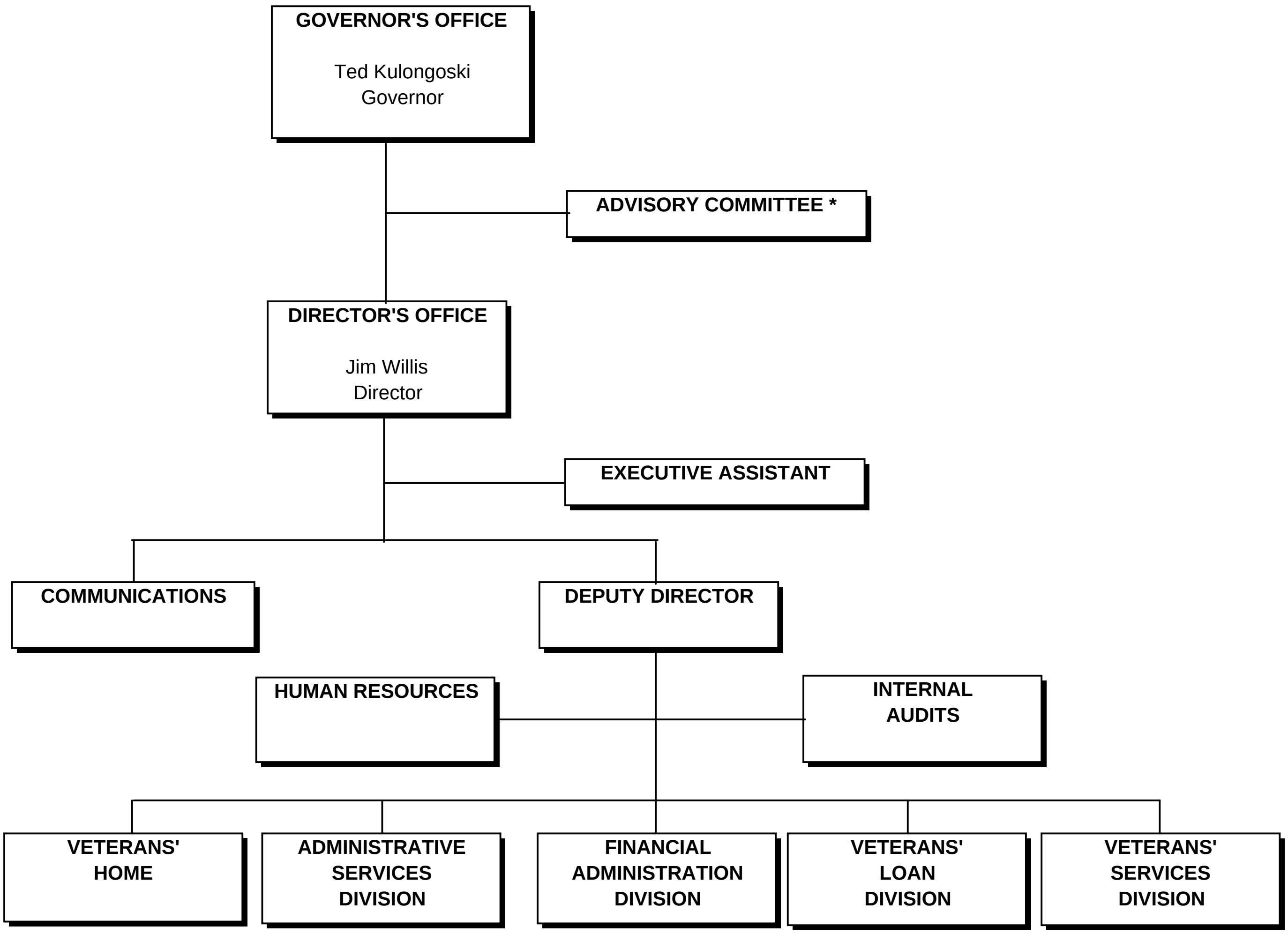
Acknowledgements - The preparation of this report reflects the combined efforts of the Department's staff. The professionalism, commitment, and effort of the individuals involved is very much appreciated.

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, 2008
Staryl C. Austin, Jr.	March 15, 2008	Harold C. Jordan	December 31, 2006
Furlton M. Burns	March 15, 2008	Tino E. Ornelas	September 30, 2007
Walter R. Crews	March 15, 2008	Vacant Position	
David Fairclo	March 15, 2008		

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, 2004 and 2003, 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, 2004 and 2003, 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, 2004 and 2003, and the changes in financial position 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 introductory section, other supplemental section and statistical section 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 them.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 5, 2004 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 tables of contents.

OREGON AUDITS DIVISION

Bill Bradbury
Secretary of State

November 5, 2004

STATE OF OREGON
DEPARTMENT OF VETERANS' AFFAIRS
STATEMENT OF NET ASSETS
PROPRIETARY FUNDS
JUNE 30, 2004 AND JUNE 30, 2003

	Enterprise Funds			
	Veterans' Loan Program		Veterans' Home Program	
	June 30, 2004	June 30, 2003	June 30, 2004	June 30, 2003
ASSETS				
Current Assets				
Cash and Cash Equivalents	$ 109,561,351	$ 128,981,842	$ 726,735	$ 478,842
Cash and Cash Equivalents - Restricted	6,257,846	7,130,822	-	-
Securities Lending Cash Collateral	263,145,877	59,557,642	342,687	63,195
Receivables:				
Accrued Interest	5,545,325	8,586,686	-	-
Due from State Treasury	-	6,000,000	-	-
Loan Cancellation Life Insurance Premiums	217,577	274,500	-	-
Federal Per Diem	-	-	661,432	390,000
Other	23,533	12,600	-	16,794
Due from Other Funds	5,269	163	-	-
Real Estate Owned	171,189	302,563	-	-
Prepaid Expenses	19,449	26,563	553	846
Total Current Assets	384,947,416	210,873,381	1,731,407	949,677
Noncurrent Assets				
Cash and Cash Equivalents - Restricted	405,536,924	353,982,441	-	-
Investments - Restricted	155,641,016	266,394,138	-	-
Mortgage Loans and Contracts Receivable (Net)	339,922,044	456,419,543	-	-
Patient Receivable (Net)	-	-	3,572	3,606
Notes Receivable	360,000	-	-	-
Deferred Underwriter's Discount	1,913,369	2,209,215	-	-
Capital Assets:				
Building, Property and Equipment	9,945,155	9,955,561	12,517,677	12,506,729
Land	-	-	600,073	600,073
Works of Art and Historical Treasures	85,170	85,170	70,000	70,000
Accumulated Depreciation	(5,032,348)	(4,647,330)	(2,161,834)	(1,878,984)
Total Noncurrent Assets	908,371,330	1,084,398,738	11,029,488	11,301,424
TOTAL ASSETS	$ 1,293,318,746	$ 1,295,272,119	$ 12,760,895	$ 12,251,101
LIABILITIES				
Current Liabilities				
Accounts Payable	$ 566,738	$ 762,672	$ 958,079	$ 411,023
Loan Cancellation Life Insurance Premium Payable	347,345	455,246	-	-
Deposit Liabilities	1,495,581	1,910,501	-	976
Accrued Interest on Bonds	12,368,445	16,329,000	-	-
Obligations under Securities Lending	263,145,877	59,557,642	342,687	63,195
Compensated Absences Payable	417,495	453,859	16,073	13,480
Bonds Payable-Maturing Within One Year (Net)	83,314,364	104,119,165	-	-
Matured Bonds Payable	6,257,846	7,130,822	-	-
Total Current Liabilities	367,913,691	190,718,907	1,316,839	488,674
Noncurrent Liabilities				
Bonds Payable-Maturing After One Year (Net)	798,269,848	964,911,356	-	-
Arbitrage Rebate Payable	385,380	287,175	-	-
Total Noncurrent Liabilities	798,655,228	965,198,531	-	-
TOTAL LIABILITIES	1,166,568,919	1,155,917,438	1,316,839	488,674
NET ASSETS				
Invested in Capital Assets (Restated)	4,997,977	5,393,401	11,025,916	11,297,818
Net Assets, Unrestricted	121,751,850	133,961,280	418,140	464,609
TOTAL NET ASSETS	$ 126,749,827	$ 139,354,681	$ 11,444,056	$ 11,762,427

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

Enterprise Funds	
TOTAL	
June 30, 2004	June 30, 2003
$ 110,288,086	$ 129,460,684
6,257,846	7,130,822
263,488,564	59,620,837
5,545,325	8,586,686
-	6,000,000
217,577	274,500
661,432	390,000
23,533	29,394
5,269	163
171,189	302,563
20,002	27,409
386,678,823	211,823,058
405,536,924	353,982,441
155,641,016	266,394,138
339,922,044	456,419,543
3,572	3,606
360,000	-
1,913,369	2,209,215
22,462,832	22,462,290
600,073	600,073
155,170	155,170
(7,194,182)	(6,526,314)
919,400,818	1,095,700,162
$ 1,306,079,641	$ 1,307,523,220
$ 1,524,817	$ 1,173,695
347,345	455,246
1,495,581	1,911,477
12,368,445	16,329,000
263,488,564	59,620,837
433,568	467,339
83,314,364	104,119,165
6,257,846	7,130,822
369,230,530	191,207,581
798,269,848	964,911,356
385,380	287,175
798,655,228	965,198,531
1,167,885,758	1,156,406,112
16,023,893	16,691,219
122,169,990	134,425,889
$ 138,193,883	$ 151,117,108

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, 2004 AND JUNE 30, 2003

	Enterprise Funds			
	Veterans' Loan Program		Veterans' Home Program	
	June 30, 2004	June 30, 2003	June 30, 2004	June 30, 2003
OPERATING REVENUES				
Interest Income:				
Mortgage Loans	$ 26,789,783	$ 36,742,510	$ -	$ -
Contracts	1,698,531	2,535,147	-	-
Investment Income	13,338,726	24,675,139	8,390	8,487
Loan Cancellation Life Insurance Premiums	2,704,444	3,642,487	-	-
Loan Cancellation Life Insurance Processing Fee	425,004	425,004	-	-
Resident Revenue	-	-	6,157,125	5,044,610
Other Fees and Charges	939,950	1,189,691	2,134	-
Conservatorship Fees	345,750	364,510	-	-
Gain on Sale of Foreclosed Property	493,409	39,121	-	-
TOTAL OPERATING REVENUES	46,735,597	69,613,609	6,167,649	5,053,097
OPERATING EXPENSES				
Bond Interest	44,537,191	58,066,877	-	-
Interest on Taxable Line of Credit	-	7,500	-	-
Salaries and Other Payroll Expenses	5,875,969	6,838,554	213,063	205,262
Bond Expenses	1,155,355	909,379	-	-
Securities Lending Investment Expense	1,899,175	630,893	1,846	654
Real Estate Owned Expense	52,526	80,757	-	-
Services and Supplies	2,140,262	2,958,497	107,766	134,843
Claims Expense - Loan Cancellation Life Insurance	4,927,874	5,121,239	-	-
Veterans' Home Operations	-	-	6,181,784	4,732,459
Depreciation Expense	408,883	431,391	288,918	353,480
Bad Debt Expense	(1,656,784)	(1,744,700)	(100)	1,600
Special Payments	-	51,000	-	-
Other Expenses	-	210,232	-	-
TOTAL OPERATING EXPENSES	59,340,451	73,561,619	6,793,277	5,428,298
OPERATING INCOME (LOSS)	(12,604,854)	(3,948,010)	(625,628)	(375,201)
Transfers				
Net Transfers from Veterans' Home Trust Fund	-	-	298,257	17,709
Capital Contributions	-	-	9,000	-
CHANGE IN NET ASSETS	(12,604,854)	(3,948,010)	(318,371)	(357,492)
NET ASSETS - Beginning	139,354,681	143,302,691	11,762,427	12,114,469
Prior Period Adjustment	-	-	-	5,450
NET ASSETS - Beginning, Restated	139,354,681	143,302,691	11,762,427	12,119,919
NET ASSETS - Ending	$ 126,749,827	$ 139,354,681	$ 11,444,056	$ 11,762,427

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

Enterprise Funds	
TOTAL	
June 30, 2004	June 30, 2003
$ 26,789,783	$ 36,742,510
1,698,531	2,535,147
13,347,116	24,683,626
2,704,444	3,642,487
425,004	425,004
6,157,125	5,044,610
942,084	1,189,691
345,750	364,510
493,409	39,121
52,903,246	74,666,706
44,537,191	58,066,877
-	7,500
6,089,032	7,043,816
1,155,355	909,379
1,901,021	631,547
52,526	80,757
2,248,028	3,093,340
4,927,874	5,121,239
6,181,784	4,732,459
697,801	784,871
(1,656,884)	(1,743,100)
-	51,000
-	210,232
66,133,728	78,989,917
(13,230,482)	(4,323,211)
298,257	17,709
9,000	-
(12,923,225)	(4,305,502)
151,117,108	155,417,160
-	5,450
151,117,108	155,422,610
$ 138,193,883	$ 151,117,108

STATE OF OREGON
DEPARTMENT OF VETERANS' AFFAIRS
STATEMENT OF CASH FLOWS
PROPRIETARY FUNDS
FOR THE FISCAL YEARS ENDED JUNE 30, 2004 AND JUNE 30, 2003

	Enterprise Funds	
	Veterans' Loan Program	
	June 30, 2004	June 30, 2003
Cash Flows from Operating Activities:		
Receipts from Customers	$ 4,137,551	$ 5,234,631
Receipts from Other Funds for Services	693,865	795,522
Loan Principal Repayments	149,929,334	169,065,380
Loan Interest Received	29,325,191	39,969,132
Payments to Employees for Services	(5,920,029)	(6,934,041)
Payments to Suppliers	(7,188,254)	(6,844,187)
Payments to Other Funds for Services	(717,746)	(1,090,920)
Distributions to Other Governments	(39,069)	-
Loans Made	(31,341,898)	(41,422,613)
Other Receipts (Payments)	(422,970)	(243,733)
Net Cash Provided (Used) in Operating Activities	138,455,975	158,529,171
Cash Flows from Noncapital Financing Activities:		
Principal Payments on Bonds	(188,212,976)	(161,091,939)
Interest Payments on Bonds	(48,601,805)	(62,063,946)
Interest Payments on Loans	-	(7,500)
Bond Issuance Costs	(789,326)	(877,460)
Transfers from Other Funds	-	-
Net Cash Provided (Used) in Noncapital Financing Activities	(237,604,107)	(224,040,845)
Cash Flows from Capital and Related Financing Activities:		
Acquisition of Capital Assets	(13,459)	(228,891)
Proceeds from Sale of Capital Assets	559	1,555
Net Cash Provided (Used) in Capital and Related Financing Activities	(12,900)	(227,336)
Cash Flows from Investing Activities:		
Purchases of Investments	(360,249,694)	(102,781,635)
Proceeds from Sales or Maturities of Investments	470,234,935	118,296,208
Interest on Investments and Cash Balances	20,436,807	23,678,443
Investment Income from Securities Lending	1,899,175	630,893
Investment Expense from Securities Lending	(1,899,175)	(630,893)
Net Cash Provided (Used) in Investing Activities	130,422,048	39,193,016
Net Increase (Decrease) in Cash and Cash Equivalents	31,261,016	(26,545,994)
Cash and Cash Equivalents - Beginning	490,095,105	516,641,099
Cash and Cash Equivalents - Ending	$ 521,356,121	$ 490,095,105
Reconciled to Statement of Net Assets:		
Cash and Cash Equivalents - Current	$ 109,561,351	$ 128,981,842
Cash and Cash Equivalents - Current, Restricted	6,257,846	7,130,822
Cash and Cash Equivalents - Noncurrent, Restricted	405,536,924	353,982,441
Cash and Cash Equivalents - Ending (shown above)	$ 521,356,121	$ 490,095,105

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

Enterprise Funds		Enterprise Funds	
Veterans' Home Program		TOTAL	
June 30, 2004	June 30, 2003	June 30, 2004	June 30, 2003
$ 5,901,645	$ 5,089,610	$ 10,039,196	$ 10,324,241
-	-	693,865	795,522
-	-	149,929,334	169,065,380
-	-	29,325,191	39,969,132
(210,470)	(208,527)	(6,130,499)	(7,142,568)
(5,689,326)	(4,912,038)	(12,877,580)	(11,756,225)
(52,875)	(2,279)	(770,621)	(1,093,199)
-	-	(39,069)	-
-	-	(31,341,898)	(41,422,613)
2,134	(6,120)	(420,836)	(249,853)
(48,892)	(39,354)	138,407,083	158,489,817
-	-	(188,212,976)	(161,091,939)
-	-	(48,601,805)	(62,063,946)
-	-	-	(7,500)
-	-	(789,326)	(877,460)
298,257	17,709	298,257	17,709
298,257	17,709	(237,305,850)	(224,023,136)
(8,016)	-	(21,475)	(228,891)
-	-	559	1,555
(8,016)	-	(20,916)	(227,336)
-	-	(360,249,694)	(102,781,635)
-	-	470,234,935	118,296,208
6,544	7,833	20,443,351	23,686,276
1,846	654	1,901,021	631,547
(1,846)	(654)	(1,901,021)	(631,547)
6,544	7,833	130,428,592	39,200,849
247,893	(13,812)	31,508,909	(26,559,806)
478,842	492,654	490,573,947	517,133,753
$ 726,735	$ 478,842	$ 522,082,856	$ 490,573,947
$ 726,735	$ 478,842	$ 110,288,086	$ 129,460,684
-	-	6,257,846	7,130,822
-	-	405,536,924	353,982,441
$ 726,735	$ 478,842	$ 522,082,856	$ 490,573,947

(Continued on next page)

STATE OF OREGON
DEPARTMENT OF VETERANS' AFFAIRS
STATEMENT OF CASH FLOWS
PROPRIETARY FUNDS
FOR THE FISCAL YEARS ENDED JUNE 30, 2004 AND JUNE 30, 2003

(Continued from prior page)

	Enterprise Funds	
	Veterans' Loan Program	
	June 30, 2004	June 30, 2003
Reconciliation of Operating Income to Net Cash Provided (Used) by Operating Activities:		
Operating Income	$ (12,604,854)	$ (3,948,010)
Adjustments to Reconcile Operating Income to Net Cash Provided (Used) by Operating Activities:		
Depreciation and Amortization of Capital Assets	408,883	431,391
Amortization of Bond Premium, Discount and Underwriter's Discount on Called Bonds	293,597	76,443
Bad Debt Expense	(1,656,784)	(1,744,700)
Interest Received on Investments Reported as Operating Revenue	(13,338,726)	(24,675,139)
Investment Expense	1,899,175	630,893
Interest Payments on Bonds Reported as Operating Expense	44,537,191	58,074,377
Bond Costs	789,326	1,003,533
Net Changes in Assets and Liabilities:		
Accounts and Interest Receivable	913,338	792,886
Prepaid Items	14,714	18,709
Loans and Contracts Receivable	117,960,493	127,967,598
Accounts Payable	(308,536)	245,105
Deposit Liabilities	(415,479)	(245,285)
Compensated Absences Payable	(36,363)	(98,630)
Total Adjustments	151,060,829	162,477,181
Net Cash Provided (Used) by Operating Activities	$ 138,455,975	$ 158,529,171
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	(6,766,081)	(735,473)
Capital Contributions	-	-
Foreclosed Property	259,815	334,925
Total Noncash Investing and Capital and Related Financing Activities	$ (6,506,266)	$ 5,599,452

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

Enterprise Funds		Enterprise Funds	
Veterans' Home Program		TOTAL	
June 30, 2004	June 30, 2003	June 30, 2004	June 30, 2003
$ (625,628)	$ (375,201)	$ (13,230,482)	$ (4,323,211)
288,918	353,480	697,801	784,871
-	-	293,597	76,443
(100)	1,600	(1,656,884)	(1,743,100)
(8,390)	(8,487)	(13,347,116)	(24,683,626)
1,846	654	1,901,021	631,547
-	-	44,537,191	58,074,377
-	-	789,326	1,003,533
(254,504)	50,206	658,834	843,092
293	(54)	15,007	18,655
-	(5,206)	117,960,493	127,962,392
547,056	(46,960)	238,520	198,145
(976)	(6,121)	(416,455)	(251,406)
2,593	(3,265)	(33,770)	(101,895)
576,736	335,847	151,637,565	162,813,028
$ (48,892)	$ (39,354)	$ 138,407,083	$ 158,489,817
$ -	$ -	$ -	$ 6,000,000
-	-	(6,766,081)	(735,473)
9,000	-	9,000	-
-	-	259,815	334,925
$ 9,000	$ -	$ (6,497,266)	$ 5,599,452

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 activities 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.

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.

Prepaid Expenses

Prepaid expenses consist of postage on hand at year-end.

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

This is the Capital Asset component of Net Assets *(equity)* net of accumulated depreciation.

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. All revenues and expenses not meeting this definition would be reported as nonoperating revenues and 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 is 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, 2004 was $109,561,351 for current, unrestricted cash and cash equivalents; $6,257,846 for current, restricted cash and cash equivalents; and $405,536,924 in restricted, noncurrent cash and cash equivalents *(combined total was $521,356,121)*. The bank balance of these Veterans' Loan Program cash balances was $521,508,367 as of the same date. The Veterans' Home Program book balance of cash and cash equivalents as of June 30, 2004 was $726,735 for current, unrestricted cash and cash equivalents. The bank balance of these Veterans' Home Program cash balances was $727,733 as of the same date. The combined book balance of cash and cash equivalents of all types for both programs was $522,082,856 at June 30, 2004.

A combined total of $491,085,900 *(Veterans' Loan Program with $490,358,167 and the Veterans Home Program with $727,733)* at June 30, 2004 was held in demand accounts with the State Treasurer and invested in the Oregon Short-Term Fund (OSTF). 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 13 percent in U.S. government securities; 24 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 $24,892,354 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, 2004 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 $6,257,846 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, 2003, the matured bonds payable balance was $7,130,822.

At June 30, 2003 the Department had a book balance of Cash and Cash Equivalents of $490,095,105, which was composed of $128,981,842 in current, unrestricted cash; $7,130,822 in current, restricted cash; and $353,982,441 in noncurrent, restricted cash. The bank balance for cash at June 30, 2003 was $489,320,062.

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, 2004, 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, 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, 2004. 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, 2004 the carrying value of the other investments below are equal to the fair value.

	Category 1	Category 2	Category 3	Carrying Amount
Investments				
Investments Held By State Treasurer				
U.S. Government And Agency Securities	$ 62,606,776	$ -	$ -	$ 62,606,775
International Bonds	10,387,550	-	-	10,387,550
Corporate Bonds	50,906,101	-	-	50,906,101
Total Investments Held By State Treasurer	$ 123,900,427	$ -	$ -	$ 123,900,426
Repurchase Agreements	10,731,764	-	-	10,731, 764
Total By Risk category	$ 134,632,191	$ -	$ -	$ 134,632,190
Investments - Not Categorized				
Guaranteed Investment Contracts				$ 21,008,826
Investments Held By Broker-Dealers Under Securities Loans With Cash Collateral:				
U.S. Government And Agency Securities				226,228,209
Securities Lending Short-Term Collateral Investment Pool (Oregon Short-Term Fund Only):				231,270,248
Less:				
Securities Lending Amounts				(457,498,457)
Total Investments-Restricted				$ 155,641,016

Restricted Assets

Included in Cash and Cash Equivalents and Investments are amounts designated as restricted. Restrictions on the Department's cash and investments can arise from Oregon's constitutional provision or enabling legislation, federal tax law relating to bond proceeds, bond covenants and from certain other contractual arrangements. The primary purpose of the restricted assets will be to meet upcoming debt service requirements. As of June 30, 2004, the Department had restricted assets of $567,435,786. As of June 30, 2003, the Department had restricted assets of $627,507,401.

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.

The Department had $32,025,478 in securities on loan as of June 30, 2004. State Street invested cash collateral in the amount of $32,238,000 on the Department's behalf as of that date. The Department had $212,522 in 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, 2004 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, 2004 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, 2004, the fair value of the securities on loan from the OSTF and the fair value of securities purchased with the cash collateral were $3,777,513,662 and $3,861,704,641, respectively.

Investment Income

The following table details the components of Investment Income for the years ended June 30, 2004 and June 30, 2003:

		June 30, 2004		June 30, 2003
Veterans' Loan Program:				
Investment Income: Accrual Basis	$	18,205,632	$	24,779,719
Securities Lending Revenue		1,899,175		630,893
Increase/(Decrease) in Fair Value of Investments		(6,766,081)		(735,473)
Investment Income	$	13,338,726	$	24,675,139
Veterans' Home Program:				
Investment Income: Accrual Basis	$	6,544	$	7,833
Securities Lending Revenue		1,846		654
Investment Income	$	8,390	$	8,487

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, 2004 is approximately $346 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 2004 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, 2004 from $8.60 million to $6.90 million, or approximately 2.00 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, 2004 and June 30, 2003.

		June 30, 2004		June 30, 2003
Loans Receivable	$	329,930,505	$	439,630,786
Contracts Receivable		16,896,539		25,391,757
Total Loans and Contracts Receivable	$	346,827,044	$	465,022,543
Less: Allowance for Principal Losses		(6,905,000)		(8,603,000)
Net Loans and Contracts Receivable	$	339,922,044	$	456,419,543

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, 2004, there were 237 non-amortizing accounts with an aggregate principal balance of approximately $22,572,000. This represents 6.64 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, 2004, the department made no new home loans to an eligible veteran employee. At June 30, 2004 the balance of existing home loans was $338,842 based on loans made to six employees, including two Department managers. This amount represents less than 0.099% of the total loans and contracts receivable. At June 30, 2003 the balance of existing home loans was $486,541 based on loans made to seven employees, including two Department managers.

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, 2004, the Department provided this relief to some borrowers and deferred loan interest income of approximately $16,800. This interest amount was subsequently capitalized on these loans. In total, $834,500 in loans were restructured in this fashion. From these restructured loans the Department received approximately $34,400 in mortgage interest income during the fiscal year. 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, 2004 and June 30, 2003:

	June 30, 2004	June 30, 2003
Veterans' Loan Program		
Building, Property, and Equipment	$ 9,945,155	$ 9,955,561
Less: Accumulated Depreciation	(5,032,348)	(4,647,330)
Building, Property and Equipment, Carrying Value	$ 4,912,807	$ 5,308,231
Works of Art and Historical Treasures, Non-Depreciating	$ 85,170	$ 85,170
Total Capital Assets, Net	$ 4,997,977	$ 5,393,401
Veterans' Home Program		
Building, Property and Equipment	$ 12,517,677	$ 12,506,729
Works of Art and Historical Treasures, Depreciating	30,000	30,000
Less: Accumulated Depreciation	(2,161,834)	(1,878,984)
Depreciable Capital Assets, Carrying Value	$ 10,385,843	$ 10,657,745
Works of Art and Historical Treasures, Non-Depreciating	40,000	40,000
Land	600,073	600,073
Total Capital Assets, Net	$ 11,025,916	$ 11,297,818
Total Capital Assets, Net	$ 16,023,893	$ 16,691,219

The following table provides detail on the balances and activities of the Department's Proprietary fund capital assets for the year ended June 30, 2004:

	Beginning Balance	Increases	Decreases	Ending Balance
Capital Assets Not Being Depreciated:				
Land	$ 600,073	$ -	$ -	$ 600,073
Works of Art and Historical Treasures	125,170	-	-	125,170
Total Capital Assets Not Being Depreciated	725,243	-	-	725,243
Capital Assets Being Depreciated:				
Buildings	19,594,818	-	-	19,594,818
Property and Equipment	2,867,472	30,475	(29,933)	2,868,014
Works of Art and Historical Treasures	30,000	-	-	30,000
Total Capital Assets Being Depreciated	22,492,290	30,475	(29,933)	22,492,832
Less Accumulated Depreciation:				
Buildings	(4,512,060)	(364,875)	-	(4,876,935)
Property and Equipment	(1,999,504)	(329,926)	29,933	(2,299,497)
Works of Art and Historical Treasures	(14,750)	(3,000)	-	(17,750)
Total Accumulated Depreciation	(6,526,314)	(697,801)	29,933	(7,194,182)
Total Capital Assets, Net	$ 16,691,219	$ (667,326)	$ -	$ 16,023,893

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, 2003 and June 30, 2004:

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
Bonds Issued		*none*
Bonds Retired		(187,340,000)
Bonds Payable *(Par)* at June 30, 2004	$	882,145,000

Shown below are the components of net bonds payable as disclosed on the balance sheet for June 30, 2004:

		Current		Noncurrent		Total
Bonds Payable (Par)	$	83,245,000	$	798,900,000	$	882,145,000
Premium on Bonds Sold		127,983		195,236		323,219
Discount on Bonds Sold		(58,619)		(825,388)		(884,007)
Net Bonds Payable	$	83,314,364	$	798,269,848	$	881,584,212

The following schedule summarizes future debt service requirements to maturity as of June 30, 2004:

Fiscal Year	Principal	Interest [(1)]	Total
2005	$ 83,245,000	$ 38,078,795	$ 121,323,795
2006	63,355,000	32,011,208	95,366,208
2007	63,540,000	26,941,888	90,481,888
2008	63,295,000	21,830,773	85,125,773
2009	42,945,000	16,761,456	59,706,456
2010-2014	25,090,000	68,208,353	93,298,353
2015-2019	295,330,000	58,880,651	354,210,651
2020-2024	123,095,000	38,807,311	161,902,311
2025-2029	40,320,000	28,176,222	68,496,222
2030-2034	29,740,000	18,137,278	47,877,278
2035-2039	27,810,000	10,821,018	38,631,018
2040-2044	24,380,000	2,688,956	27,068,956
TOTAL	$ 882,145,000	$ 361,343,909	$ 1,243,488,909

Shown below are the outstanding bond issues and their final maturities *(in fiscal years)* as of June 30, 2004:

		Original Coupon Rates				Final
Series	**Dated**	**From**	**To**	**Issued**	**Outstanding**	**Maturity**
LX (60)	November 1, 1979	6.500	8.000%	$ 200,000,000	$ 20,000,000	2005
LXI (61)	January 1, 1980	7.000	15.000%	300,000,000	100,000,000	2009
LXII (62)	April 1, 1980	8.500	11.250%	300,000,000	90,000,000	2009
LXIII (63)	July 1, 1980	7.300	20.000%	300,000,000	90,000,000	2009
LXIV (64)	October 1, 1980	8.000	19.500%	300,000,000	10,000,000	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	18,940,000	2027
76A	April 1, 1997	3.950	6.050%	40,000,000	15,405,000	2029
77	April 1, 1998	3.850	5.300%	40,000,000	26,830,000	2030
78A	March 1, 2000	4.000	5.500%	10,000,000	2,830,000	2024
78B	July 6, 2000	5.800	5.800%	10,000,000	3,310,000	2024
79A	March 1, 2000	4.550	6.000%	22,000,000	11,420,000	2032
80A	August 15, 2000	4.300	5.700%	35,000,000	22,045,000	2033
81	September 1, 2001	5.125	5.250%	60,150,000	50,895,000	2043
82	June 1, 2002	5.375	5.500%	60,000,000	50,470,000	2043
Total Bonds Outstanding as of June 30, 2004:					$ 882,145,000	

(1) $370,000,000 of Series 73E,F,G and H Variable Demand Rate bonds are included at an assumed interest rate of 1.015%, the rate in effect at June 30, 2004. See Note 7 for further information on these bonds.

7. DEMAND BONDS

Included in long-term debt at June 30, 2004 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 (BLG) 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, 2004. 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, 2004, the Department is required to pay a yearly commitment fee, which is payable quarterly in arrears, at a rate of .15 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 30, 2007 for JP Morgan Chase Bank and June 30, 2015 for BLG *(scheduled expiration dates)*, 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. However, BLG does have the option to terminate its purchase commitment obligations, at its sole discretion, as of June 30, 2007.

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 cannot exceed $30 million. As of June 30, 2004 and June 30, 2003, the Department had no outstanding balance from its taxable line of credit. A final payment of $7,500 on this short-term borrowing was made during the fiscal year ended June 30, 2003.

9. INTERFUND TRANSACTIONS

At June 30, 2004, the Veterans' Loan Program had outstanding receivables of $5,269, which consisted of $4,700 due from the Governor's Office for a job rotation assignment and $569 due from the Department's Conservatorship Trust Fund. This balance is shown as a "Due from Other Funds" on the Statement of Net Assets.

At June 30, 2003, the Veterans' Loan Program had an outstanding receivable of $163 due from the Department's Conservatorship Trust Fund.

10. EMPLOYEE RETIREMENT PLAN

The 2003 Oregon Legislature created the Oregon Public Service Retirement Plan (OPSRP). Public employees hired on or after August 29, 2003 become part of OPSRP, unless membership was previously established in the Oregon Public Employee's Retirement System (PERS). OPSRP is a hybrid (defined contribution/defined benefit) pension plan with two components: the Pension Program (defined benefit) and the Individual Account Program (defined contribution). Beginning January 1, 2004, PERS member contributions were deposited into the Individual Account Program (IAP) portion of OPSRP. PERS members retain their existing PERS accounts, but any future member contributions will be deposited in the member's IAP account, not into the member's PERS account. A copy of the Oregon Public Employees Retirement System annual financial report may be obtained from Fiscal Services Division, PERS, PO Box 23700, Tigard, Oregon 97281-3700.

<u>Oregon Public Employee's Retirement System (PERS)</u>
The Department's employees who were plan members before August 29, 2003 participate in the Oregon Public Employee's Retirement System (PERS), a cost-sharing multiple-employer defined benefit pension plan. PERS is administered by the Public Employees Retirement Board under the guidelines of Oregon Revised Statutes, chapter 238. The PERS retirement allowance, payable monthly for life, may be selected from several retirement benefit options. Options include survivorship benefits and lump sum payments. PERS also provides death and disability benefits.

The Department is required by statute to contribute actuarially computed amounts as determined by PERS (the agency). Rates are subject to change as a result of subsequent actuarial valuations. The rate of each covered employee's salary for fiscal year 2004 was 11.31 percent for July through October and 4.71 percent for November through June. Employer contributions for the years ending June 30, 2004, 2003, and 2002 were $287,918, $498,200 and $514,900, respectively, equal to the required contributions for each year.

<u>Oregon Public Service Retirement Plan (OPSRP)</u>
The Pension Program, a cost-sharing multiple-employer defined benefit pension plan, is the defined benefit portion of Oregon Public Service retirement Plan (OPSRP). The Pension Program is administered by the Public Employees Retirement Board under the guidelines of Oregon Revised Statutes, chapter 238A. The Pension Program monthly pension benefit is payable for life and, after the death of the member, payable to the designated beneficiary at either the same amount or one-half of the amount, depending on the option the member chose at retirement. If the monthly pension benefit is less than $200, or the monthly death benefit payable to the beneficiary of a deceased member is less than $200, a lump sum payment that represents the actuarial equivalent of the present value of the pension or death benefit will be paid to the member or the deceased member's beneficiary.

The Department is required by statute to contribute actuarially computed amounts as determined by PERS (the agency). Rates are subject to change as a result of subsequent actuarial valuations. The rate of each covered employee's salary for fiscal year 2004 was 8.04 percent. Employer contributions for the year ending June 30, 2004 were $657, equal to the required contribution for the year.

The Individual Account Program (IAP) is the defined contribution portion of OPSRP. The IAP is administered by the Public Employees Retirement Board under the guidelines of Oregon Revised Statutes, chapter 238A. It is applicable to all new hires on or after August 29, 2003 and for active PERS members as of January 1, 2004. Covered employees are required by State statute to contribute 6.0 percent of their salary to the plan. Current law requires employers that had been paying the member contributions into PERS to pay employee contributions to the IAP until at least December 31, 2005. Employer contributions for the year ending June 30, 2004 were $249,058, equal to the required contributions for the year.

11. PRIOR PERIOD ADJUSTMENTS

In the basic financial statements a total of $5,450 was presented as a prior period adjustment. In accordance with GAAP, this adjustment was presented as an adjustment to the earliest year presented -- the fiscal year ended June 30, 2003. The following prior period adjustment is shown in the accompanying financial statements:

- During the fiscal year ended June 30, 2004, the Department recorded a prior period adjustment of $5,450. This adjustment was a capital asset-related adjustment in the Veterans' Home 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. The total cost for the land lease for each fiscal year ended June 30, 2004 and June 30, 2003 was $6,508. The future yearly minimum lease payment will remain the same amount until June 30, 2006. At that time it is expected that this lease will be replaced with a lease containing a higher rental rate due to inflation.

The Department leases office space to state agency tenants at its headquarters in Salem. For the fiscal year ended June 30, 2004, the total rental income received from tenants was $494,208. The new lease agreements were signed with each tenant agency in June of 2004 with no change in the lease payment. Each lease term is for three years and expires on June 30, 2007. The total future rental income for the lease term is $1,482,624. Future rental income may increase to a higher rental rate due to inflation. The approximate historical cost of this office space is $1,663,400 with a carrying value of $1,006,300 *(historical cost less accumulated depreciation of $657,100)*.

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 for the cost of servicing 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, 2004 and June 30, 2003 there has been no significant reductions in insurance coverage in any risk category. Also, for the past four fiscal years *(July 1, 2000 through June 30, 2004)* there have been no claims that exceeded the Department's property or liability coverage.

14. SUBSEQUENT EVENTS

The following subsequent events occurred after June 30, 2004:

- On September 23, 2004, the Department entered into a one year taxable line of credit agreement to help preserve certain refunding opportunities that may be used to finance veterans' housing loans. The taxable line of credit is with KeyBank National Association and the interest rate is based on a LIBOR index *(London InterBank Offered Rate)* or the bank's prime rate. The borrowing limit on the line of credit cannot exceed $30 million.
    - On September 30, 2004, the Department made a withdrawal of $20,000,000 from the taxable line of credit.
    - On October 29, 2004, the Department made a withdrawal of $10,000,000 from the taxable line of credit.
- On October 1, 2004, the Department called the following general obligation bonds: $10,000,000 of Series 64, $3,280,000 of Series 75, $2,300,000 of Series 76A, $2,345,000 of Series 77, $365,000 of Series 78A, $365,000 of Series 78B, $1,445,000 of Series 79A, $1,925,000 of Series 80A, $6,680,000 of Series 81, and $9,925,000 of Series 82 general obligation bonds.

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OTHER SUPPLEMENTAL SECTION

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Governmental Funds

<u>General Fund</u>

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.

<u>Special Revenue Funds</u>

Special revenue funds are used to account for specific revenues that are legally restricted to expenditure for particular purposes.

Veterans' Trust Accounts - 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 other veteran-related trust accounts.

UNAUDITED
STATE OF OREGON
DEPARTMENT OF VETERANS' AFFAIRS
BALANCE SHEET
GOVERNMENTAL FUNDS
JUNE 30, 2004 and JUNE 30, 2003

	General Fund		Special Revenue Fund	
			Veterans' Home Trust	
	June 30, 2004	June 30, 2003	June 30, 2004	June 30, 2003
ASSETS				
Current Assets				
Cash and Cash Equivalents	$ -	$ -	$ 418,936	$ 526,178
Securities Lending Cash Collateral	-	-	197,212	69,293
Receivables:				
Due from State General Fund	122,981	-	-	-
Due from Other Funds	-	-	1,119	1,346
Prepaid Items	126	38	-	-
Total Current Assets	123,107	38	617,267	596,817
TOTAL ASSETS	$ 123,107	$ 38	$ 617,267	$ 596,817
LIABILITIES				
Current Liabilities				
Accounts Payable	$ 122,981	$ -	$ -	$ -
Obligations under Securities Lending	-	-	197,212	69,293
Total Current Liabilities	122,981	-	197,212	69,293
TOTAL LIABILITIES	$ 122,981	$ -	$ 197,212	$ 69,293
FUND BALANCES				
Reserved for Prepaid Items	$ 126	$ 38	$ -	$ -
Unreserved, Undesignated Fund Balance	-	-	420,055	527,524
TOTAL FUND BALANCES	$ 126	$ 38	$ 420,055	$ 527,524
TOTAL LIABILITIES AND FUND BALANCES	$ 123,107	$ 38	$ 617,267	$ 596,817

Special Revenue Fund		Governmental Funds	
Other Veterans' Trust Accounts		TOTAL	
June 30, 2004	June 30, 2003	June 30, 2004	June 30, 2003
$ 105,510	$ 115,880	$ 524,446	$ 642,058
49,684	15,147	246,896	84,440
-	-	122,981	-
-	-	1,119	1,346
-	-	126	38
155,194	131,027	895,568	727,882
$ 155,194	$ 131,027	$ 895,568	$ 727,882
$ -	$ -	$ 122,981	$ -
49,684	15,147	246,896	84,440
49,684	15,147	369,877	84,440
$ 49,684	$ 15,147	$ 369,877	$ 84,440
$ -	$ -	$ 126	$ 38
105,510	115,880	525,565	643,404
$ 105,510	$ 115,880	$ 525,691	$ 643,442
$ 155,194	$ 131,027	$ 895,568	$ 727,882

UNAUDITED

STATE OF OREGON

DEPARTMENT OF VETERANS' AFFAIRS

COMBINED STATEMENT OF REVENUES, EXPENDITURES

AND CHANGES IN FUND BALANCES

GOVERNMENTAL FUNDS

FOR THE FISCAL YEARS ENDED JUNE 30, 2004 and JUNE 30, 2003

	General Fund		Special Revenue Fund Veterans' Home Trust	
	June 30, 2004	June 30, 2003	June 30, 2004	June 30, 2003
Revenues				
Donations	$ -	$ -	$ 180,371	$ 154,264
Interest Income	-	-	9,004	8,380
Other	-	-	-	-
Total Revenues	-	-	189,375	162,644
Expenditures				
Veterans' Services				
Personal Services	602,655	475,199	-	-
Services and Supplies	69,508	43,535	11,183	19,513
Securities Lending Investment Expense	-	-	2,048	646
Special Payments	398,770	343,206	-	-
Total Expenditures	1,070,933	861,940	13,231	20,159
Other Financing Sources (Uses)				
State Appropriations	1,070,933	861,940	-	-
Operating Transfer In from DMV	-	-	14,644	12,657
Operating Transfer In Intra-fund	-	-	-	378
Operating Transfer Out to Veterans Home	-	-	(48,257)	(17,709)
Operating Transfer Out Intra-fund	-	-	(250,000)	-
Total Other Financing Sources (Uses)	1,070,933	861,940	(283,613)	(4,674)
Net Change in Fund Balance	-	-	(107,469)	137,811
Beginning Fund Balance	38	137	527,524	389,713
Change in Reserve for Prepaid Items	88	(99)	-	-
Ending Fund Balance	$ 126	$ 38	$ 420,055	$ 527,524

Special Revenue Fund		Governmental Funds	
Other Veterans' Trust Accounts		TOTAL	
June 30, 2004	June 30, 2003	June 30, 2004	June 30, 2003
$ -	$ -	$ 180,371	$ 154,264
1,876	2,129	10,880	10,509
-	1,000	-	1,000
1,876	3,129	191,251	165,773
-	-	602,655	475,199
2,619	644	83,310	63,692
427	164	2,475	810
9,200	-	407,970	343,206
12,246	808	1,096,410	882,907
-	-	1,070,933	861,940
-	-	14,644	12,657
-	-	-	378
-	-	(48,257)	(17,709)
-	(378)	(250,000)	(378)
-	(378)	787,320	856,888
(10,370)	1,943	(117,839)	139,754
115,880	113,937	643,442	503,787
-	-	88	(99)
$ 105,510	$ 115,880	$ 525,691	$ 643,442

UNAUDITED

STATE OF OREGON

DEPARTMENT OF VETERANS' AFFAIRS

SCHEDULE OF LEGISLATIVE AUTHORIZATION (NON-GAAP BUDGETARY BASIS)

COMPARED TO ACTUAL EXPENDITURES SUBJECT TO BUDGET

GOVERNMENTAL FUND

FOR THE BIENNIUM ENDING JUNE 30, 2005

	General Fund		
	2003-2005 Budget	First Year Actual June 30, 2004	Second Year Balance
General Fund:			
Veterans' Services Division - Appropriation	$ 2,527,749	$ 944,581	$ 1,583,168
Total General Fund	$ 2,527,749	$ 944,581	$ 1,583,168

Fiduciary Fund

Private Purpose Trust Fund

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 250 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.

UNAUDITED

STATE OF OREGON

DEPARTMENT OF VETERANS' AFFAIRS

STATEMENT OF NET ASSETS

FIDUCIARY FUND

JUNE 30, 2004 and JUNE 30, 2003

	Private Purpose Trust Fund	
	Conservatorship Program	
	June 30, 2004	June 30, 2003
ASSETS		
Current Assets		
Cash and Cash Equivalents	$ 22,858,057	$ 21,533,230
Investments	2,440,746	2,475,891
Security Lending Cash Collateral	10,879,045	2,844,672
Receivables:		
Accrued Interest	24,070	25,235
Other	8,100	3,751
Total Current Assets	36,210,018	26,882,779
Noncurrent Assets		
Contract Receivables	174,056	178,249
Conservatorship Real Property	3,615,755	3,787,197
Conservatorship Personal Property	542,003	672,596
Total Noncurrent Assets	4,331,814	4,638,042
TOTAL ASSETS	$ 40,541,832	$ 31,520,821
LIABILITIES		
Current Liabilities		
Due to Other Funds	$ 569	$ 163
Obligations under Securities Lending	10,879,045	2,844,672
Total Current Liabilities	10,879,614	2,844,835
Noncurrent Liabilities		
Mortgages on Conservatorship Real Property	627,784	958,956
Total Noncurrent Liabilities	627,784	958,956
TOTAL LIABILITIES	11,507,398	3,803,791
NET ASSETS		
Net Assets Held in Trust for Individuals	29,034,434	27,717,030
TOTAL NET ASSETS	$ 29,034,434	$ 27,717,030

UNAUDITED

STATE OF OREGON

DEPARTMENT OF VETERANS' AFFAIRS

STATEMENT OF CHANGES IN

FIDUCIARY NET ASSETS

FIDUCIARY FUND

FOR THE FISCAL YEARS ENDED JUNE 30, 2004 and JUNE 30, 2003

	Private Purpose Trust Fund	
	Conservatorship Program	
	June 30, 2004	June 30, 2003
ADDITIONS		
Contributions:		
Veterans' Benefits	$ 7,451,382	$ 8,189,227
Investment Income:		
Interest Income	377,647	399,684
Valuation Changes and Redemptions of Investments	247,873	(34,660)
TOTAL ADDITIONS	$ 8,076,902	$ 8,554,251
DEDUCTIONS		
Veterans' Services: Beneficiary Care	$ 6,673,587	$ 8,019,095
Securities Lending Investment Expense	85,911	30,807
TOTAL DEDUCTIONS	6,759,498	8,049,902
Net Increase/ (Decrease)	1,317,404	504,349
CHANGE IN NET ASSETS	1,317,404	504,349
BEGINNING NET ASSETS	27,717,030	27,212,681
ENDING NET ASSETS	$ 29,034,434	$ 27,717,030

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STATISTICAL SECTION

UNAUDITED

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 ENDED 1995 - 2004

	June 30, 2004	June 30, 2003	June 30, 2002	June 30, 2001
REVENUES				
Mortgage Loan Interest Income	$ 26,789,783	$ 36,742,510	$ 43,749,526	$ 50,861,579
Contract Interest Income	1,698,531	2,535,147	3,522,372	4,562,401
Investment Income (2)	13,338,726	24,675,139	35,956,850	57,521,901
Gain on Sale of Foreclosed Property	493,409	39,121	172,472	9,052
Gain (Loss) on Sale of Investments (2)	-	-	-	-
Loan Cancellation Life Insurance Premiums (3)	2,704,444	3,642,487	-	-
Loan Cancellation Life Insurance Processing Fees	425,004	425,004	425,004	425,004
Other Fees and Charges	939,950	1,189,691	1,447,451	1,342,762
Conservatorship Fees	345,750	364,510	338,136	353,417
TOTAL REVENUES	$ 46,735,597	$ 69,613,609	$ 85,611,811	$ 115,076,116
EXPENSES				
Bond Interest Expense	$ 44,537,191	$ 58,066,877	$ 68,560,732	$ 85,455,556
Interest on Taxable Line of Credit	-	7,500	580,883	-
Salaries and Other Payroll Expenses	5,875,969	6,838,554	6,974,557	6,932,307
Bond Expenses	1,155,355	909,379	868,243	925,722
Securities Lending Investment Expense	1,899,175	630,893	522,316	1,156,100
Real Estate Owned Expense	52,526	80,757	73,308	57,863
Services and Supplies	2,140,262	2,958,497	2,480,268	2,741,678
Claims Expense - Loan Cancellation Life Insurance (3)	4,927,874	5,121,239	-	-
Depreciation Expense	408,883	431,391	538,555	453,159
Bad Debt Expense	(1,656,784)	(1,744,700)	(906,906)	(1,078,111)
Special Payments	-	51,000	-	-
Other Expenses	-	210,232	180,045	74,888
TOTAL EXPENSES	$ 59,340,451	$ 73,561,619	$ 79,872,001	$ 96,719,162
Income/ (Loss) before Extraordinary or Special Items	$ (12,604,854)	$ (3,948,010)	$ 5,739,810	$ 18,356,954
Extraordinary or Special items:				
Loss on Extinguishment of Debt	$ -	$ -	$ -	$ (17,231)
Gain from Litigation	-	-	-	-
CHANGE IN NET ASSETS	$ (12,604,854)	$ (3,948,010)	$ 5,739,810	$ 18,339,723
NET ASSETS				
Beginning Net Assets (1)	$ 139,354,681	$ 143,302,691	$ 94,931,080	$ 76,591,357
Prior Period Adjustment	-	-	42,556,801	-
Cumulative Effect of Change in Accounting Principle	-	-	75,000	-
Beginning Net Assets, Restated	$ 139,354,681	$ 143,302,691	$ 137,562,881	$ 76,591,357
Ending Net Assets, Restated	$ 126,749,827	$ 139,354,681	$ 143,302,691	$ 94,931,080

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

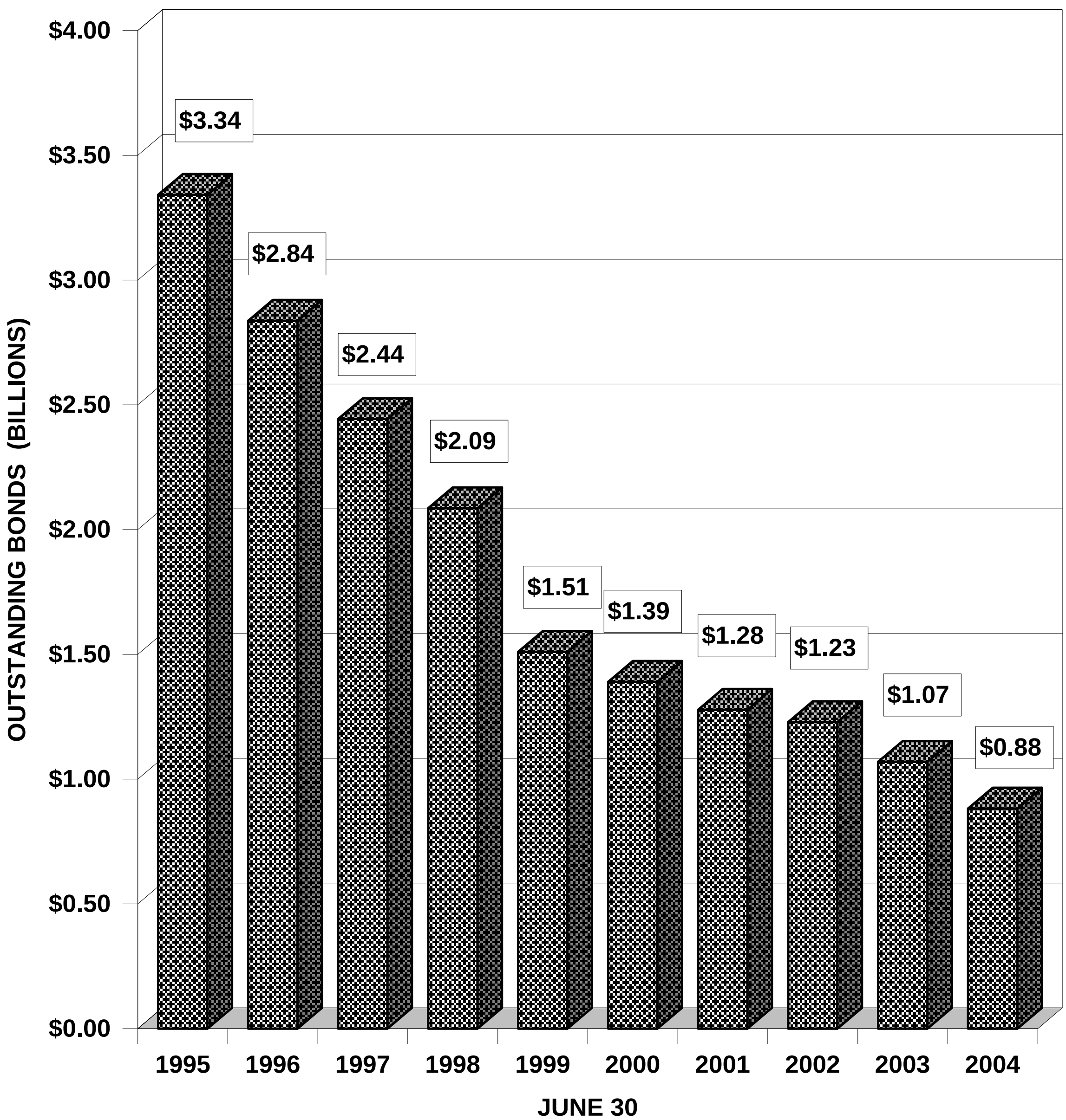
2 Investment income includes change in fair value, as required by GASB Statement 31, beginning in the fiscal year ending June 30, 1998. Gain or loss on sale of investments is not reported under GASB Statement 31.

3 Starting in fiscal year 2003, the Department included the activity of the Loan Cancellation Life Insurance program in the Statement of Revenues, Expenses, And Changes In Fund Net Assets.

June 30, 2000	June 30, 1999	June 30, 1998	June 30, 1997	June 30, 1996	June 30, 1995
$ 57,259,424	$ 68,967,805	$ 84,739,050	$ 101,149,885	$ 119,299,277	$ 137,627,560
5,648,408	7,603,132	10,413,658	13,302,547	16,741,582	19,925,191
38,492,961	48,834,865	80,184,016	88,584,123	91,392,885	106,181,662
16,892	32,324	106,330	292,921	438,213	354,743
-	-	-	(771,619)	(1,265,290)	(2,295,346)
-	-	-	-	-	-
399,937	327,540	433,763	497,874	561,115	601,875
1,402,798	1,055,894	932,092	884,689	742,319	459,468
345,554	322,973	334,784	334,328	335,634	325,256
$ 103,565,974	$ 127,144,533	$ 177,143,693	$ 204,274,748	$ 228,245,735	$ 263,180,409
$ 93,957,700	$ 117,276,619	$ 153,677,775	$ 186,918,415	$ 215,402,978	$ 259,118,354
-	-	-	-	-	-
6,886,703	6,829,801	6,952,431	6,958,822	7,374,399	7,963,439
819,421	952,673	1,478,508	1,774,314	2,310,443	2,677,130
2,006,704	1,607,492	1,588,540	4,656,093	-	-
42,230	49,096	50,806	79,340	170,172	232,218
2,679,295	3,055,525	3,473,771	3,197,130	3,317,255	3,091,085
-	-	-	-	-	-
360,840	317,751	338,820	235,128	417,097	522,733
(1,227,068)	(3,346,273)	(2,934,825)	(3,217,416)	(3,858,097)	(7,126,322)
-	-	-	-	-	-
42,749	42,477	53,475	32,406	23,258	20,052
$ 105,568,574	$ 126,785,161	$ 164,679,301	$ 200,634,232	$ 225,157,505	$ 266,498,689
$ (2,002,600)	$ 359,372	$ 12,464,392	$ 3,640,516	$ 3,088,230	$ (3,318,280)
$ (11,888)	$ (12,271,433)	$ (3,870,466)	$ (5,676,618)	$ (10,519,290)	$ (4,112,981)
-	654,385	-	-	-	3,283,024
$ (2,014,488)	$ (11,257,676)	$ 8,593,926	$ (2,036,102)	$ (7,431,060)	$ (4,148,237)
$ 78,605,845	$ 89,863,521	$ 78,681,347	$ 80,717,449	$ 88,148,509	$ 92,296,746
-	-	-	-	-	-
-	-	2,588,248	-	-	-
$ 78,605,845	$ 89,863,521	$ 81,269,595	$ 80,717,449	$ 88,148,509	$ 92,296,746
$ 76,591,357	$ 78,605,845	$ 89,863,521	$ 78,681,347	$ 80,717,449	$ 88,148,509

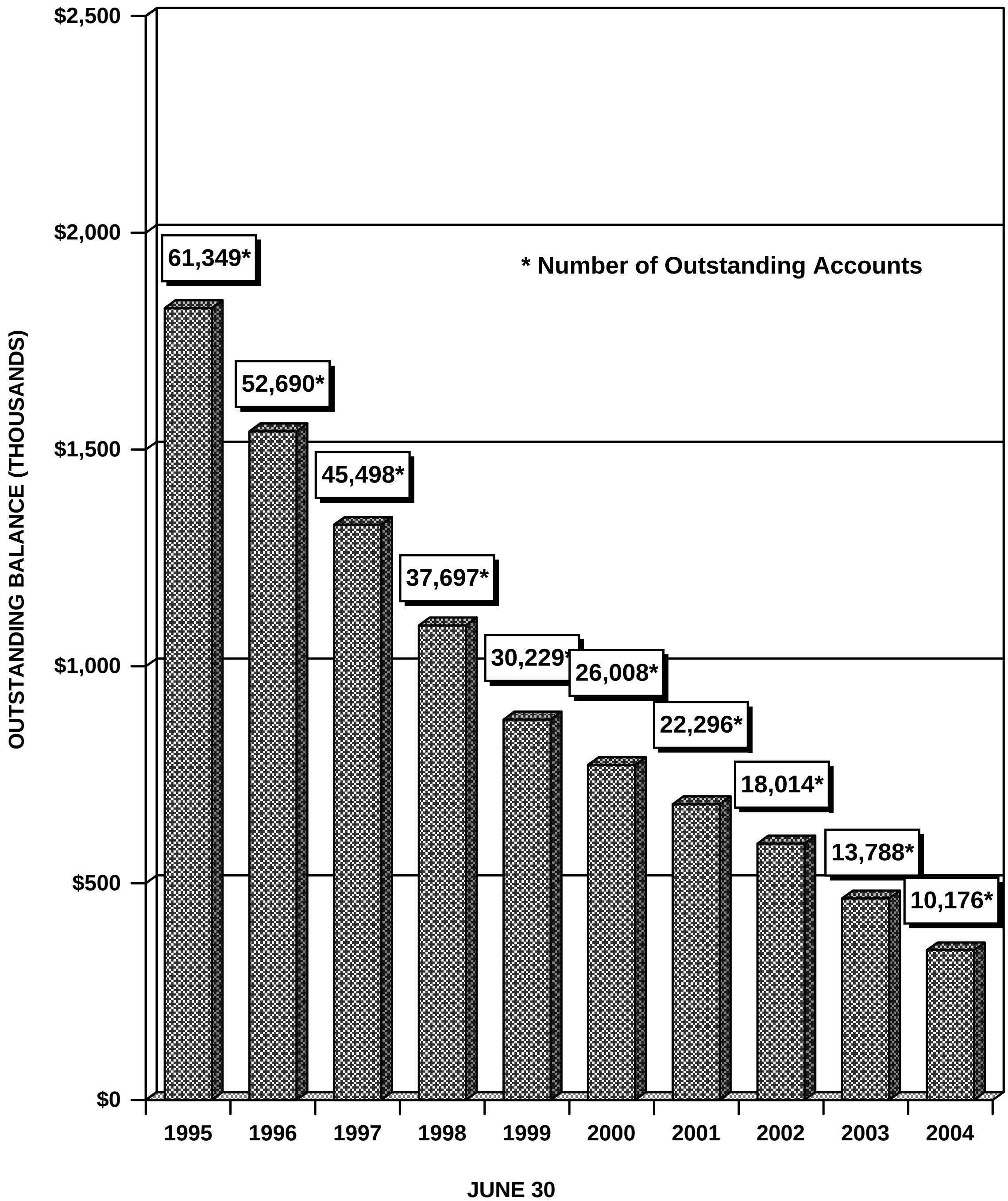
UNAUDITED
OREGON DEPARTMENT OF VETERANS' AFFAIRS

COMPARATIVE SUMMARY OF BONDS OUTSTANDING



Source: Financial Statements of the Oregon Department of Veterans' Affairs.

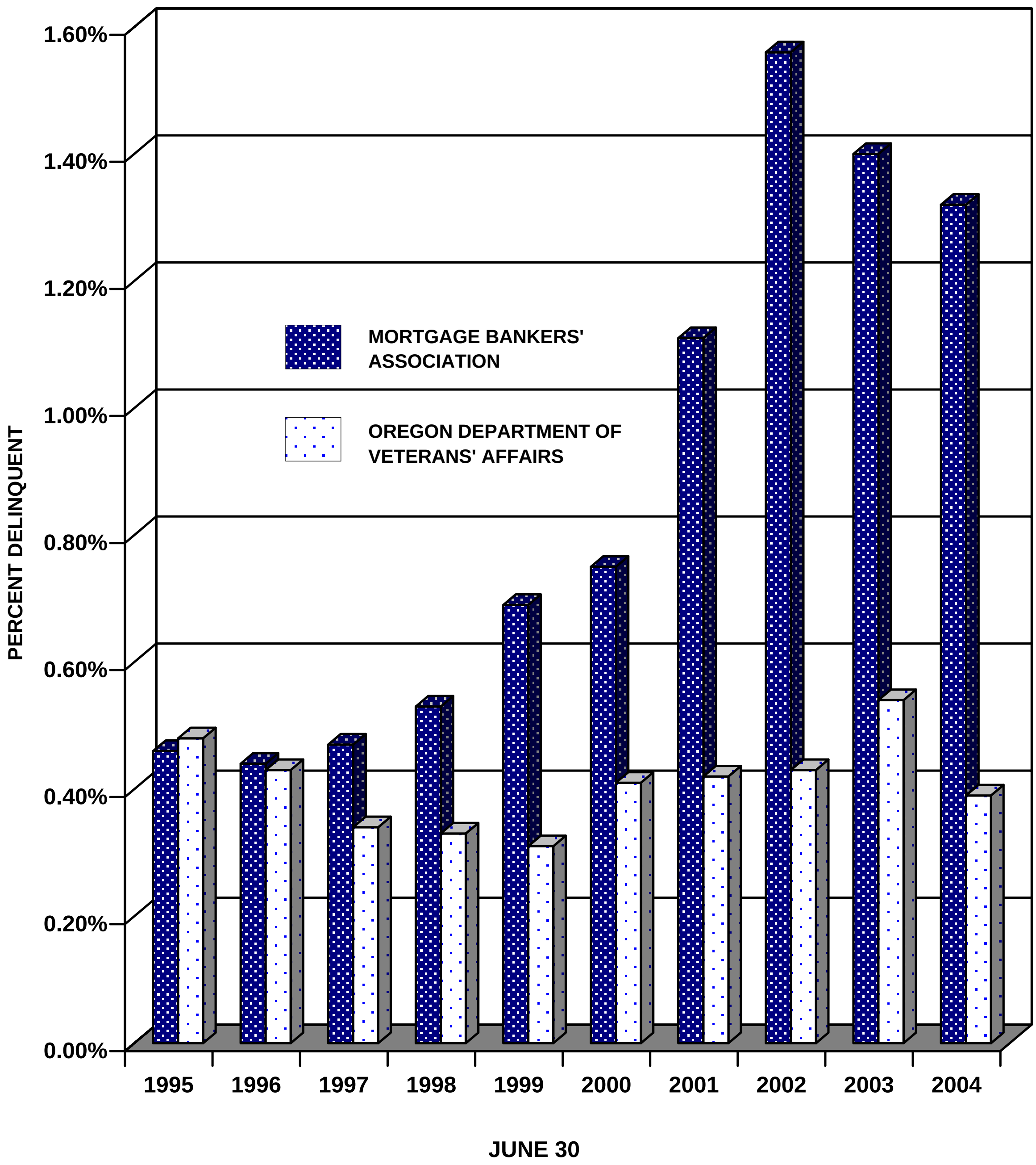
UNAUDITED
OREGON DEPARTMENT OF VETERANS' AFFAIRS
COMPARATIVE SUMMARY OF LOANS AND CONTRACTS OUTSTANDING



Sources: Statistical Reports and Financial Statements of the Oregon Department of Veterans' Affairs.

UNAUDITED
OREGON DEPARTMENT OF VETERANS' AFFAIRS

COMPARATIVE SUMMARY OF 90+ DAY DELINQUENCIES

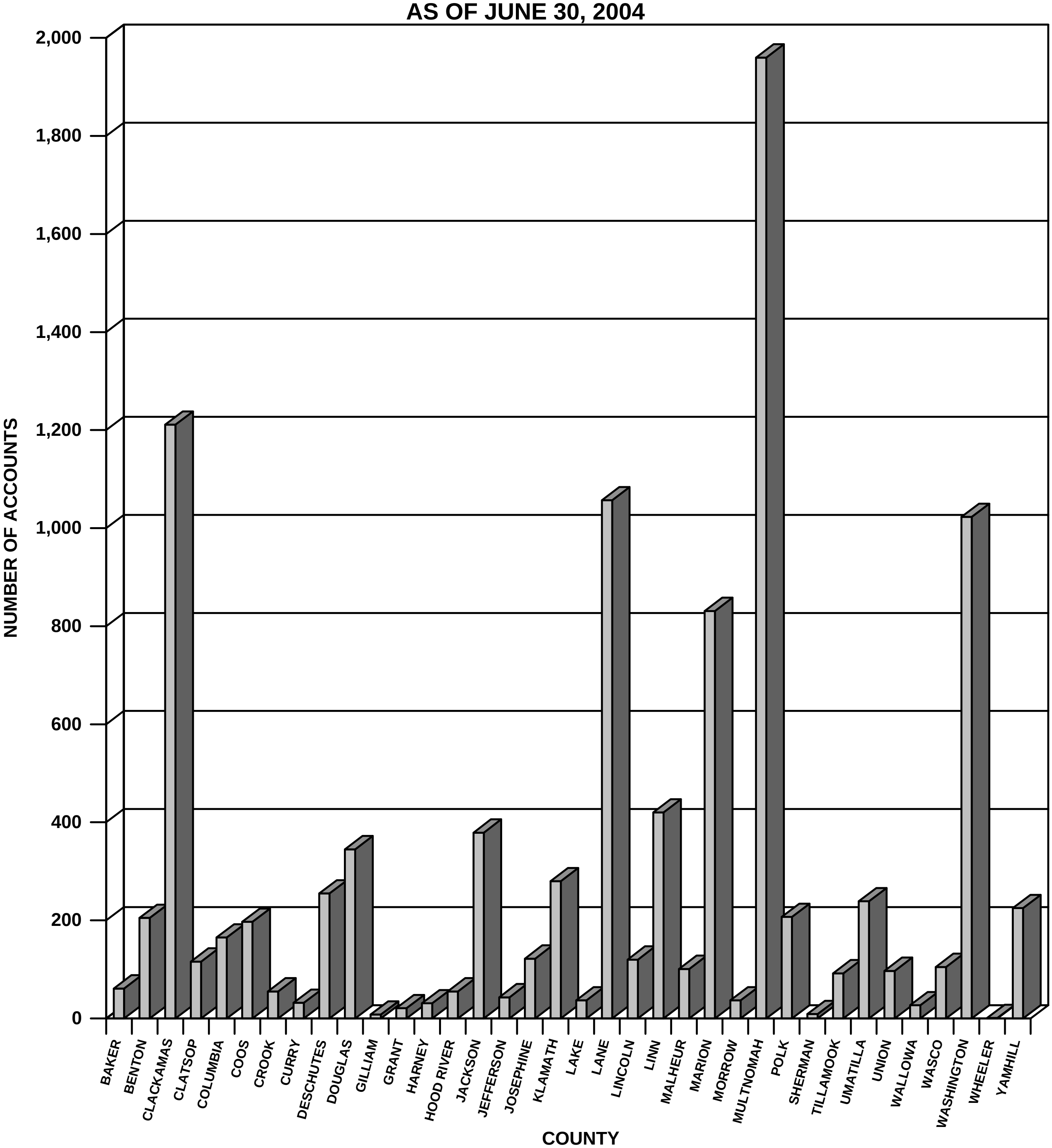


Sources: National Delinquency Survey (Oregon, All Loans) - Mortgage Bankers Association and the Oregon Department of Veterans' Affairs. 90+ Day Delinquncies includes past due loans and loans in foreclosure.

UNAUDITED

OREGON DEPARTMENT OF VETERANS' AFFAIRS

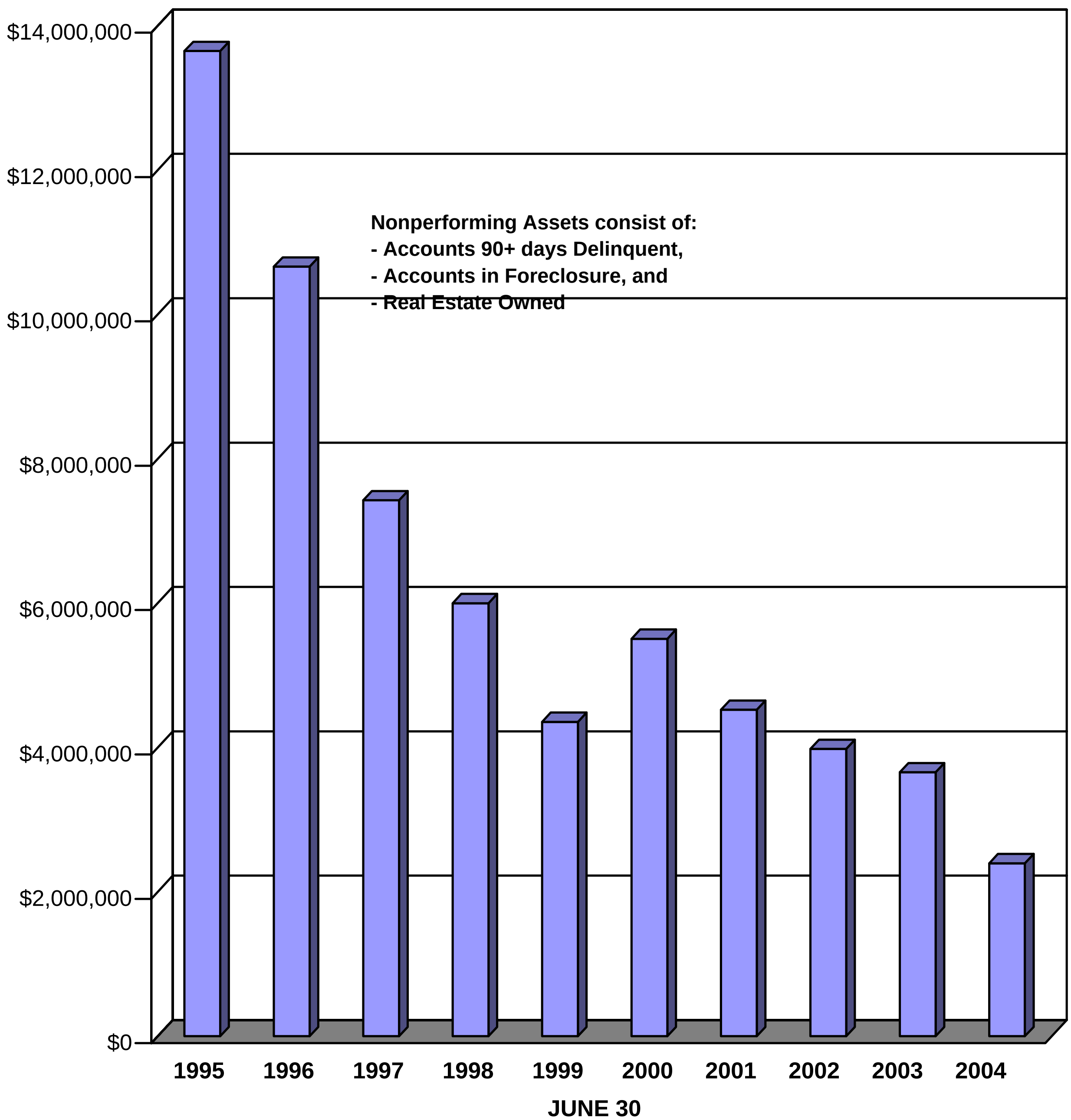
OUTSTANDING LOAN AND CONTRACT ACCOUNTS BY COUNTY AS OF JUNE 30, 2004



Source: Oregon Department of Veterans' Affairs.

UNAUDITED
OREGON DEPARTMENT OF VETERANS' AFFAIRS

COMPARATIVE SUMMARY OF NONPERFORMING ASSETS



Sources: Statistical Reports and Financial Statements of the Oregon Department of Veterans' Affairs.

OTHER REPORTS

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Auditing for a Better Oregon

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254 State Capitol
Salem, Oregon 97301-4047

Jim Willis, Director
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Salem, Oregon 97301-1285

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, 2004 and 2003, and have issued our report thereon dated November 5, 2004. 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 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 5, 2004

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
700 Summer ST NE, Salem, OR 97301-1285
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This information is also available in alternate formats, upon request.