Secretary of State

State of Oregon

DEPARTMENT OF ENERGY

Small Scale Energy Loan Program

For the Fiscal Years Ended June 30, 2004 and 2003

Audits Division

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Secretary of State

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DEPARTMENT OF ENERGY

Small Scale Energy Loan Program

For the Fiscal Years Ended June 30, 2004 and 2003

Audits Division

No. 2005-09

March 22, 2005

OFFICE OF THE
SECRETARY OF STATE
Bill Bradbury
Secretary of State

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Auditing for a Better Oregon

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

Michael Grainey, Director
Department of Energy
625 Marion Street NE
Salem, Oregon 97301-3742

This report presents the results of our annual audit of the Department of Energy, Small Scale Energy Loan Program (SELP).

As required by auditing standards, we performed the audit to obtain reasonable assurance about whether the financial statements and accompanying notes have been presented fairly by management. Our Independent Auditor's Report and the financial statements for the fiscal years ended June 30, 2004 and 2003, are included in the Financial Section of this report. We concluded that the financial statements are fairly presented in accordance with accounting principles generally accepted in the United States of America.

Auditing standards also require us to review the department's internal control and compliance with applicable laws and regulations. Our report on the results of those reviews is included in the Other Reports section of this report. We noted no instances of noncompliance that are required to be reported under *Government Auditing Standards*. Similarly, we did not note any material weaknesses in internal control over financial reporting.

We appreciated the cooperation and assistance of the department's management and staff during the course of our audit.

OREGON AUDITS DIVISION

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

FINANCIAL SECTION

OFFICE OF THE
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INDEPENDENT AUDITOR'S REPORT

We have audited the accompanying financial statements of the Small Scale Energy Loan Program, an enterprise fund of the State of Oregon, Department of Energy, 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 financial statements present only the Small Scale Energy Loan Program, an enterprise fund of the State of Oregon, Department of Energy. The financial statements 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 Small Scale Energy Loan Program as of

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June 30, 2004 and 2003, and the changes in its financial position and its cash flows, thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 23, 2005, on our consideration of the Small Energy Loan Program's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit. That report is separately presented in the Other Reports section as listed in the table of contents.

OREGON AUDITS DIVISION

Bill Bradbury
Secretary of State

February 23, 2005

STATE OF OREGON
DEPARTMENT OF ENERGY
SMALL SCALE ENERGY LOAN PROGRAM
ENTERPRISE FUND
BALANCE SHEETS
JUNE 30, 2004 AND JUNE 30, 2003

ASSETS	2004	2003
Current Assets:		
Cash and Cash Equivalents	$3,683,865	$5,988,903
Cash and Cash Equivalents—Restricted	64,755,862	39,663,689
Accounts Receivable	90,646	112,308
Loan Interest Receivable	2,825,232	1,395,976
Total Current Assets	71,355,605	47,160,876
Noncurrent Assets:		
Cash and Cash Equivalents—Restricted	3,337,066	3,580,477
Arbitrage Rebate Receivable	–	198,071
Deferred Bond Issuance Costs	413,588	390,213
Loans Receivable (Net)	104,591,076	121,396,264
Other Receivables	21,279	24,712
Capital Assets	242,770	–
Total Noncurrent Assets	108,605,779	125,589,737
Total Assets	$179,961,384	$172,750,613

LIABILITIES AND NET ASSETS	2004	2003
Current Liabilities:		
Accounts Payable	$38,509	$19,884
Matured Bonds Payable	85,975	85,975
Bond Interest Payable	3,301,067	3,494,712
Compensated Absences Payable	49,073	45,931
Deferred Income	227,315	–
Bonds Payable	44,660,000	12,430,000
Total Current Liabilities	48,361,939	16,076,502
Noncurrent Liabilities:		
Arbitrage Rebate Liability	–	278,404
Borrowers' Reserve Fund Liability	3,337,066	3,576,747
Bonds Payable	110,682,582	135,932,854
Total Noncurrent Liabilities	114,019,648	139,788,005
Total Liabilities	162,381,587	155,864,507
Net Assets:		
Invested in Capital Assets	242,770	–
Restricted for Debt Service	13,896,114	10,943,164
Unrestricted	3,440,913	5,942,942
Total Net Assets	17,579,797	16,886,106
Total Liabilities and Net Assets	$179,961,384	$172,750,613

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

STATE OF OREGON
DEPARTMENT OF ENERGY
SMALL SCALE ENERGY LOAN PROGRAM
ENTERPRISE FUND
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS
FOR THE FISCAL YEARS ENDED JUNE 30, 2004 AND JUNE 30, 2003

	2004	2003
OPERATING REVENUES		
Interest on Loans	$8,079,173	$9,144,367
Interest on Cash and Investments	497,162	665,286
Application and Commitment Fees	10,870	44,920
Loan Fees	102,650	22,282
Holding Cost Fees	337,140	407,779
Miscellaneous	243,561	40,254
Total Operating Revenues	9,270,556	10,324,888
OPERATING EXPENSES		
Bond Interest and Debt Service Expense	7,387,454	7,872,264
Personal Services	685,081	649,566
Services and Supplies	434,127	501,468
Amortization of Deferred Bond Issuance Costs	60,689	64,971
Bad Debt Expense	71,645	30,228
Bond Refunding Loan Receivable Write-Downs	22,418	107
Total Operating Expenses	8,661,414	9,118,604
Operating Income/Change In Net Assets	609,142	1,206,284
Net Assets—Beginning	16,886,106	15,679,822
Prior Period Adjustment	84,549	—
Net Assets—Beginning—As Restated	16,970,655	15,679,822
Net Assets—Ending	$17,579,797	$16,886,106

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

STATE OF OREGON

DEPARTMENT OF ENERGY

SMALL SCALE ENERGY LOAN PROGRAM

ENTERPRISE FUND

STATEMENTS OF CASH FLOWS

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

	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash Received from Customers	$ 654,623	$ 557,910
Loan Principal Repayments	23,875,602	11,323,939
Loan Interest Received	6,877,233	8,352,613
Loans Disbursed to Borrowers	(7,164,477)	(3,022,858)
Cash Paid to Vendors for Goods and Services	(419,812)	(501,342)
Cash Paid for Employees	(681,785)	(652,214)
Net Cash Provided by Operating Activities	23,141,384	16,058,048
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Proceeds from Bonds	19,245,865	–
Principal Paid on Bonds	(12,430,000)	(34,655,000)
Interest Paid on Bonds	(7,417,236)	(8,534,215)
Bond Issue Costs Paid	(70,015)	(7,233)
Net Cash Used By Non-Capital Financing Activities	(671,386)	(43,196,448)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisition of Capital Assets	(165,213)	–
Net Cash Used By Capital and Related Financing Activities	(165,213)	–
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from Sales and Maturities of Investments	–	450,000
Interest Received on Cash and Investments	238,939	743,342
Net Cash Provided By Investing Activities	238,939	1,193,342
Net Increase (Decrease) In Cash And Cash Equivalents	22,543,724	(25,945,058)
Cash and Cash Equivalents—Beginning	49,233,069	75,178,127
Cash and Cash Equivalents—Ending	$71,776,793	$49,233,069
Cash and Cash Equivalents	3,683,865	5,988,903
Cash and Cash Equivalents—Restricted	68,092,928	43,244,166
Total Cash and Cash Equivalents	$71,776,793	$49,233,069

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

STATE OF OREGON
DEPARTMENT OF ENERGY
SMALL SCALE ENERGY LOAN PROGRAM
ENTERPRISE FUND
STATEMENTS OF CASH FLOWS (continued)
FOR THE FISCAL YEARS ENDED JUNE 30, 2004 AND JUNE 30, 2003

	2004	2003
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating Income	$609,142	$1,206,284
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities:		
Bad Debt	71,645	30,228
Loan Receivable Write-downs	22,418	107
Amortization of Deferred Bond Issue Costs	60,689	64,971
Interest Received on Investments Reported as Operating Revenue	(517,342)	(665,286)
Bond Interest and Debt Service Expense Reported as Operating Expense	7,387,454	7,872,264
(Increase)/Decrease in Assets:		
Accounts Receivable	21,663	(112,308)
Loan Interest Receivable	(1,429,256)	(791,753)
Loan Receivable	16,711,125	8,319,304
Other Receivables	3,433	(24,712)
Arbitrage Receivable	198,071	10,251
Increase/(Decrease) in Liabilities:		
Accounts Payable	11,566	12,733
Matured Bonds Payable	–	(20,300)
Compensated Absences	3,142	(2,783)
Deferred Income	227,315	–
Borrowers Reserves	(239,681)	159,048
Total Adjustments	22,532,242	14,851,764
Net Cash Provided By Operations	$23,141,384	$16,058,048
Noncash Investing, Capital, and Financing Activities:		
Net Change in Fair Value of Investments	–	(8,364)
Total Noncash Investing, Capital, and Financing Activities	–	$(8,364)

STATE OF OREGON
DEPARTMENT OF ENERGY
SMALL SCALE ENERGY LOAN PROGRAM
Notes to the Financial Statements
ENTERPRISE FUND
JUNE 30, 2004 AND JUNE 30, 2003

The accompanying financial statements of the Small Scale Energy Loan Program (SELP) have been prepared in conformity with Generally Accepted Accounting Principles as prescribed by the Governmental Accounting Standards Board (GASB), the Financial Accounting Standards Board (FASB), and the American Institute of Certified Public Accountants.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

The Small Scale Energy Loan Program (SELP) was created through the adoption of Oregon Constitution Article XI-J by statewide vote in May 1980 and implemented through Oregon Revised Statutes Chapter 470. Article XI-J authorizes the sale of State General Obligation Bonds to finance secured loans for the development of small-scale energy conservation and renewable energy projects within Oregon. SELP is a self-supporting program that is part of the State of Oregon and its Department of Energy. The Department of Energy operates other programs, which have no impact on the bond-related activity of SELP.

B. Basis of Presentation

The accounts of the Department of Energy are organized on the basis of funds, which are considered a separate accounting entity with a self-balancing set of accounts. The State accounts for SELP are an enterprise fund. Enterprise funds are used for operations that are financed and operated in a manner similar to private business enterprises, where the costs of providing goods and services to the general public on a continuing basis is intended to be financed or recovered primarily through user charges. Enterprise fund reporting focuses on the determination of operating income changes in net assets, financial position and cash flows. Under GASB Statement 20, SELP does not apply FASB pronouncements issued after November 30, 1989, for proprietary activities, unless GASB amends its pronouncements to specifically adopt FASB pronouncements issued after that date.

C. Measurement Focus and Basis of Accounting

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. Enterprise funds are presented on the accrual basis using 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. All assets and liabilities associated with the operations of these funds are included on the Balance Sheet. Net total assets are segregated into capital assets, restricted assets, and unrestricted assets. The Statement of Revenues, Expenses and Changes in Fund Net Assets present increases (i.e., revenues) and decreases (i.e., expenses) in net total assets. The Statement of Cash Flows provides information about how SELP finances and meets the cash flow needs of its proprietary activities.

D. Budgetary Process

The Oregon Legislature approves budgets for a biennial period. Operating expenses are subject to budget limitation and bond related expenses are subject to administrative limitation. The Emergency Board of the Legislature approves any increase in the budget that may be necessary during the interim. Both types of limitation are funded from revenues of self-supporting activities and lapse at the end of the biennium. Budgets are adopted on a basis that differs from generally accepted accounting principles and financial reporting standards. For budgetary purposes, transactions related to the treatment of bond proceeds, loan disbursements and other operating revenues and expenditures are recorded on a cash basis and converted to the accrual basis for financial reporting purposes.

E. Cash and Cash Equivalents

Cash and cash equivalents are defined as cash held in the State Treasury and cash on deposit outside the State Treasury. All SELP monies are held in the Oregon Short-Term Fund (OSTF), a cash and investment pool available for use by all funds and local governments. The OSTF pool operates as a demand deposit account and funds held in the OSTF are considered cash equivalents.

F. Restricted Assets

Use of all cash, cash equivalents, and investments of SELP are restricted as to purpose and use by Article XI-J of the Oregon Constitution, Bond Indenture, and State statute. SELP's funds are restricted to funding loans and paying bond debt service and operating costs. Individual borrower reserve accounts have been established to meet certain loan requirements and the balances of these accounts as of June 30, 2004 and 2003 were sufficient to meet all contractual agreements. Cash on deposit with a fiscal agent is held on behalf of bondholders and is the result of unclaimed monies from matured bonds and coupons.

G. Capital Assets

Capital assets are reported at historical cost or estimated historical cost if the original cost cannot be determined. Donated capital assets are reported at their fair market value at the time received. Capital assets costing less than $5,000 and having an estimated useful life of less than one year are not capitalized. Maintenance that does not add to the value of assets or significantly extend asset lives is expensed rather than capitalized.

Depreciation or amortization of capital assets is charged as an expense against operations over the estimated useful life using the straight-line method of depreciation. Once placed into service, the estimated useful life of capital assets is five years.

H. Receivables

Receivables reported are amounts due that represent revenues earned or accrued in the applicable period. Types of receivables included in this classification relate to interest, loans receivable, and other miscellaneous receivables. Interest receivable on investments and loans are recorded at their net recoverable amount by management policy. Loans receivable are recorded net of an allowance for uncollectible accounts. The allowances for uncollectible accounts as of June 30, 2004 and 2003, were $2,355,954 and $2,284,309, respectively.

I. Operating Revenues and Expenses

Operating revenues include interest and fees on program loans as well as earnings on cash and investments related to SELP's loan program. Administrative expenses and bond program related expenses are considered operating expenses. Non-operating revenues and expenses include any gain or loss on the disposition of investments.

J. Compensated Absences

Employees accrue vacation leave at various accrual rates and may generally be paid for up to a maximum of 250 hours 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, as employees may not convert accrued sick leave into cash at termination.

K. Arbitrage Rebate Liability

Internal Revenue Code Section 148(f) requires issuers of tax-exempt bonds to rebate income from the investment of bond proceeds that exceeds limits established for each bond issue. These limits are based on the bond yield as calculated for federal tax purposes for each bond issue and are subject to certain exceptions. Arbitrage rebate payments are due not later than 60 days after the end of the fifth anniversary of each bond issue and every five years thereafter in an amount equal to at least 90 percent of the calculated arbitrage liability. Final arbitrage rebate payments are due not later than 60 days after the final retirement of all bonds in an issue in an amount equal to 100 percent of the calculated arbitrage liability. SELP records arbitrage rebate as a reduction of investment revenue.

L. Bond Expenses

Bond issuance costs are capitalized as deferred charges and amortized over the term of the related bond issue. Bond premiums and discounts arising from the sale of a particular bond issue are deferred and charged or credited to interest expense over the term of the bond issue, using the bonds-outstanding method of amortization. Deferred amounts related to debt refunding are reflected as a reduction to Bonds Payable and are amortized over the shorter of the term of the refunding or refunded bonds using the bonds-outstanding method of amortization. The bonds-outstanding method of amortization most closely approximates the effective-interest method.

M. Borrower's Reserve Accounts

SELP holds reserve investments for certain municipal borrowers. All interest earned on these reserve accounts is credited to the borrower's account when received. Excess funds in the reserve accounts are remitted to the borrowers upon request.

N. Comparative Data

Comparative financial statements are presented in order to provide an understanding of the changes in SELP's financial position and operations. A reclassification of restricted cash and net assets for the prior year was made on the financial statements to be consistent with the current year presentation.

NOTE 2. CASH AND INVESTMENTS

SELP funds are held in demand accounts with the State Treasurer. The State's investment policies are governed by statute, and are overseen by the Oregon Investment Council. The State Treasurer is the investment officer responsible for the funds on deposit in the State Treasury. In accordance with Oregon statutes, the investment funds are invested, and the investments of those funds managed, as would a prudent investor, exercising reasonable care, skill and caution. Investments in the Oregon Short-Term Fund (OSTF) are further governed by portfolio guidelines issued by the Oregon Short-Term Fund Board. Earnings on the OSTF are allocated on a pro-rata basis on daily account balances.

SELP has elected early implementation of GASB Statement 40, *Deposit and Investment Risk Disclosures,* modifying the footnote disclosure of cash and investments under GASB Statement 3.

A. Cash Deposits

As of June 30, 2004, the book balance of cash and cash equivalents was $71,776,793. The bank balance was $71,796,485 of which $71,710,510 was held in demand accounts with the State Treasurer invested in the Oregon Short-Term Fund (OSTF) and $85,975 was held by the State's fiscal agent. State Treasurer demand deposit accounts and time certificate of deposit investments of the OSTF are held in state banks and insured or collateralized in excess of FDIC coverage for a minimum of 25 percent in accordance with State statute.

Securities in the Short-Term Fund are held by the Treasury's agent in the name of the State of Oregon. They consist of government securities, certificates of deposit, bankers' acceptances, and other short-term commercial paper. A separate financial report for the OSTF is prepared by the Treasurer. Copies of the report can be obtained from the Oregon State Treasury, Finance Division, 350 Winter Street, NE, Suite 100, Salem, Oregon 97301-3896, or from their web site at http://www.ost.state.or.us/About/Boards/OSTF/Financial%20Statements/index.htm.

As of June 30, 2003, the book balance of cash and cash equivalents was $49,233,069. The bank balance was $49,203,483, of which $49,117,508 was held in demand accounts with the State Treasurer invested in the Oregon Short-Term Fund (OSTF) and $85,975 was held by the State's fiscal agent.

The Bank of New York, in its capacity as the State's fiscal agent, holds SELP funds for redemption of bonds and coupons that have matured but have not yet been redeemed. On June 30, 2004 and 2003 those funds remain constant at $85,975 respectively. The funds are backed by the faith and credit of Bank of New York, and are neither insured nor collateralized.

Bond Indenture and statute require SELP cash and investments to be segregated into the Loan Fund and the Sinking Fund. Cash and investments as of June 30, 2004 and 2003, respectively, consisted of:

	June 30, 2004	June 30, 2003
	Cash	Cash
Loan Fund	$17,024,352	$21,629,245
Sinking Fund		
Program Account	4,009,532	8,436,289
Bond Reserve	–	–
Principal and Interest	9,571,951	9,564,712
Redemption Account	31,625,000	–
Extraordinary Expense	6,122,917	5,939,804
Borrower's Accounts	3,337,066	3,577,044
Fiscal Agent Cash	85,975	85,975
TOTAL	$71,776,793	$49,233,069

B. Investments

The Bond Indenture and State statute authorize SELP to invest through the State Treasurer in United States Treasury and government agency bonds, notes and bills; state and municipal bonds of the four highest ratings; and corporate bonds. SELP's investment policy further limits the amount of investment in any one company to 5 percent of the fund's total par value. Structured notes and securities tied to foreign currencies or their indices are excluded from allowable investments. As of June 30, 2004 and 2003, respectively, SELP's investment portfolio remained in demand accounts with the State Treasurer invested in the Oregon Short-Term Fund.

NOTE 3. LOANS RECEIVABLE

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

	June 30, 2004	June 30, 2003
Loans and contracts receivable	$106,947,030	$123,680,573
State agency loans	20,629,252	19,623,393
Net credit risk exposure	$86,317,778	$104,057,180

SELP uses the allowance method to estimate uncollectible loans and contracts receivable. The allowance for loans and contracts is based primarily upon a percentage of new loans made during the fiscal year. Management periodically adjusts the allowance to accommodate changes in economic conditions, non-performing assets, historical loss experience, and other conditions that may affect the ultimate collectibility of the loans and contracts. In 2003 and 2004, SELP management determined that the balance of the allowance account was sufficient to cover projected losses for the loan and contract portfolio.

SELP was awarded a court judgment against a borrower as a result of loan delinquency during fiscal year 2003. The settlement is reported as component of other receivables in the amount of $21,279 and consists of the remaining principal transferred from the loan portfolio plus accrued interest and associated court costs. The receivable remains unchanged as of June 30, 2004.

SELP holds agreements with two borrowers that allow for a temporary modification of the payment terms of the borrowers' loans. SELP agrees to forbear against issuing a notice of default and enforcement of its security interests under the loan documents. Both borrowers have complied with the terms of the applicable agreements, but of the $2,825,232 in Loan Interest Receivable, approximately $1,010,987 of accrued interest is expected to be collected later than one year after June 30, 2004.

During the fiscal year 2004, SELP sold bonds to refund the outstanding 1994 Series A, B, E and F bonds to reduce the interest costs of the program. Federal arbitrage law restricts the amount SELP can earn on loans funded by tax-exempt bonds. When the savings to borrowers is large, SELP reduces the interest rate on outstanding loans to comply with the federal requirement. When the amount of the savings to the borrowers is small or the remaining life of the loan is less than two years, SELP shares the savings with borrowers by reducing the principal balance of their loans. The principal reductions made to loans funded with the refunded bond series totaled $22,418, which is recognized as of June 30, 2004 as a reduction of operating income. For those borrowers receiving interest rate reductions, the cost to the program will be recognized over the remaining life of the loan through lower interest earnings. SELP will also recognize the refunding savings over the remaining life of the new bonds through lower interest payments to bondholders.

NOTE 4. BONDS PAYABLE AND DEBT SERVICE

Since SELP's inception in 1980, it has issued general obligation bonds totaling $529,130,000, of which $156,360,000 was outstanding as of June 30, 2004. Bond proceeds are loaned to individual residents, businesses, nonprofit organizations, state agencies, school districts and local governments in Oregon to complete energy conservation and renewable resource energy projects. The following table provides a summary of bond transactions as presented on the balance sheets for the fiscal years ended June 30, 2004 and June 30, 2003:

	June 30, 2004	June 30, 2003
Bonds Payable—beginning	$149,520,000	$184,175,000
Bonds issued	19,270,000	–
Bonds retired	(12,430,000)	(34,655,000)
Bonds Payable—ending	156,360,000	149,520,000
Discount on Bonds Payable	(1,017,418)	(1,157,146)
Net Bonds Payable	$155,342,582	$148,362,854

Notes to the Financial Statements (continued)
June 30, 2004 and June 30, 2003

Debt Service Requirements to Maturity

The following table summarizes the amounts necessary to pay all future bonded debt principal and interest requirements as of June 30, 2004, for each fiscal year during the next five years period ending June 30, 2009, and in five year increments thereafter:

Years Ending June 30	Principal	Interest	Total Debt Service
2005	$44,660,000	$6,090,897	$50,750,897
2006	12,695,000	4,657,742	17,352,742
2007	11,170,000	4,196,741	15,366,741
2008	10,925,000	3,808,011	14,733,011
2009	8,235,000	3,409,002	11,644,002
2010-2014	40,535,000	11,826,313	52,361,313
2015-2019	20,750,000	3,917,390	24,667,390
2020-2024	3,890,000	1,413,920	5,303,920
2025-2028	3,500,000	448,750	3,948,750
TOTALS	$156,360,000	$39,768,766	$196,128,766

The following table summarizes the outstanding bonds by series as of June 30, 2004:

SCHEDULE OF DEBT ISSUED AND OUTSTANDING
General Obligation Bonds

Original Issue						Bonds Outstanding				
			Coupon Interest Range							
Series	Dated Date	Final Maturity	From	To	Amount	Beginning Balance	Increases	Decreases	Ending Balance	Due Within One Year
1994A	May–94	Jul–09	3.500%	5.750%	$ 2,000,000	$ 1,115,000	$–	$ 135,000	$ 980,000	$ 980,000
1994B	May–94	Jul–07	4.300%	5.375%	19,325,000	7,700,000	–	1,605,000	6,095,000	6,095,000
1994C	May–94	Jul–15	3.550%	6.000%	4,015,000	2,665,000	–	245,000	2,420,000	2,420,000
1994D	May–94	Jul–15	6.125%	7.950%	14,960,000	12,190,000	–	545,000	11,645,000	11,645,000
1994E	Oct–94	Jul–11	4.600%	6.000%	15,000,000	10,370,000	–	915,000	9,455,000	9,455,000
1994F	Oct–94	Jul–11	4.450%	6.250%	7,010,000	5,075,000	–	345,000	4,730,000	4,730,000
1994G	Oct–94	Jul–06	7.200%	8.000%	1,000,000	490,000	–	110,000	380,000	380,000
1998A	Mar–98	Jan–14	3.900%	4.900%	3,000,000	2,505,000	–	180,000	2,325,000	190,000
1998B	Mar–98	Jan–02	3.800%	4.250%	5,930,000	–	–	–	–	–
1998C	Oct–98	Jul–19	3.500%	4.800%	5,500,000	5,055,000	–	200,000	4,855,000	210,000
1998D	Oct–98	Jan–28	4.100%	4.800%	14,535,000	13,660,000	–	290,000	13,370,000	305,000
1998E	Oct–98	Jan–17	3.650%	4.900%	2,000,000	1,680,000	–	90,000	1,590,000	90,000
1998F	Oct–98	Jan–08	3.650%	4.250%	3,970,000	2,505,000	–	435,000	2,070,000	465,000
1998G	Oct–98	Jan–17	3.650%	4.900%	2,500,000	1,470,000	–	255,000	1,215,000	250,000
1998H	Oct–98	Jan–08	3.650%	4.250%	3,050,000	1,785,000	–	280,000	1,505,000	300,000
1999A	Oct–99	Jan–17	4.750%	5.100%	25,995,000	22,515,000	–	1,330,000	21,185,000	1,385,000
1999B	Apr–99	Jan–15	4.000%	4.750%	9,100,000	6,040,000	–	685,000	5,355,000	820,000
1999C	Apr–99	Jul–11	4.000%	4.600%	2,115,000	1,585,000	–	155,000	1,430,000	155,000
1999D	Apr–99	Jan–14	5.500%	6.000%	8,840,000	4,700,000	–	1,220,000	3,480,000	1,230,000
2000A	Apr–00	Jul–17	4.500%	5.500%	7,320,000	5,720,000	–	860,000	4,860,000	925,000
2001A	May–01	Jul–18	4.000%	5.000%	2,000,000	2,000,000	–	–	2,000,000	–
2001B	May–01	Jan–17	3.700%	5.125%	11,000,000	10,460,000	–	560,000	9,900,000	580,000
2001C	May–01	Jul–07	4.875%	5.750%	1,000,000	845,000	–	165,000	680,000	175,000

	Original Issue					Bonds Outstanding				
			Coupon Interest Range			Beginning			Ending	Due Within
Series	Dated Date	Final Maturity	From	To	Amount	Balance	Increases	Decreases	Balance	One Year
2001D	Oct–01	Apr–16	2.300%	4.500%	$ 4,000,000	$ 3,950,000	$ –	$ 245,000	$ 3,705,000	$ 255,000
2001E	Oct–01	Oct–16	3.150%	4.850%	1,600,000	1,600,000	–	–	1,600,000	–
2001F	Oct–01	Oct–16	3.150%	6.000%	11,500,000	10,890,000	–	645,000	10,245,000	665,000
2002A	May–02	Oct–12	3.000%	4.250%	10,950,000	10,950,000	–	935,000	10,015,000	955,000
2004A	Apr–04	Jul–16	2.000%	3.500%	11,035,000	–	11,035,000	–	11,035,000	–
2004B	Apr–04	Jul–07	2.000%	2.000%	4,385,000	–	4,385,000	–	4,385,000	–
2004C	Apr–04	Jul–15	2.000%	3.750%	3,850,000	–	3,850,000	–	3,850,000	–
	Total General Obligation Bonds				$529,130,000	$149,520,000	$19,270,000	$12,430,000	$156,360,000	$44,660,000

NOTE 5. CHANGES IN LONG TERM LIABILITIES

Long-term liability activity for the fiscal year is as follows:

	Beginning Balance	**Additions**	**Reductions**	**Ending Balance**	**Due Within One Year**
Net Bonds Payable	$148,362,854	$19,245,865	$12,266,137	$155,342,582	$44,660,000
Arbitrage Rebate Liability	278,404	–	278,404	–	–
Borrowers' Reserve Fund Liability	3,576,747	345,887	585,568	3,337,066	–
Total Long-Term Liabilities	$152,218,005	$19,591,752	$13,130,109	$158,679,648	$44,660,000

NOTE 6. COMMITMENTS

As of June 30, 2004 and June 30, 2003, SELP had committed but undistributed loan funds of $13,672,988 and $21,500,227, respectively, for various alternative energy and energy conservation projects within the state of Oregon. Funds are committed pursuant to legal agreements with borrowers. Additional funds have been designated for future energy project loans in the amounts of $3,677,031 and $2,572,970 as of June 30, 2004 and June 30, 2003 respectively.

NOTE 7. DEBT REFUNDING

On April 22, 2004, SELP issued the following General Obligation Alternate Energy Bonds: $11,035,000 in 2004 Series A with an average interest rate of 2.50 percent, $4,385,000 in 2004 Series B with an average interest rate of 1.45 percent, and $3,850,000 in 2004 Series C with an average interest rate of 3.35 percent. The 2004 Series A will fund $2,000,000 of new energy project loans and the remaining $17,270,000 will be used to refund various General Obligation Alternate Energy Bonds issued in 1994. The current refunding reduces SELP's total debt service payments over the next 11 years by $2,522,473 and results in an economic gain on a present value basis of $2,113,747. Of the subsequent savings, 70.72 percent will be passed on to related SELP borrowers to comply with federal arbitrage regulations, and is more fully described in Note 3.

On May 15, 2002, SELP issued $10,950,000 in 2002 Series A General Obligation Alternate Energy Refunding Bonds with an average interest rate of 3.76 percent. The principal amount of the bonds and $400,000 of bond reserve funds were used to refund $11,370,000 of outstanding 1993 Series A bonds. The current refunding was undertaken to reduce the total debt service payments over 11 years by

$446,114 and resulted in an economic gain on a present value basis of $496,531. On July 1, 2002, SELP called $22,890,000 of outstanding bonds. In addition to 1993 Series A, the 1993 Series B bonds were redeemed with proceeds received as a prepayment during fiscal year 2002.

NOTE 8. CAPITAL ASSETS

As of June 30, 2004, SELP capital assets consisted of the accumulated costs of developing a new database for the program. Management expects the Data Processing Software will be placed into service during the fiscal year ended June 30, 2005. SELP has no outstanding debt related to capital assets. A summary of SELP's capital asset activity is presented in the following table:

	Beginning Balance	Additions	Deletions	Ending Balance
Data Processing Software	$ –	$242,770	$ –	$242,770
Less: Depreciation/Amortization	$ –	$ –	$ –	$ –
Total Net Capital Assets	$ –	$242,770	$ –	$242,770

NOTE 9. PRIOR PERIOD ADJUSTMENT

A prior period adjustment to net assets was made to capitalize the expenses of developing the program database prior to fiscal year ended June 30, 2004. The result is an increase in capital assets and net assets of $84,549, representing the costs incurred during the software development stage of the project for fiscal years ended June 30, 2003 and 2002. The $158,221 balance for the data processing software was for costs incurred during the current fiscal year.

NOTE 10. EMPLOYEE RETIREMENT PLAN

The 2003 Oregon Legislature created a new plan to provide public employees hired on or after August 29, 2003 with retirement benefits. The Oregon Public Service Retirement Plan (OPSRP) is a hybrid pension plan with two components: the Pension Program (defined benefit plan) and the Individual Account Program (defined contribution plan). Public Employees Retirement System (PERS) members retain their existing PERS accounts but, beginning January 1, 2004, any future member contributions were 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, P.O. Box 23700, Tigard, OR 97281-3700.

A. Oregon Public Employee's Retirement System (PERS)

SELP employees who were plan members before August 29, 2003 participate in the Oregon Public Employee's Retirement System (PERS), a cost-sharing multiple employer 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.

Covered employees are required by State statute to contribute 6.0 percent of their salary to the plan through December 31, 2003. Current law permits employers to pay employee contributions to the Retirement Fund on behalf of the employees. SELP 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. For fiscal year 2004 the rate of each covered employees salary was 11.31 percent for July through October and 4.71 percent for November through June. The amounts contributed by SELP for the years ended June 30, 2004, 2003, and 2002 were $45,858, $73,644, and $85,787, respectively, equal to the required contributions each year.

B. Oregon Public Service Retirement Plan (OPSRP)

The defined benefit portion of the Oregon Public Service Retirement Plan (OPSRP) is the Pension Program. This program is a cost-sharing multiple-employer-defined benefit pension plan 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 a 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 representing 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.

SELP 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. SELP did not have any employees hired on or after August 29, 2003 and, as such, was not required to contribute to the OPSRP Pension Program for fiscal year 2004.

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. The 6.0 percent required employee contribution required by State statute were credited to the accounts of covered employees effective January 1, 2004. 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. The amount contributed by SELP for the fiscal year ended June 30, 2004 was $20,565, equal to the required contributions for the year.

NOTE 11. RISK FINANCING

The State of Oregon administers property and casualty insurance programs covering State government through its Insurance Fund. The Insurance Fund services claims for direct physical loss or damage to State property; tort liability claims brought against the State, its officers, employees, or agents; workers' compensation; and employees, elected officials, and members of commissions and boards for honesty. Faithful performance coverage is provided for key positions in state government required by law to be covered.

SELP participates in the Insurance Fund. The cost of servicing insurance claims and payments is covered by charging an assessment to each State entity based on its share of services provided in a prior period. The total statewide assessment of each coverage is based on independent biennial actuarial forecasts and administrative expenses, less any available fund balance in the Insurance Fund from the prior biennium.

NOTE 12. SUBSEQUENT EVENTS

On July 1, 2004, SELP called $31,625,000 of outstanding General Obligation Alternate Energy Bonds prior to maturity. The 1994 Series A and E bonds were refunded using the proceeds of 2004 Series A; the 1994 Series B bonds were refunded using the proceeds of 2004 Series B; and the 1994 Series F bonds were refunded using the proceeds of 2004 Series C. The 1994 Series C, D and G were redeemed prior to maturity with proceeds from loan prepayments and other funds on hand.

OTHER REPORTS

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REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

We have audited the financial statements of the Small Scale Energy Loan Program (SELP) an enterprise fund of the State of Oregon, Department of Energy, as of and for the years ended June 30, 2004 and 2003, and have issued our report thereon dated February 23, 2005. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the department's internal control over SELP's financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on 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 reportable 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 caused by error or fraud 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.

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Compliance and Other Matters
As part of obtaining reasonable assurance about whether the SELP's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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 or other matters that are required to be reported under *Government Auditing Standards.*

This report is intended solely for the information and use of the Department of Energy's management, the governor of the State of Oregon, the Oregon Legislative Assembly and is not intended to be and should not be used by anyone other than those specified parties.

OREGON AUDITS DIVISION

Bill Bradbury
Secretary of State

February 23, 2005

FACTS ABOUT THE SECRETARY OF STATE AUDITS DIVISION

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

Directory of Key Officials

State Auditor	Cathy Pollino, CGFM, MBA
Deputy State Auditor	Charles A. Hibner, CPA
Deputy State Auditor	Mary E. Wenger, CPA

Audit Team

Kelly Olson, CPA, Audit Manager

David Moon, CPA, MBA

Todd Kimball

This report, a public record, is intended to promote the best possible management of public resources. Copies may be obtained from our website on the internet at:

http://www.sos.state.or.us/audits/audithp.htm

by phone at 503-986-2255

or by mail from:

Oregon Audits Division
255 Capitol Street NE, Suite 500
Salem, OR 97310

The courtesies and cooperation extended by officials and employees of the Small Scale Energy Loan Program during the course of this audit were commendable and sincerely appreciated.

Auditing to Protect the Public Interest and Improve Oregon Government

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