Oregon Department of Veterans' Affairs

Annual Financial Report
Enterprise Funds
For The Fiscal Years Ended
June 30, 2005 and June 30, 2004

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, 2005 and June 30, 2004

Jim Willis
Director

Bruce Shriver, CPA
Chief Financial Officer

Report Prepared By

Carol Clevenberg
Ron Weisser, CPA
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With the assistance of the
Financial Administration Division,
Administrative Services Division,
and Public Information Section

Cover Photo:
Artist's rendering of the proposed
Afghan-Iraqi Freedom War Memorial

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The Afghan-Iraqi Freedom War Memorial

Following the loss of their son, Army Warrant Officer Erik Kesterson, in a helicopter crash in Iraq, Clay and MJ Kesterson of Independence formed a foundation to create a memorial honoring all Oregon military members who have been killed in Afghanistan and Iraq. Other Oregon families who have lost a loved one in that region have joined with the Kestersons in their fundraising effort.

Oregon Governor Ted Kulongoski signed House Bill 2795 on Friday, September 2, 2005, to help fund the Afghan-Iraqi Freedom War Memorial.

The official signing ceremony was held near the proposed memorial site of the Oregon Department of Veterans' Affairs north grounds.

Sen. Peter Courtney, Clay Kesterson, Rep. Brad Witt, MJ Kesterson and Rep. Donna Nelson joined the Governor and Director Willis at the signing.

The founders of the Memorial effort, Clay and MJ Kesterson of Independence were joined by friends, Memorial Project Manager Bill McMichaels and Col. George Lanning of the Oregon National Guard.

Families who have lost loved ones in Afghanistan and Iraq, military veterans and several legislators attended the event.

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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

October 28, 2005

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, 2005, and June 30, 2004. 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 an increase of 1.5 percent at an annual rate. This is the eighth consecutive quarterly growth in jobs but breaks a string of four quarters of growth above 2.0 percent. On a year-over-year *(Y/Y)* basis, jobs increased in the second quarter by 3.1 percent. Y/Y growth has been above 2.0 percent since the second quarter of 2004.

The job recovery was late to join the business recovery underway in the state. Since mid-2003, job gains spread across all sectors. The rising economic tide did not raise all industries equally. Health services sailed through the recession and continue to add workers. Food products have struggled through mergers and closures. High tech and professional and business services added more workers since 2003 but have yet to regain all the jobs lost during the recession.

The most recent Blue Chip Job Growth rankings place Oregon 6th in the nation. For Y/Y job growth, between June 2004 and June 2005, jobs increased by 47,600 or 2.95 percent. A year ago, Oregon was ranked 8th.

Future Outlook – With the second quarter of 2005 ushering in the eighth consecutive quarter of job growth, the evidence points to a well-established economic recovery in the job market. The Employment Department reported that last January the state reached a new high for total nonfarm employment. Last May was the first job loss month since June of 2003 *(January of 2004 was also a job loss month but this was due to the severe ice storm)*. The national economy is expected to continue to grow but at a slower rate. The Oregon State Office of Economic Analysis *(OEA)* forecasts employment to rise by 3.0 percent for 2005, the strongest yearly growth since 1997. Job growth in 2006 is projected to be 1.5 percent, reflecting the slowing growth projected for the national economy. The economy continues to expand with 1.4 percent job growth in 2007. Additional OEA forecasts for specific sectors of Oregon's economy are discussed in the following paragraphs.

Total private nonfarm employment will increase in 2005, growing by 3.3 percent. The sector will continue to improve through 2006. Total private nonfarm employment will grow 1.6 percent in 2006 and 1.5 percent in 2007. Manufacturing will increase by 2.5 percent in 2005 and then show mild declines of 0.2 percent in 2006 and 0.8 percent in 2007. Job levels will still be below average job levels in 2000. Private non-manufacturing jobs will increase by 3.5 percent in 2005, 2.0 percent in 2006 and 2007.

Wood product manufacturing is projected to be up 2.2 percent in 2005 and then decline by 1.5 percent in 2006 and 4.0 percent in 2007.

The sector that contains semiconductors, computer and electronic products, will improve to show gains of 1.0 percent for 2005. The job outlook is more uncertain with declines of 3.3 percent in 2006 and 1.5 percent in 2007. The outer years are projected to keep this sector in a no growth pattern.

Transportation equipment will increase by 7.7 percent in 2005. Job gains will not be as strong but continue in 2006 with growth of 1.9 percent. Employment will slightly decline with a loss of 0.2 percent in 2007.

Construction will increase jobs at a strong 7.7 percent in 2005. Job growth will continue at a milder pace with 1.9 percent in 2006 and 2.2 percent in 2007.

Trade job growth will improve this year compared to 2004. Retail trade job growth will be stronger in 2005 at 3.4 percent and grow 1.3 percent in 2006 and 1.4 percent in 2007. Wholesale trade will be positive in 2005 with annual job growth of 2.5 percent followed by job gains of 0.9 percent in 2006 and 0.5 percent in 2007.
Professional and business services and health services will see some of the strongest growth. Professional and business services will grow 3.1 percent in 2005 followed by 3.1 percent growth in 2006 and 3.5 percent in 2007. Health services will increase 4.3 percent, 3.2 percent, and 2.9 percent on average for the same years.

Leisure and hospitality, which includes accommodations and food services, is expected to grow by 3.5 percent in 2005, 2.5 percent in 2006, and 1.6 percent in 2007.

Government employment is expected to increase by 1.5 percent in 2005 followed by growth of 0.7 percent in 2006 and 0.9 percent in 2007. State and local government jobs will slowly improve as tax revenues improve with the stronger economy.

Population growth is expected to be higher than the U.S. average, but slower than the growth experienced in the mid-1990s. Growth will be slightly higher than during the recession over the next three years, with increases of 1.2 percent for 2005, 2006, and 2007.

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, 2005, this Program had approximately 8,000 mortgage loans and contracts outstanding, with a principal balance of approximately $290 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 residents and had occupancy of approximately 125 residents at June 30, 2005. The Department owns the OVH and as of October 1, 2003, has contracted with Veterans Care Centers of Oregon *(VCCO)*, a non-profit organization, to provide the services needed by the residents.

The major issue related to the Department's client base is that the composition and essential necessities 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. In addition, with the ongoing conflicts in Iraq and Afghanistan, it is becoming increasingly important to help meet the needs of our younger returning veterans.

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. The Department of Administrative Services and the Oregon Legislature maintain budgetary controls.

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, 2005, the Veterans' Loan Program had approximately $1.02 billion in assets *(primarily consisting of loan and contract receivables, cash and cash equivalents, and investment securities)*, and about $0.90 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, 2005, the Veterans' Home Program had assets of approximately $13.2 million consisting primarily of capital assets, receivables and cash and cash equivalents and approximately $1.6 million in liabilities consisting primarily of short-term payables.

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

Moody's Investor Service	Aa3
Fitch Ratings	AA-
Standard & Poor's	AA-

As of June 30, 2005, the Department had approximately $802 million in outstanding debt. During fiscal year 2005, the Department issued approximately $60 million in bonds and retired approximately $140 million.

Cash Management - All monies collected by the Department are turned over to the State Treasurer, who is responsible for the control of cash and the investment of State funds. On June 30, 2005, the Department's Enterprise funds cash, cash equivalents *(excluding securities lending collateral)*, and investments totaled approximately $643.8 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 that 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.

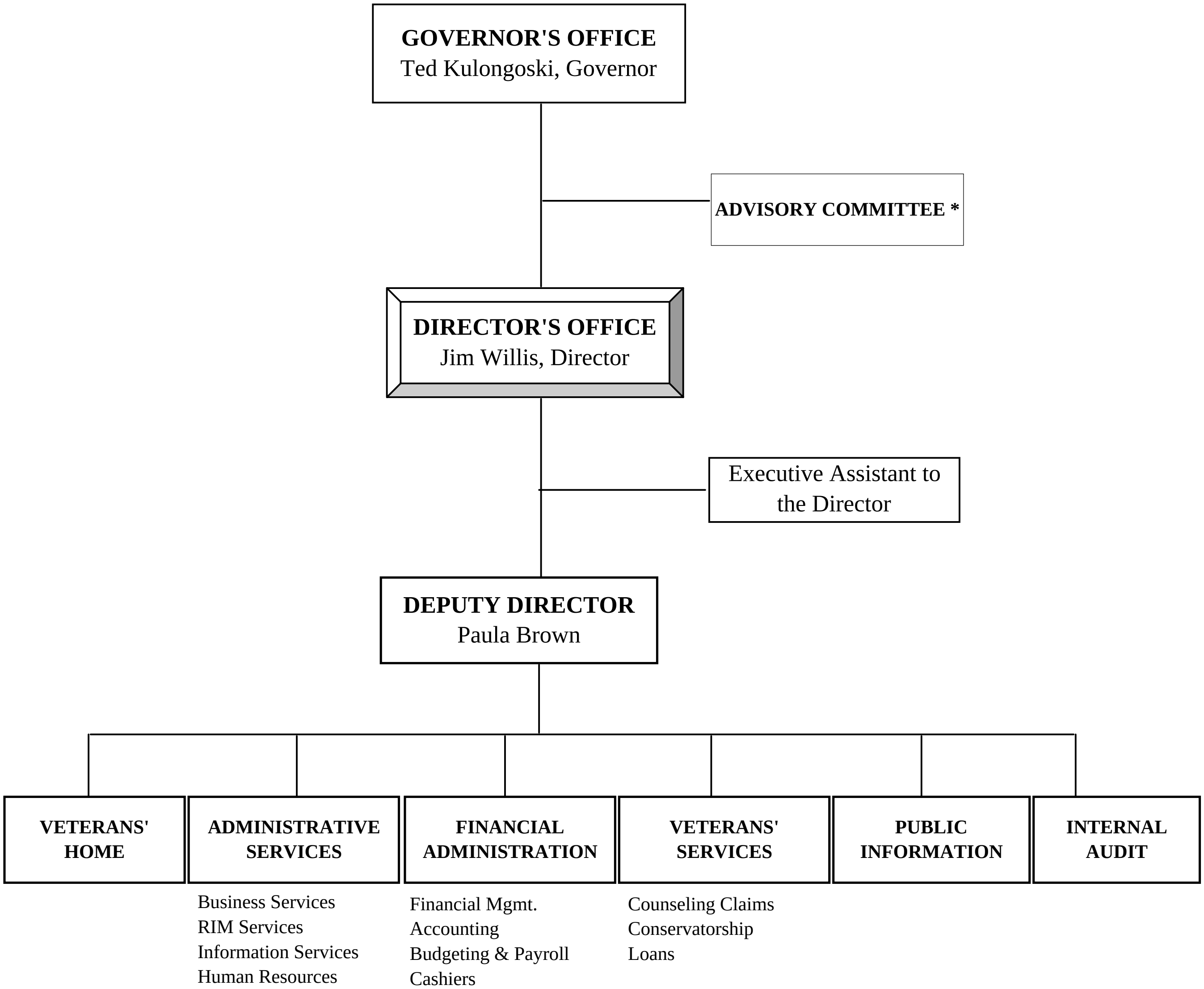
Independent Audit - The Secretary of State, Audits Division, has audited or contracted for the audit of the financial records, books of account, and transactions of the Department for the years ended June 30, 2005 and June 30, 2004. The auditors used generally accepted government auditing standards in 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 are very much appreciated.

Respectfully submitted,

Jim Willis
Director

Bruce W. Shriver
Chief Financial Officer



* 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, 2009	Irv Fletcher	March 31, 2006
Staryl C. Austin, Jr.	March 15, 2008	Robert Haltiner	March 15, 2008
Furlton M. Burns	March 15, 2008	Tino E. Ornelas	September 30, 2007
Walter R. Crews	March 15, 2008	Charles E. Schmidt	September 30, 2008
David Fairclo	March 15, 2008		

FINANCIAL SECTION

MERINA
& COMPANY, LLP

CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS

PARTNERS
JOHN W. MERINA, CPA • KAMALA K. AUSTIN, CPA

INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying financial statements of the enterprise funds of the state of Oregon, Department of Veterans' Affairs (department), as listed in the accompanying table of contents, as of and for the year ended June 30, 2005. 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. The financial statements of the Oregon Department of Veterans' Affairs as of June 30, 2004, were audited by other auditors whose report dated November 5, 2004, expressed an unqualified opinion on those statements.

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

As discussed in Note 1, the 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, 2005 and 2004, and the changes of 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 department, an enterprise fund of the state of Oregon, Department of Veterans' Affairs, as of June 30, 2005 and 2004, 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.

5499 AMY STREET • WEST LINN, OREGON 97068 • PHONE: (503) 723-0300 • FAX: (503) 723-9946 • WWW.MERINACPAS.COM

Our audit was conducted for the purpose of forming opinions on the basic financials 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 October 28, 2005, on our consideration of the state of Oregon, Department of Veterans' Affairs internal control over financial reporting and 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* should be read in conjunction with this report in considering the results of our audit. That report is separately presented in the other reports as listed in the table of contents.

Merina & Company, LLP

Merina & Company, LLP
West Linn, Oregon
October 28, 2005

STATE OF OREGON
DEPARTMENT OF VETERANS' AFFAIRS
STATEMENT OF NET ASSETS
PROPRIETARY FUNDS
JUNE 30, 2005 AND JUNE 30, 2004

	Enterprise Funds			
	Veterans' Loan Program		Veterans' Home Program	
	June 30, 2005	June 30, 2004	June 30, 2005	June 30, 2004
ASSETS				
Current Assets				
Cash and Cash Equivalents	$ 74,807,764	$ 109,561,351	$ 1,414,057	$ 726,735
Cash and Cash Equivalents - Restricted	4,537,629	6,257,846	-	-
Securities Lending Cash Collateral	84,522,242	263,145,877	248,379	342,687
Receivables:				
Accrued Interest	3,876,695	5,545,325	-	-
Loan Cancellation Life Insurance Premiums	185,655	217,577	-	-
Resident Care Related	-	-	818,414	661,432
Other	11,731	23,533	-	-
Due from Other Funds	494,164	5,269	5,405	-
Real Estate Owned	96,048	171,189	-	-
Prepaid Expenses	8,115	19,449	553	553
Total Current Assets	168,540,043	384,947,416	2,486,808	1,731,407
Noncurrent Assets				
Cash and Cash Equivalents - Restricted	428,157,516	405,536,924	-	-
Investments - Restricted	134,928,764	155,641,016	-	-
Mortgage Loans and Contracts Receivable (Net)	284,220,290	339,922,044	-	-
Resident Care Receivable (Net)	-	-	3,572	3,572
Notes Receivable	360,000	360,000	-	-
Other Receivable	481,294	-	-	-
Deferred Underwriter's Discount	1,929,928	1,913,369	-	-
Capital Assets:				
Building, Property and Equipment	9,945,155	9,945,155	12,517,677	12,517,677
Improvements Other than Buildings	-	-	7,250	-
Land	-	-	600,073	600,073
Works of Art and Historical Treasures	85,170	85,170	70,000	70,000
Accumulated Depreciation	(5,391,789)	(5,032,348)	(2,449,306)	(2,161,834)
Total Noncurrent Assets	854,716,328	908,371,330	10,749,266	11,029,488
TOTAL ASSETS	$ 1,023,256,371	$ 1,293,318,746	$ 13,236,074	$ 12,760,895
LIABILITIES				
Current Liabilities				
Accounts Payable	$ 361,717	$ 566,738	$ 873,212	$ 958,079
Loan Cancellation Life Insurance Premium Payable	137,379	347,345	-	-
Due to Other Funds	-	-	493,755	-
Deposit Liabilities	1,674,166	1,495,581	361	-
Accrued Interest on Bonds	9,891,835	12,368,445	-	-
Obligations under Securities Lending	84,522,242	263,145,877	248,379	342,687
Compensated Absences Payable	360,289	417,495	4,936	16,073
Bonds Payable-Maturing Within One Year (Net)	62,727,149	83,314,364	-	-
Matured Bonds Payable	4,537,629	6,257,846	-	-
Total Current Liabilities	164,212,406	367,913,691	1,620,643	1,316,839
Noncurrent Liabilities				
Bonds Payable-Maturing After One Year (Net)	738,766,577	798,269,848	-	-
Arbitrage Rebate Payable	402,055	385,380	-	-
Total Noncurrent Liabilities	739,168,632	798,655,228	-	-
TOTAL LIABILITIES	903,381,038	1,166,568,919	1,620,643	1,316,839
NET ASSETS				
Invested in Capital Assets	4,638,536	4,997,977	10,745,694	11,025,916
Net Assets, Unrestricted	115,236,797	121,751,850	869,737	418,140
TOTAL NET ASSETS	$ 119,875,333	$ 126,749,827	$ 11,615,431	$ 11,444,056

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

Enterprise Funds			
TOTAL			
June 30, 2005		June 30, 2004	
$	76,221,821	$	110,288,086
	4,537,629		6,257,846
	84,770,621		263,488,564
	3,876,695		5,545,325
	185,655		217,577
	818,414		661,432
	11,731		23,533
	499,569		5,269
	96,048		171,189
	8,668		20,002
	171,026,851		386,678,823
	428,157,516		405,536,924
	134,928,764		155,641,016
	284,220,290		339,922,044
	3,572		3,572
	360,000		360,000
	481,294		-
	1,929,928		1,913,369
	22,462,832		22,462,832
	7,250		-
	600,073		600,073
	155,170		155,170
	(7,841,095)		(7,194,182)
	865,465,594		919,400,818
$	1,036,492,445	$	1,306,079,641
$	1,234,929	$	1,524,817
	137,379		347,345
	493,755		-
	1,674,527		1,495,581
	9,891,835		12,368,445
	84,770,621		263,488,564
	365,225		433,568
	62,727,149		83,314,364
	4,537,629		6,257,846
	165,833,049		369,230,530
	738,766,577		798,269,848
	402,055		385,380
	739,168,632		798,655,228
	905,001,681		1,167,885,758
	15,384,230		16,023,893
	116,106,534		122,169,990
$	131,490,764	$	138,193,883

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, 2005 AND JUNE 30, 2004

	Enterprise Funds			
	Veterans' Loan Program		Veterans' Home Program	
	June 30, 2005	June 30, 2004	June 30, 2005	June 30, 2004
OPERATING REVENUES				
Interest Income:				
Mortgage Loans	$ 21,225,116	$ 26,789,783	$ -	$ -
Contracts	1,188,374	1,698,531	-	-
Investment Income	18,013,534	13,338,726	24,217	8,390
Loan Cancellation Life Insurance Premiums	2,523,140	2,704,444	-	-
Loan Cancellation Life Insurance Processing Fee	220,834	425,004	-	-
Resident Revenue	-	-	8,680,118	6,157,125
Other Fees and Charges	947,834	939,950	2,825	2,134
Conservatorship Fees	334,340	345,750	-	-
Gain on Sale of Foreclosed Property	139,199	493,409	-	-
TOTAL OPERATING REVENUES	44,592,371	46,735,597	8,707,160	6,167,649
OPERATING EXPENSES				
Bond Interest	37,103,554	44,537,191	-	-
Interest on Taxable Line of Credit	159,267	-	-	-
Salaries and Other Payroll Expenses	4,793,870	5,875,969	512,025	213,063
Bond Expenses	1,324,123	1,155,355	-	-
Securities Lending Investment Expense	2,199,165	1,899,175	4,349	1,846
Real Estate Owned Expense	47,490	52,526	-	-
Services and Supplies	1,776,839	2,140,262	208,319	107,766
Claims Expense - Loan Cancellation Life Insurance	4,637,009	4,927,874	-	-
Veterans' Home Operations	-	-	7,596,750	6,181,784
Depreciation Expense	359,441	408,883	287,472	288,918
Bad Debt Expense	(1,104,080)	(1,656,784)	5,211	(100)
Other Expenses	170,187	-	-	-
TOTAL OPERATING EXPENSES	51,466,865	59,340,451	8,614,126	6,793,277
OPERATING INCOME (LOSS)	(6,874,494)	(12,604,854)	93,034	(625,628)
Transfers				
Net Transfers from Veterans' Home Trust Fund	-	-	71,091	298,257
Capital Contributions	-	-	7,250	9,000
CHANGE IN NET ASSETS	(6,874,494)	(12,604,854)	171,375	(318,371)
NET ASSETS - Beginning	126,749,827	139,354,681	11,444,056	11,762,427
NET ASSETS - Ending	$ 119,875,333	$ 126,749,827	$ 11,615,431	$ 11,444,056

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

Enterprise Funds	
TOTAL	
June 30, 2005	June 30, 2004
$ 21,225,116	$ 26,789,783
1,188,374	1,698,531
18,037,751	13,347,116
2,523,140	2,704,444
220,834	425,004
8,680,118	6,157,125
950,659	942,084
334,340	345,750
139,199	493,409
53,299,531	52,903,246
37,103,554	44,537,191
159,267	-
5,305,895	6,089,032
1,324,123	1,155,355
2,203,514	1,901,021
47,490	52,526
1,985,158	2,248,028
4,637,009	4,927,874
7,596,750	6,181,784
646,913	697,801
(1,098,869)	(1,656,884)
170,187	-
60,080,991	66,133,728
(6,781,460)	(13,230,482)
71,091	298,257
7,250	9,000
(6,703,119)	(12,923,225)
138,193,883	151,117,108
$ 131,490,764	$ 138,193,883

State of Oregon
Department of Veterans' Affairs
Statement of Cash Flows
Proprietary Funds
For the Fiscal Years Ended June 30, 2005 and June 30, 2004

	Enterprise Funds	
	Veterans' Loan Program	
	June 30, 2005	June 30, 2004
Cash Flows from Operating Activities:		
Receipts from Customers	$ 14,394,320	$ 4,137,551
Receipts from Other Funds for Services	662,719	693,865
Loan Principal Repayments	86,915,345	149,929,334
Loan Interest Received	22,709,860	29,325,191
Payments to Employees for Services	(5,215,957)	(5,920,029)
Payments to Suppliers	(17,008,349)	(7,188,254)
Payments to Other Funds for Services	(535,686)	(717,746)
Distributions to Other Governments	-	(39,069)
Loans Made	(30,973,966)	(31,341,898)
Other Receipts (Payments)	178,587	(422,970)
Net Cash Provided (Used) in Operating Activities	71,126,873	138,455,975
Cash Flows from Noncapital Financing Activities:		
Proceeds from Bond Sales	60,000,000	-
Taxable Line of Credit Proceeds	40,000,000	-
Principal Payments on Bonds	(141,740,217)	(188,212,976)
Principal Payments on Taxable Line of Credit	(40,000,000)	-
Interest Payments on Bonds	(39,649,513)	(48,601,805)
Interest Payments on Taxable Line of Credit	(159,267)	-
Bond Issuance Costs	(1,288,927)	(789,326)
Transfers from Other Funds	-	-
Net Cash Provided (Used) in Noncapital Financing Activities	(122,837,924)	(237,604,107)
Cash Flows from Capital and Related Financing Activities:		
Acquisition of Capital Assets	-	(13,459)
Proceeds from Sale of Capital Assets	826	559
Net Cash Provided (Used) in Capital and Related Financing Activities	826	(12,900)
Cash Flows from Investing Activities:		
Purchases of Investments	(266,427,899)	(360,249,694)
Proceeds from Sales or Maturities of Investments	285,530,634	470,234,935
Interest on Investments and Cash Balances	18,754,278	20,436,807
Investment Income from Securities Lending	2,199,165	1,899,175
Investment Expense from Securities Lending	(2,199,165)	(1,899,175)
Net Cash Provided (Used) in Investing Activities	37,857,013	130,422,048
Net Increase (Decrease) in Cash and Cash Equivalents	(13,853,212)	31,261,016
Cash and Cash Equivalents - Beginning	521,356,121	490,095,105
Cash and Cash Equivalents - Ending	$ 507,502,909	$ 521,356,121
Reconciled to Statement of Net Assets:		
Cash and Cash Equivalents - Current	$ 74,807,764	$ 109,561,351
Cash and Cash Equivalents - Current, Restricted	4,537,629	6,257,846
Cash and Cash Equivalents - Noncurrent, Restricted	428,157,516	405,536,924
Cash and Cash Equivalents - Ending (shown above)	$ 507,502,909	$ 521,356,121

Enterprise Funds Veterans' Home Program June 30, 2005	Enterprise Funds Veterans' Home Program June 30, 2004	Enterprise Funds TOTAL June 30, 2005	Enterprise Funds TOTAL June 30, 2004
$ 8,520,130	$ 5,901,645	$ 22,914,450	$ 10,039,196
-	-	662,719	693,865
-	-	86,915,345	149,929,334
-	-	22,709,860	29,325,191
(128,902)	(210,470)	(5,344,859)	(6,130,499)
(7,778,433)	(5,689,326)	(24,786,782)	(12,877,580)
(12,007)	(52,875)	(547,693)	(770,621)
-	-	-	(39,069)
-	-	(30,973,966)	(31,341,898)
2,825	2,134	181,412	(420,836)
603,613	(48,892)	71,730,486	138,407,083
-	-	60,000,000	-
-	-	40,000,000	-
-	-	(141,740,217)	(188,212,976)
-	-	(40,000,000)	-
-	-	(39,649,513)	(48,601,805)
		(159,267)	-
-	-	(1,288,927)	(789,326)
71,091	298,257	71,091	298,257
71,091	298,257	(122,766,833)	(237,305,850)
(7,250)	(8,016)	(7,250)	(21,475)
-	-	826	559
(7,250)	(8,016)	(6,424)	(20,916)
-	-	(266,427,899)	(360,249,694)
-	-	285,530,634	470,234,935
19,868	6,544	18,774,146	20,443,351
4,349	1,846	2,203,514	1,901,021
(4,349)	(1,846)	(2,203,514)	(1,901,021)
19,868	6,544	37,876,881	130,428,592
687,322	247,893	(13,165,890)	31,508,909
726,735	478,842	522,082,856	490,573,947
$ 1,414,057	$ 726,735	$ 508,916,966	$ 522,082,856
$ 1,414,057	$ 726,735	$ 76,221,821	$ 110,288,086
-	-	4,537,629	6,257,846
-	-	428,157,516	405,536,924
$ 1,414,057	$ 726,735	$ 508,916,966	$ 522,082,856

STATE OF OREGON
DEPARTMENT OF VETERANS' AFFAIRS
STATEMENT OF CASH FLOWS
PROPRIETARY FUNDS
FOR THE FISCAL YEARS ENDED JUNE 30, 2005 AND JUNE 30, 2004

(Continued from prior page)

	Enterprise Funds	
	Veterans' Loan Program	
	June 30, 2005	June 30, 2004
Reconciliation of Operating Income to Net Cash Provided (Used) by Operating Activities:		
Operating Income	$ (6,874,494)	$ (12,604,854)
Adjustments to Reconcile Operating Income to Net Cash Provided (Used) by Operating Activities:		
Depreciation and Amortization of Capital Assets	359,441	408,883
Amortization of Bond Premium, Discount and Underwriter's Discount on Called Bonds	247,321	293,597
Bad Debt Expense	(1,104,080)	(1,656,784)
Interest Received on Investments Reported as Operating Revenue	(18,013,534)	(13,338,726)
Investment Expense	2,199,165	1,899,175
Interest Payments on Bonds Reported as Operating Expense	37,262,821	44,537,191
Bond Costs	1,076,802	789,326
Net Changes in Assets and Liabilities:		
Accounts and Interest Receivable	341,871	913,338
Due from Other Funds	-	-
Prepaid Items	11,334	14,714
Loans and Contracts Receivable	56,277,198	117,960,493
Accounts Payable	(778,351)	(308,536)
Due to Other Funds	-	-
Deposit Liabilities	178,585	(415,479)
Compensated Absences Payable	(57,206)	(36,363)
Total Adjustments	78,001,367	151,060,829
Net Cash Provided (Used) by Operating Activities	$ 71,126,873	$ 138,455,975
Noncash Investing and Capital and Related Financing Activities:		
Net Change in Fair Value of Investments	(1,472,614)	(6,766,081)
Capital Contributions	-	-
Foreclosed Property	563,724	259,815
Total Noncash Investing and Capital and Related Financing Activities	$ (908,890)	$ (6,506,266)

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

Enterprise Funds		Enterprise Funds	
Veterans' Home Program		TOTAL	
June 30, 2005	June 30, 2004	June 30, 2005	June 30, 2004
$ 93,034	$ (625,628)	$ (6,781,460)	$ (13,230,482)
287,471	288,918	646,912	697,801
-	-	247,321	293,597
5,211	(100)	(1,098,869)	(1,656,884)
(24,217)	(8,390)	(18,037,751)	(13,347,116)
4,349	1,846	2,203,514	1,901,021
-	-	37,262,821	44,537,191
-	-	1,076,802	789,326
(154,941)	(254,504)	186,930	658,834
(5,405)	-	(5,405)	-
-	293	11,334	15,007
-	-	56,277,198	117,960,493
(84,867)	547,056	(863,218)	238,520
493,755	-	493,755	-
361	(976)	178,946	(416,455)
(11,138)	2,593	(68,344)	(33,770)
510,579	576,736	78,511,946	151,637,565
$ 603,613	$ (48,892)	$ 71,730,486	$ 138,407,083
-	-	(1,472,614)	(6,766,081)
7,250	9,000	7,250	9,000
-	-	563,724	259,815
$ 7,250	$ 9,000	$ (901,640)	$ (6,497,266)

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, resident-care related *(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, land improvements, 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 and land improvements)*.

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, charges for resident-related care 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, 83 and 84 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, 83 and 84 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, 2005 was $74,807,764 for current, unrestricted cash and cash equivalents; $4,537,629 for current, restricted cash and cash equivalents; and $428,157,516 in restricted, noncurrent cash and cash equivalents *(combined total was $507,502,909)*. The bank balance of these Veterans' Loan Program cash balances was $507,518,253 as of the same date. The Veterans' Home Program book balance of cash and cash equivalents as of June 30, 2005 was $1,414,057 for current, unrestricted cash and cash equivalents. The bank balance of these Veterans' Home Program cash balances was $1,405,688 as of the same date. The combined book balance of cash and cash equivalents of all types for both programs was $508,916,966 at June 30, 2005.

A combined total of $479,754,909 *(Veterans' Loan Program with $478,349,221 and the Veterans Home Program with $1,405,688)* at June 30, 2005 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 55 percent in U.S. government securities; 31 percent in short-term commercial paper; 13 percent in corporate notes; and the remainder in time certificates of deposit. 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 $24,631,402 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, 2005 the Department estimated that required balance to be $4,656,000. 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 $4,537,629 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, 2004, the matured bonds payable balance was $6,257,846.

At June 30, 2004 the Department had a book balance of Cash and Cash Equivalents of $522,082,856, which was composed of $110,288,086 in current, unrestricted cash; $6,257,846 in current, restricted cash; and $405,536,924 in noncurrent, restricted cash. The bank balance for cash at June 30, 2004 was $522,236,100.

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, 2005, 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, 2005. 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, 2005 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	$ 41,948,672	$ -	$ -	$ 41,948,672
International Bonds	10,034,456	-	-	10,034,456
Corporate Bonds	61,592,521	-	-	61,592,521
Total Investments Held By State Treasurer	$ 113,575,649	$ -	$ -	$ 113,575,649
Repurchase Agreements	8,190,017	-	-	8,190,017
Total By Risk category	$ 121,765,666	$ -	$ -	$ 121,765,666
Investments - Not Categorized				
Guaranteed Investment Contracts				$ 13,163,098
Investments Held By Broker-Dealers Under Securities Loans With Cash Collateral:				
U.S. Government And Agency Securities				83,043,564
Securities Lending Short-Term Collateral				
Investment Pool *(Oregon Short-Term Fund Only)*:				84,535,302
Less:				
Securities Lending Amounts				(167,578,866)
Total Investments-Restricted				$ 134,928,764

The schedule below presents the schedule of interest rate risk and credit quality disclosure as of June 30, 2005.

Investment type	Moody's Credit rating	Investment Maturities (in years): Less than 1 year	1-5 years	6-10 years	More than 10 years	Total Fair Value
		$	$	$	$	$
U.S. Agency Securities	AAA	10,122,175	31,826,497	-	-	41,948,672
International Debt Securities	AAA	10,034,456	-	-	-	10,034,456
Corporate Bonds	A3	10,004,460	5,877,561	-	-	15,882,021
Corporate Bonds	BAA1	-	2,706,550	-	-	2,706,550
Corporate Bonds	BAA2	13,597,801	29,406,149	-	-	43,003,950
Guaranteed Investment Contracts	N/A	1,349,718		-	20,003,397	21,353,115
Total Investments		$ 45,108,609	$ 69,816,757	$ -	$ 20,003,397	$ 134,928,764

Concentration of Credit Risk:
Concentration of credit risk is the risk of loss attributed to the magnitude of investment in a single issuer. On June 30, 2005, 7.90% of the Department's total investments were in Ford Motor Company, 6.07% with Bayerische Hypo-und Vereinsbank AG *(New York Branch)* and 5.24% in General Motors Corporation.

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, 2005, the Department had restricted assets of $567,623,909. As of June 30, 2004, the Department had restricted assets of $567,435,786.

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. 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. Both Oregon State Treasury and the broker-dealer borrowers maintain the right to terminate all securities lending transactions on demand. As a consequence, the maturities of investments made with cash collateral during the year generally do not match the maturities of their securities loans. On June 30, 2005, the Department had no securities on loan.

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. As of June 30, 2005, the fair value of all securities on loan from the OSTF was $1,452,573,416. The total cash collateral received for the securites on loan from OSTF was $1,482,782,589. The fair value of all investments made with the cash collateral received for those securities on loan was $1,478,666,455.

Total cash collateral received for securities on loan for the Department's proprietary funds was $84,770,621. Total fair value of all investments made with cash collateral was $84,535,302. Total securities on loan *(Department's share of OSTF securities on loan)* was $83,043,564.

Investment Income

The following table details the components of Investment Income for the years ended June 30, 2005 and June 30, 2004:

		June 30, 2005		June 30, 2004
Veterans' Loan Program:				
Investment Income: Accrual Basis	$	17,286,983	$	18,205,632
Securities Lending Revenue		2,199,165		1,899,175
Increase/(Decrease) in Fair Value of Investments		(1,472,614)		(6,766,081)
Investment Income	$	18,013,534	$	13,338,726
Veterans' Home Program:				
Investment Income: Accrual Basis	$	19,868	$	6,544
Securities Lending Revenue		4,349		1,846
Investment Income	$	24,217	$	8,390

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, 2005 is approximately $290 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 2005 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, 2005 from $6.90 million to $5.80 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, 2005 and June 30, 2004.

		June 30, 2005		June 30, 2004
Loans Receivable	$	278,245,063	$	329,930,505
Contracts Receivable		11,775,227		16,896,539
Total Loans and Contracts Receivable	$	290,020,290	$	346,827,044
Less: Allowance for Principal Losses		(5,800,000)		(6,905,000)
Net Loans and Contracts Receivable	$	284,220,290	$	339,922,044

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, 2005, there were 193 non-amortizing accounts with an aggregate principal balance of approximately $18,459,000. This represents 6.49 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, 2005, the department made no new home loans to an eligible veteran employee. At June 30, 2005 the balance of existing home loans was $130,793 based on loans made to three employees. This amount represents less than 0.050% of the total loans and contracts receivable. At June 30, 2004 the balance of existing home loans was $338,842 based on loans made to six 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, 2005, the Department provided this relief to some borrowers and deferred loan interest income of approximately $9,100. This interest amount was subsequently capitalized on these loans. In total, $321,900 in loans were restructured in this fashion. From these restructured loans the Department received approximately $8,200 in mortgage interest income during the fiscal year. 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.

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, 2005 and June 30, 2004:

		June 30, 2005		June 30, 2004
Veterans' Loan Program				
Building, Property, and Equipment	$	9,945,155	$	9,945,155
Less: Accumulated Depreciation		(5,391,789)		(5,032,348)
Building, Property and Equipment, Carrying Value	$	4,553,366	$	4,912,807
Works of Art and Historical Treasures, Non-Depreciating	$	85,170	$	85,170
Total Capital Assets, Net	$	4,638,536	$	4,997,977
Veterans' Home Program				
Building, Property and Equipment	$	12,517,677	$	12,517,677
Improvements Other than Buildings		7,250		-
Works of Art and Historical Treasures, Depreciating		30,000		30,000
Less: Accumulated Depreciation		(2,449,306)		(2,161,834)
Depreciable Capital Assets, Carrying Value	$	10,105,621	$	10,385,843
Works of Art and Historical Treasures, Non-Depreciating		40,000		40,000
Land		600,073		600,073
Total Capital Assets, Net	$	10,745,694	$	11,025,916
Total Capital Assets, Net	$	15,384,230	$	16,023,893

The following table provides detail on the balances and activities of the Department's Proprietary fund capital assets for the year ended June 30, 2005:

	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
Improvements Other than Buildings	-	7,250		7,250
Property and Equipment	2,868,014	-	-	2,868,014
Works of Art and Historical Treasures	30,000	-	-	30,000
Total Capital Assets Being Depreciated	22,492,832	7,250	-	22,500,082
Less Accumulated Depreciation:				
Buildings	(4,876,935)	(364,876)	-	(5,241,811)
Property and Equipment	(2,299,497)	(279,037)	-	(2,578,534)
Works of Art and Historical Treasures	(17,750)	(3,000)	-	(20,750)
Total Accumulated Depreciation	(7,194,182)	(646,913)	-	(7,841,095)
Total Capital Assets, Net	$ 16,023,893	$ (639,663)	$ -	$ 15,384,230

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 June 30. 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, 2004 and June 30, 2005:

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
Bonds Issued		60,000,000
Bonds Retired		(140,020,000)
Bonds Payable *(Par)* at June 30, 2005	$	802,125,000

Shown below are the components of net bonds payable as disclosed on the balance sheet for June 30, 2005:

		Current		Noncurrent		Total
Bonds Payable *(Par)*	$	62,690,000	$	739,435,000	$	802,125,000
Premium on Bonds Sold		95,768		98,346		194,114
Discount on Bonds Sold		(58,619)		(766,769)		(825,388)
Net Bonds Payable	$	62,727,149	$	738,766,577	$	801,493,726

The following schedule summarizes future debt service requirements to maturity as of June 30, 2005:

Fiscal Year	***Principal***	***Interest*** [(1)]	***Total***
2006	$ 62,690,000	$ 37,762,693	$ 100,452,693
2007	62,835,000	30,234,851	93,069,851
2008	62,650,000	25,176,738	87,826,738
2009	42,420,000	20,105,074	62,525,074
2010	2,490,000	18,070,139	20,560,139
2011-2015	12,690,000	88,369,317	101,059,317
2016-2020	389,580,000	66,490,595	456,070,595
2021-2025	32,955,000	33,771,424	66,726,424
2026-2030	40,420,000	24,753,429	65,173,429
2031-2035	36,595,000	16,064,681	52,659,681
2036-2040	43,490,000	8,373,061	51,863,061
2041-2043	13,310,000	1,090,575	14,400,575
TOTAL	$ 802,125,000	$ 370,262,577	$ 1,172,387,577

Shown below are the outstanding bond issues and their final maturities *(in fiscal years)* as of June 30, 2005:

		Original Coupon Rates				**Final**
Series	**Dated**	**From**	**To**	**Issued**	**Outstanding**	**Maturity**
LXI (61)	January 1, 1980	7.000	15.000%	300,000,000	80,000,000	2009
LXII (62)	April 1, 1980	8.500	11.250%	300,000,000	70,000,000	2009
LXIII (63)	July 1, 1980	7.300	20.000%	300,000,000	70,000,000	2009
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	12,690,000	2027
76A	April 1, 1997	3.950	6.050%	40,000,000	11,225,000	2029
77	April 1, 1998	3.850	5.300%	40,000,000	21,860,000	2030
78A	March 1, 2000	4.000	5.500%	10,000,000	1,545,000	2024
78B	July 6, 2000	5.800	5.800%	10,000,000	2,370,000	2024
79A	March 1, 2000	4.550	6.000%	22,000,000	8,780,000	2032
80A	August 15, 2000	4.300	5.700%	35,000,000	18,220,000	2033
81	September 1, 2001	5.125	5.250%	60,150,000	40,040,000	2043
82	June 1, 2002	5.375	5.500%	60,000,000	35,395,000	2043
83[(1)]	December 15, 2004	Variable		30,000,000	30,000,000	2040
84[(1)]	June 29, 2005	Variable		30,000,000	30,000,000	2040
Total Bonds Outstanding as of June 30, 2005:					$ 802,125,000	

(1) $370,000,000 of Series 73E,F,G and H; $30,000,000 of Series 83; and $30,000,000 of Series 84 are Variable Demand Rate bonds and are included at an assumed interest rate at June 30, 2005, of 2.26%, 2.50%, and 2.35% respectively. See Note 7 for further information on these bonds.

7. DEMAND BONDS

Series 73

Included in long-term debt at June 30, 2005 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)* on the applicable bonds 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 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, 2005. 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 following the last day of the applicable purchase period. Tender advances could be paid off earlier 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, 2005, the Department is required to pay a yearly commitment fee, which is payable quarterly in arrears, at a rate of 0.15 percent per annum, applied to the purchase commitment discussed above.

The present purchase commitments by the banks will generally remain in effect to the earlier of *(a)* June 30, 2007 for JP Morgan Chase Bank and November 30, 2015 for Bayerische Landesbank *(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 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; or upon the occurrence of an event of default. However, Bayerische Landesbank does have the option to terminate its purchase commitment obligations, at its sole discretion, as of June 30, 2007.

Series 83 and 84

Included in long-term debt at June 30, 2005 is $30,000,000 of State of Oregon, General Obligation, Veterans' Welfare Variable Rate Bonds, Series 83, and $30,000,000 of State of Oregon, General Obligation, Veterans' Welfare Variable Rate Bonds, Series 84. 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 Agent *(Bear, Stearns & Co. Inc.)* on the applicable bonds is authorized to use its best efforts to sell the repurchased bonds at face value by adjusting the interest rate on a weekly basis. The Remarketing Agent for such bonds will determine the interest rate borne by the 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, Dexia Credit Local, will commit to purchase any Series 83 and 84 unremarketed bonds, 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, 2005. 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*) for the time period up to 91 days; at the bank's base rate plus 1% for the time period covering 92 days up to the day before the end of the purchase commitment period; at the bank's base rate plus 2% for the time period thereafter. If the tender advance is in default, interest would accrue at the bank's base rate plus 2.5%. 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 on the earliest to occur of *(a)* the date the applicable bonds are paid in full; *(b)* the conversion date of all or a portion of the applicable bonds to a fixed rate or indexed rate; or *(c)* the effective date of delivery of a substitute alternative liquidity facility. If repayment of any tender advances does not occur within the specified timeframes contained in the SBPA, a default would have occurred.

The bank's present purchase commitment consists of the payment of the purchase price equal to the principal of and up to 34 days of accrued interest calculated at a rate of 12 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 the bank may be reduced from time to time upon occurrence of certain events specified in the SBPA. As of June 30, 2005, the Department is required to pay a yearly commitment fee, which is payable quarterly in arrears, at a rate of 0.125 percent per annum, applied to the purchase commitment defined above.

The present purchase commitment by the bank will generally remain in effect to the earlier of *(a)* June 28, 2010 *(scheduled termination date)*, unless extended at the option of the bank; *(b)* the date in which all of the applicable bonds are no longer outstanding; *(c)* the business day prior to the conversion of all or a portion of the applicable bonds to a fixed or indexed interest rate; (*d)* 30 days following the Department's receipt from the bank of a notice to terminate its purchase commitment arising from an event of default; *(e)* the business day prior to the effective date of delivery of a substitute alternative liquidity facility; *(f)* the date on which the purchase commitment with respect to the applicable bonds has been terminated in accordance with the SBPA; and (g) upon the effective date of an occurrence of a special event of default.

8. SHORT TERM DEBT

The Department entered into a taxable line of credit agreement on September 23, 2004 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, 2005, the Department had no outstanding balance from its taxable line of credit.

9. INTERFUND TRANSACTIONS

At June 30, 2005, the Veterans' Loan Program had outstanding receivables of $494,164, which consisted of $493,755 due from the Veterans' Home Program for allocation of Department expenses related to the operation of the Oregon Veterans' Home and $409 due from the Department's Conservatorship Trust Fund. The Veterans' Home Program had outstanding receivables of $5,405 due from the Veterans' Home Trust Fund related to capital improvements made at the Oregon Veterans' Home. The balances are shown as a "Due from Other Funds" on the Statement of Net Assets.

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.

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.

Oregon Public Employee's Retirement System (PERS)

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. Rates are subject to change as a result of subsequent actuarial valuations. The rate of each covered employee's salary for fiscal year 2005 was 4.71 percent. Employer contributions for the years ending June 30, 2005, 2004, and 2003 were $162,536, $287,918 and $498,200, respectively, equal to the required contributions for each year.

Oregon Public Service Retirement Plan (OPSRP)

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. Rates are subject to change as a result of subsequent actuarial valuations. The rate of each covered employee's salary for fiscal year 2005 was 8.04 percent. Employer contributions for the year ending June 30, 2005 and 2004 were $27,964 and $657, respectively, equal to the required contributions for each 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 years ending June 30, 2005 and 2004 were $207,051 and $249,058, respectively, equal to the required contributions for each year.

11. 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, 2005 and June 30, 2004 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, 2005, the total rental income received from tenants was $523,404. Lease agreements were signed with two tenant agencies in June of 2004 with no change in the lease payment. Each lease term is for three years and expires on June 30, 2007. A new lease with a third tenant agency began in July 2004 and will expire on June 30, 2006. The total future rental income for all three leases is $1,017,612. Future rental income may increase to a higher rental rate due to inflation. The approximate historical cost of this office space is $1,746,230 with a carrying value of $1,034,230 *(historical cost less accumulated depreciation of $712,005)*.

12. 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, 2005 and June 30, 2004 there has been no significant reductions in insurance coverage in any risk category. Also, for the past five fiscal years *(July 1, 2000 through June 30, 2005)* there have been no claims that exceeded the Department's property or liability coverage.

13. SUBSEQUENT EVENTS

The following subsequent event occurred after June 30, 2005:

- On October 1, 2005, the Department called the following general obligation bonds: $1,030,000 of Series 75, $915,000 of Series 76A, $1,105,000 of Series 77, $275,000 of Series 78A, $275,000 of Series 78B, $710,000 of Series 79A, $1,770,000 of Series 80A, and $2,825,000 of Series 81 general obligation bonds.
- On October 19, 2005, the Department issued a notice of redemption for $4,290,000 of Series 82 general obligation bonds that will be called on December 1, 2005.

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OTHER SUPPLEMENTAL SECTION

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Governmental Funds

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

Special Revenue Funds
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, 2005 and JUNE 30, 2004

	General Fund		Special Revenue Fund	
			Veterans' Home Trust	
	June 30, 2005	June 30, 2004	June 30, 2005	June 30, 2004
ASSETS				
Current Assets				
Cash and Cash Equivalents	$ -	$ -	$ 480,023	$ 418,936
Securities Lending Cash Collateral	-	-	84,870	197,212
Receivables:				
Due from State General Fund	139,073	122,981	-	-
Due from Other Funds	-	-	3,210	1,119
Prepaid Items	270	126	-	-
Total Current Assets	139,343	123,107	568,103	617,267
TOTAL ASSETS	$ 139,343	$ 123,107	$ 568,103	$ 617,267
LIABILITIES				
Current Liabilities				
Accounts Payable	$ 139,073	$ 122,981	$ -	$ -
Due to Other Funds/Agencies	-	-	5,405	-
Obligations under Securities Lending	-	-	84,870	197,212
Total Current Liabilities	139,073	122,981	90,275	197,212
TOTAL LIABILITIES	$ 139,073	$ 122,981	$ 90,275	$ 197,212
FUND BALANCES				
Reserved for Prepaid Items	$ 270	$ 126	$ -	$ -
Unreserved, Undesignated Fund Balance	-	-	477,828	420,055
TOTAL FUND BALANCES	$ 270	$ 126	$ 477,828	$ 420,055
TOTAL LIABILITIES AND FUND BALANCES	$ 139,343	$ 123,107	$ 568,103	$ 617,267

Special Revenue Fund		Governmental Funds	
Other Veterans' Trust Accounts		TOTAL	
June 30, 2005	June 30, 2004	June 30, 2005	June 30, 2004
$ 107,221	$ 105,510	$ 587,244	$ 524,446
18,945	49,684	103,815	246,896
-	-	139,073	122,981
-	-	3,210	1,119
-	-	270	126
126,166	155,194	833,612	895,568
$ 126,166	$ 155,194	$ 833,612	$ 895,568
$ -	$ -	$ 139,073	$ 122,981
-	-	5,405	-
18,945	49,684	103,815	246,896
18,945	49,684	248,293	369,877
$ 18,945	$ 49,684	$ 248,293	$ 369,877
$ -	$ -	$ 270	$ 126
107,221	105,510	585,049	525,565
$ 107,221	$ 105,510	$ 585,319	$ 525,691
$ 126,166	$ 155,194	$ 833,612	$ 895,568

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, 2005 and JUNE 30, 2004

	General Fund		Special Revenue Fund Veterans' Home Trust	
	June 30, 2005	June 30, 2004	June 30, 2005	June 30, 2004
Revenues				
Donations	$ -	$ -	$ 112,702	$ 180,371
Interest Income	-	-	11,640	9,004
Other	-	-	-	-
Total Revenues	-	-	124,342	189,375
Expenditures				
Veterans' Services				
Personal Services	763,292	602,655	-	-
Services and Supplies	121,352	69,508	7,446	11,183
Dues and Subscriptions	-	-	685	-
Securities Lending Investment Expense	-	-	2,276	2,048
Other Professional Services	-	-	2,097	-
State Treasury Charges	-	-	-	-
Trust Fund Grants	-	-	-	-
Special Payments	395,643	398,770	-	-
Total Expenditures	1,280,287	1,070,933	12,504	13,231
Other Financing Sources (Uses)				
State Appropriations	1,280,287	1,070,933	-	-
Operating Transfer In from DMV	-	-	17,026	14,644
Operating Transfer In Intra-fund	-	-	-	-
Operating Transfer Out to Veterans Home	-	-	(6,091)	(48,257)
Operating Transfer Out Intra-fund	-	-	(65,000)	(250,000)
Total Other Financing Sources (Uses)	1,280,287	1,070,933	(54,065)	(283,613)
Net Change in Fund Balance	-	-	57,773	(107,469)
Beginning Fund Balance	126	38	420,055	527,524
Change in Reserve for Prepaid Items	144	88	-	-
Ending Fund Balance	$ 270	$ 126	$ 477,828	$ 420,055

Special Revenue Fund		Governmental Funds	
Other Veterans' Trust Accounts		TOTAL	
June 30, 2005	June 30, 2004	June 30, 2005	June 30, 2004
$ 2,500	$ -	$ 115,202	$ 180,371
2,902	1,876	14,542	10,880
-	-	-	-
5,402	1,876	129,744	191,251
-	-	763,292	602,655
-	2,619	128,798	83,310
-	-	685	-
-	427	2,276	2,475
523	-	2,620	-
122	-	122	-
3,046	-	3,046	-
-	9,200	395,643	407,970
3,691	12,246	1,296,482	1,096,410
-	-	1,280,287	1,070,933
-	-	17,026	14,644
-	-	-	-
-	-	(6,091)	(48,257)
-	-	(65,000)	(250,000)
-	-	1,226,222	787,320
1,711	(10,370)	59,484	(117,839)
105,510	115,880	525,691	643,442
-	-	144	88
$ 107,221	$ 105,510	$ 585,319	$ 525,691

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 Original Budget	2003-2005 Final Budget	First Year Actual June 30, 2004	Second Year Actual June 30, 2005	Variance Favorable/ (Unfavorable)
General Fund:					
Veterans' Services Division - Appropriation	$ 2,445,936	$ 2,407,542	$ 944,581	$ 1,265,885	$ 197,076
Total General Fund	$ 2,445,936	$ 2,407,542	$ 944,581	$ 1,265,885	$ 197,076

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 220 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 FIDUCIARY NET ASSETS

FIDUCIARY FUND

JUNE 30, 2005 and JUNE 30, 2004

	Private Purpose Trust Fund	
	Conservatorship Program	
	June 30, 2005	June 30, 2004
ASSETS		
Current Assets		
Cash and Cash Equivalents	$ 22,651,978	$ 22,858,057
Investments	1,954,473	2,440,746
Security Lending Cash Collateral	4,093,794	10,879,045
Receivables:		
Accrued Interest	57,263	24,070
Other	12,281	8,100
Total Current Assets	28,769,789	36,210,018
Noncurrent Assets		
Contract Receivables	45,163	174,056
Conservatorship Real Property	3,404,266	3,615,755
Conservatorship Personal Property	384,582	542,003
Total Noncurrent Assets	3,834,011	4,331,814
TOTAL ASSETS	$ 32,603,800	$ 40,541,832
LIABILITIES		
Current Liabilities		
Due to Other Funds	$ 409	$ 569
Obligations under Securities Lending	4,093,794	10,879,045
Total Current Liabilities	4,094,203	10,879,614
Noncurrent Liabilities		
Mortgages on Conservatorship Real Property	1,582,309	627,784
Total Noncurrent Liabilities	1,582,309	627,784
TOTAL LIABILITIES	5,676,512	11,507,398
NET ASSETS		
Net Assets Held in Trust for Individuals	26,927,288	29,034,434
TOTAL NET ASSETS	$ 26,927,288	$ 29,034,434

UNAUDITED

STATE OF OREGON

DEPARTMENT OF VETERANS' AFFAIRS

STATEMENT OF CHANGES IN

FIDUCIARY NET ASSETS

FIDUCIARY FUND

FOR THE FISCAL YEARS ENDED JUNE 30, 2005 and JUNE 30, 2004

	Private Purpose Trust Fund			
	Conservatorship Program			
		June 30, 2005		June 30, 2004
ADDITIONS				
Contributions:				
Veterans' Benefits	$	7,209,055	$	7,451,382
Investment Income:				
Interest Income		638,021		377,647
Valuation Changes and Redemptions of Investments		(384,778)		247,873
TOTAL ADDITIONS	$	7,462,298	$	8,076,902
DEDUCTIONS				
Veterans' Services: Beneficiary Care	$	9,454,495	$	6,673,587
Securities Lending Investment Expense		114,949		85,911
TOTAL DEDUCTIONS		9,569,444		6,759,498
Net Increase/ (Decrease)		(2,107,146)		1,317,404
CHANGE IN NET ASSETS		(2,107,146)		1,317,404
BEGINNING NET ASSETS		29,034,434		27,717,030
ENDING NET ASSETS	$	26,927,288	$	29,034,434

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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 1996 - 2005

	June 30, 2005	June 30, 2004	June 30, 2003	June 30, 2002
REVENUES				
Mortgage Loan Interest Income	$ 21,225,116	$ 26,789,783	$ 36,742,510	$ 43,749,526
Contract Interest Income	1,188,374	1,698,531	2,535,147	3,522,372
Investment Income (2)	18,013,534	13,338,726	24,675,139	35,956,850
Gain on Sale of Foreclosed Property	139,199	493,409	39,121	172,472
Gain (Loss) on Sale of Investments (2)	-	-	-	-
Loan Cancellation Life Insurance Premiums (3)	2,523,140	2,704,444	3,642,487	-
Loan Cancellation Life Insurance Processing Fees	220,834	425,004	425,004	425,004
Other Fees and Charges	947,834	939,950	1,189,691	1,447,451
Conservatorship Fees	334,340	345,750	364,510	338,136
TOTAL REVENUES	$ 44,592,371	$ 46,735,597	$ 69,613,609	$ 85,611,811
EXPENSES				
Bond Interest Expense	$ 37,103,554	$ 44,537,191	$ 58,066,877	$ 68,560,732
Interest on Taxable Line of Credit	159,267	-	7,500	580,883
Salaries and Other Payroll Expenses	4,793,870	5,875,969	6,838,554	6,974,557
Bond Expenses	1,324,123	1,155,355	909,379	868,243
Securities Lending Investment Expense	2,199,165	1,899,175	630,893	522,316
Real Estate Owned Expense	47,490	52,526	80,757	73,308
Services and Supplies	1,776,839	2,140,262	2,958,497	2,480,268
Claims Expense - Loan Cancellation Life Insurance (3)	4,637,009	4,927,874	5,121,239	-
Depreciation Expense	359,441	408,883	431,391	538,555
Bad Debt Expense	(1,104,080)	(1,656,784)	(1,744,700)	(906,906)
Special Payments	-	-	51,000	-
Other Expenses	170,187	-	210,232	180,045
TOTAL EXPENSES	$ 51,466,865	$ 59,340,451	$ 73,561,619	$ 79,872,001
Income/ (Loss) before Extraordinary or Special Items	$ (6,874,494)	$ (12,604,854)	$ (3,948,010)	$ 5,739,810
Extraordinary or Special items:				
Loss on Extinguishment of Debt	$ -	$ -	$ -	$ -
Gain from Litigation	-	-	-	-
CHANGE IN NET ASSETS	$ (6,874,494)	$ (12,604,854)	$ (3,948,010)	$ 5,739,810
NET ASSETS				
Beginning Net Assets (1)	$ 126,749,827	$ 139,354,681	$ 143,302,691	$ 94,931,080
Prior Period Adjustment	-	-	-	42,556,801
Cumulative Effect of Change in Accounting Principle	-	-	-	75,000
Beginning Net Assets, Restated	$ 126,749,827	$ 139,354,681	$ 143,302,691	$ 137,562,881
Ending Net Assets, Restated	$ 119,875,333	$ 126,749,827	$ 139,354,681	$ 143,302,691

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

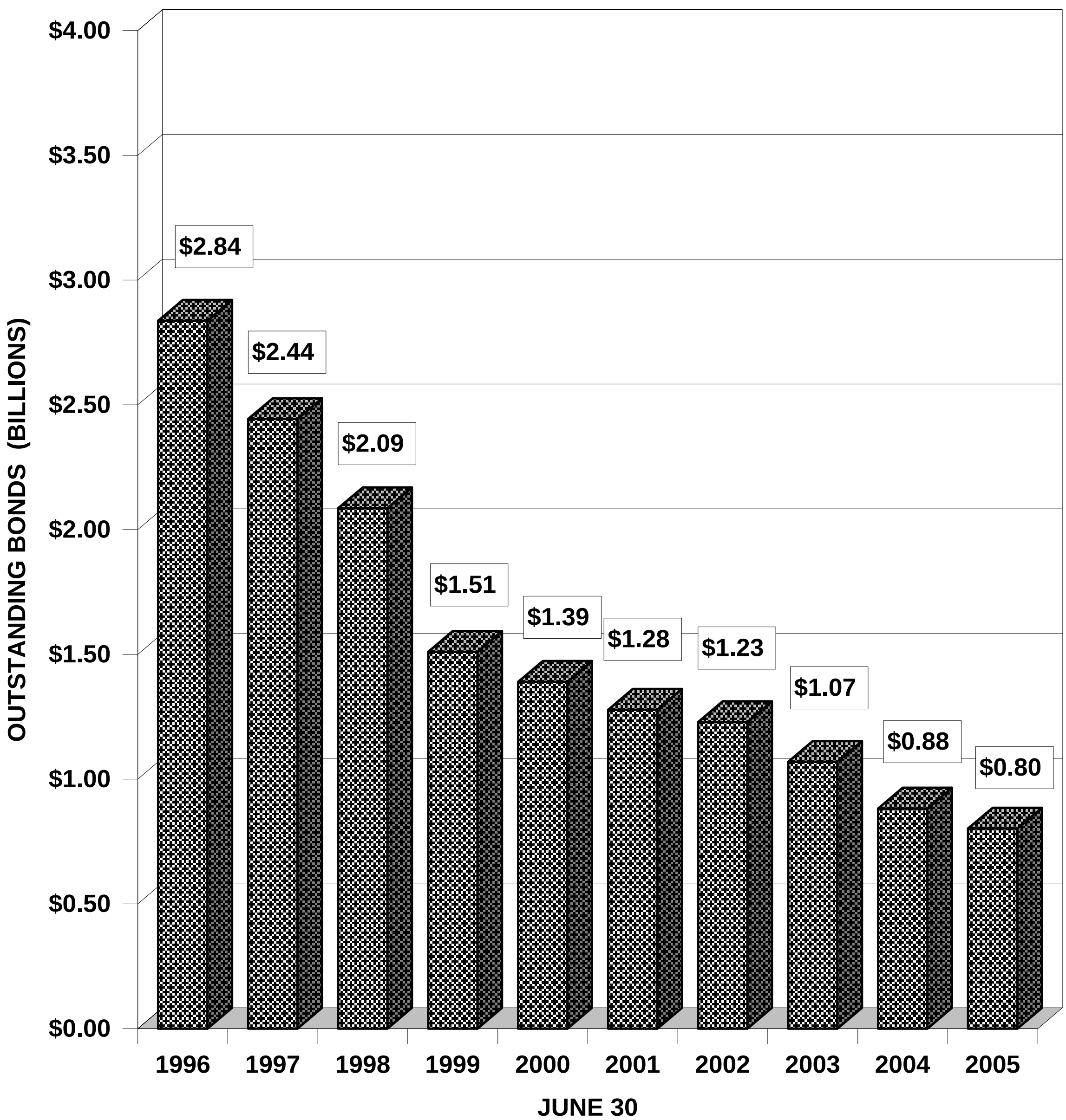
2 Investment income includes change in fair value, as required by GASB Statement 31, beginning in the fiscal year ending June 30, 1998. Gain or loss on sale of investments is not reported under GASB Statement 31.

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, 2001	June 30, 2000	June 30, 1999	June 30, 1998	June 30, 1997	June 30, 1996
$ 50,861,579	$ 57,259,424	$ 68,967,805	$ 84,739,050	$ 101,149,885	$ 119,299,277
4,562,401	5,648,408	7,603,132	10,413,658	13,302,547	16,741,582
57,521,901	38,492,961	48,834,865	80,184,016	88,584,123	91,392,885
9,052	16,892	32,324	106,330	292,921	438,213
-	-	-	-	(771,619)	(1,265,290)
-	-	-	-	-	-
425,004	399,937	327,540	433,763	497,874	561,115
1,342,762	1,402,798	1,055,894	932,092	884,689	742,319
353,417	345,554	322,973	334,784	334,328	335,634
$ 115,076,116	$ 103,565,974	$ 127,144,533	$ 177,143,693	$ 204,274,748	$ 228,245,735
$ 85,455,556	$ 93,957,700	$ 117,276,619	$ 153,677,775	$ 186,918,415	$ 215,402,978
-	-	-	-	-	-
6,932,307	6,886,703	6,829,801	6,952,431	6,958,822	7,374,399
925,722	819,421	952,673	1,478,508	1,774,314	2,310,443
1,156,100	2,006,704	1,607,492	1,588,540	4,656,093	-
57,863	42,230	49,096	50,806	79,340	170,172
2,741,678	2,679,295	3,055,525	3,473,771	3,197,130	3,317,255
-	-	-	-	-	-
453,159	360,840	317,751	338,820	235,128	417,097
(1,078,111)	(1,227,068)	(3,346,273)	(2,934,825)	(3,217,416)	(3,858,097)
-	-	-	-	-	-
74,888	42,749	42,477	53,475	32,406	23,258
$ 96,719,162	$ 105,568,574	$ 126,785,161	$ 164,679,301	$ 200,634,232	$ 225,157,505
$ 18,356,954	$ (2,002,600)	$ 359,372	$ 12,464,392	$ 3,640,516	$ 3,088,230
$ (17,231)	$ (11,888)	$ (12,271,433)	$ (3,870,466)	$ (5,676,618)	$ (10,519,290)
-	-	654,385	-	-	-
$ 18,339,723	$ (2,014,488)	$ (11,257,676)	$ 8,593,926	$ (2,036,102)	$ (7,431,060)
$ 76,591,357	$ 78,605,845	$ 89,863,521	$ 78,681,347	$ 80,717,449	$ 88,148,509
-	-	-	-	-	-
-	-	-	2,588,248	-	-
$ 76,591,357	$ 78,605,845	$ 89,863,521	$ 81,269,595	$ 80,717,449	$ 88,148,509
$ 94,931,080	$ 76,591,357	$ 78,605,845	$ 89,863,521	$ 78,681,347	$ 80,717,449

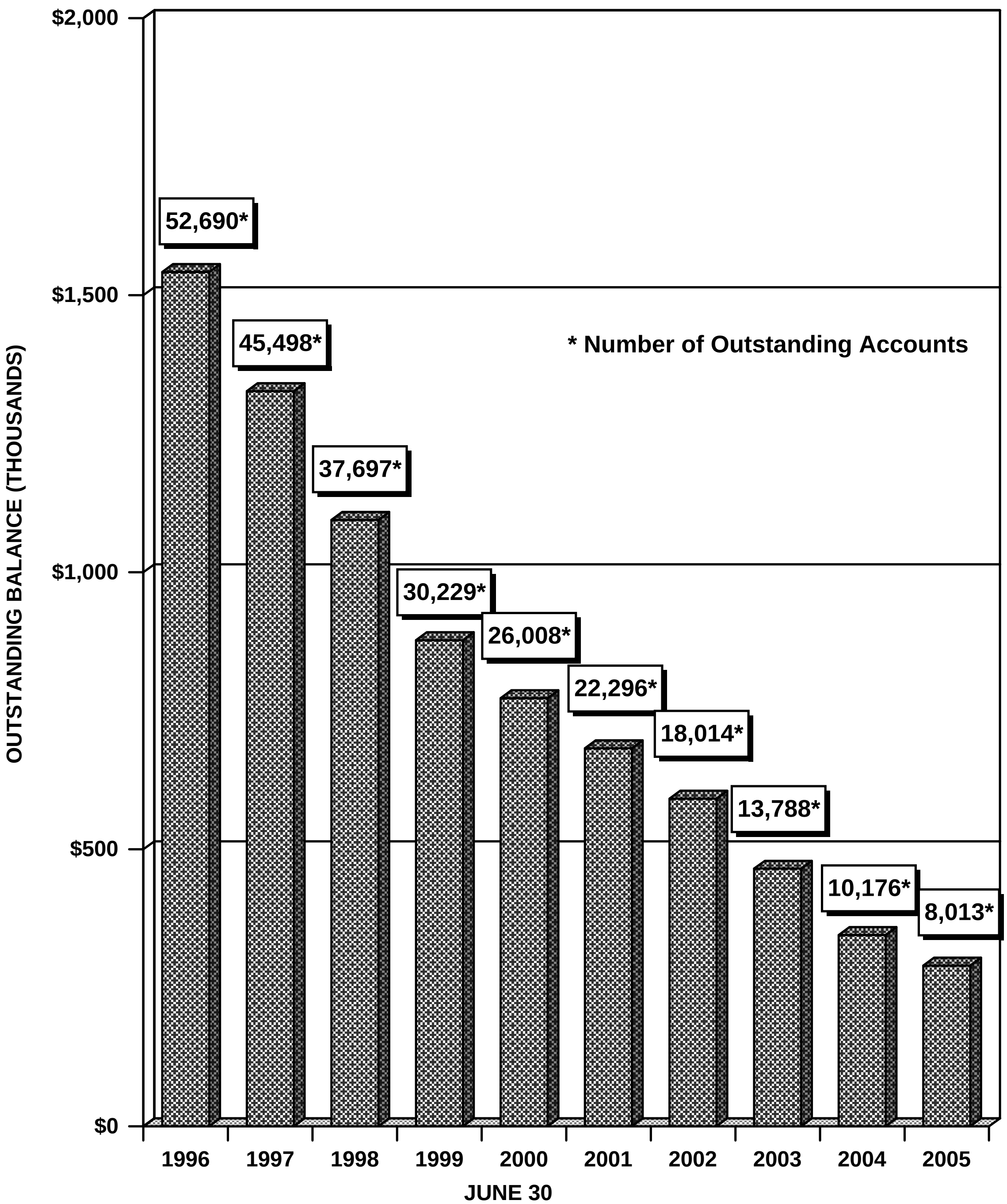
UNAUDITED
OREGON DEPARTMENT OF VETERANS' AFFAIRS

COMPARATIVE SUMMARY OF BONDS OUTSTANDING



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

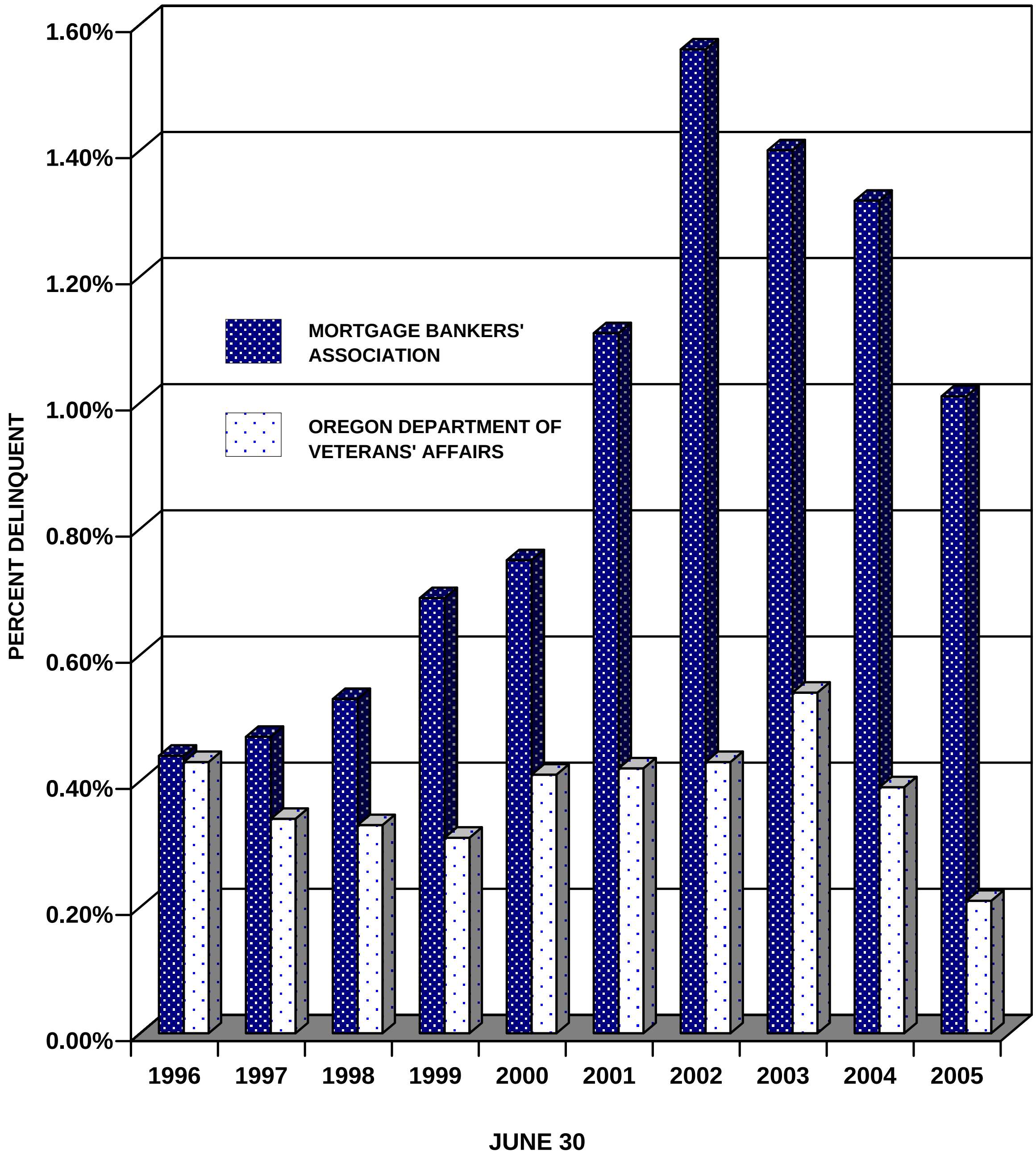
UNAUDITED
OREGON DEPARTMENT OF VETERANS' AFFAIRS
COMPARATIVE SUMMARY OF LOANS AND CONTRACTS OUTSTANDING



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

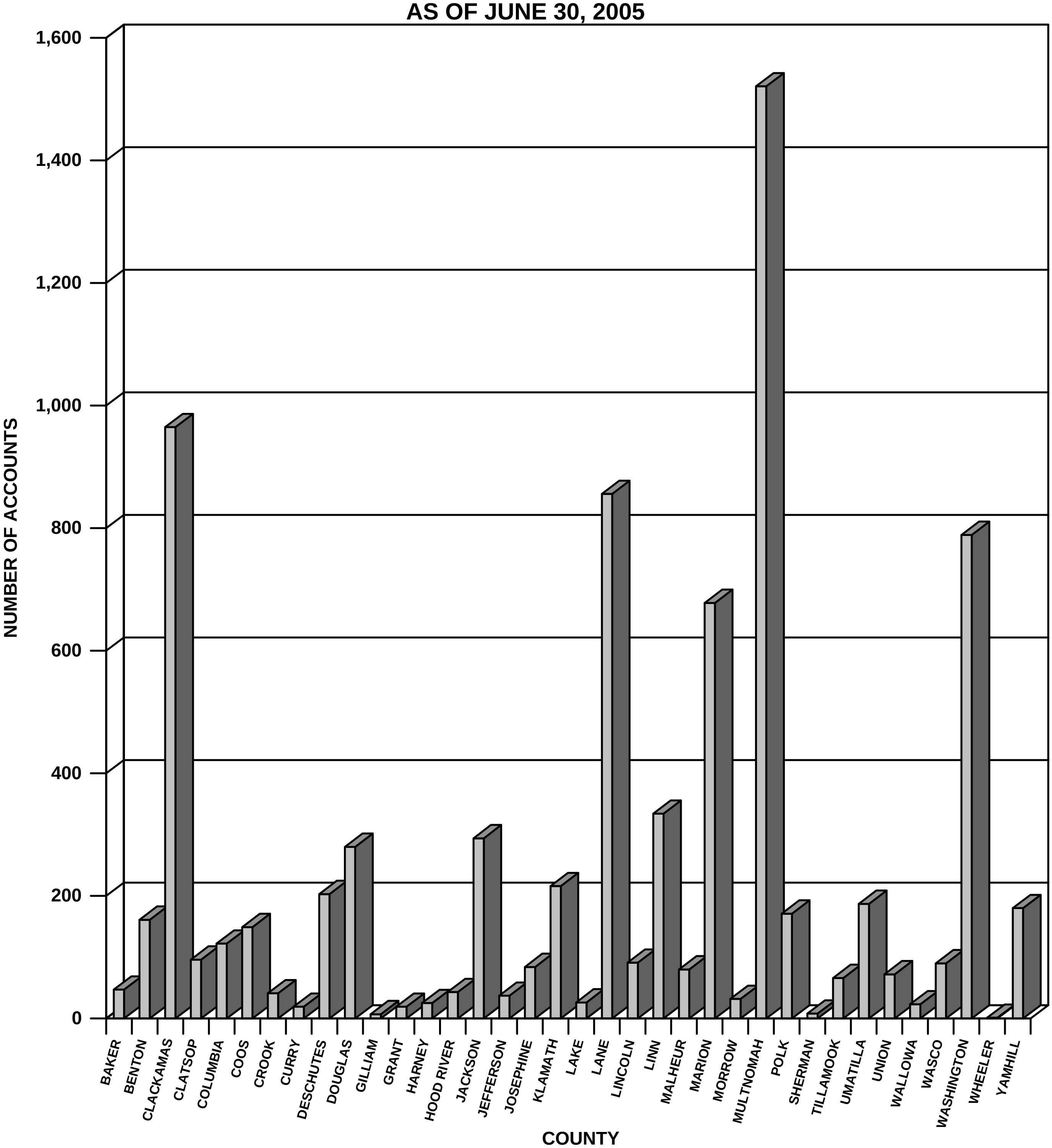


Sources: National Delinquency Survey (Oregon, All Loans) - Mortgage Bankers Association and the Oregon Department of Veterans' Affairs. 90+ Day Delinquencies includes past due loans and loans in foreclosure.

UNAUDITED

OREGON DEPARTMENT OF VETERANS' AFFAIRS

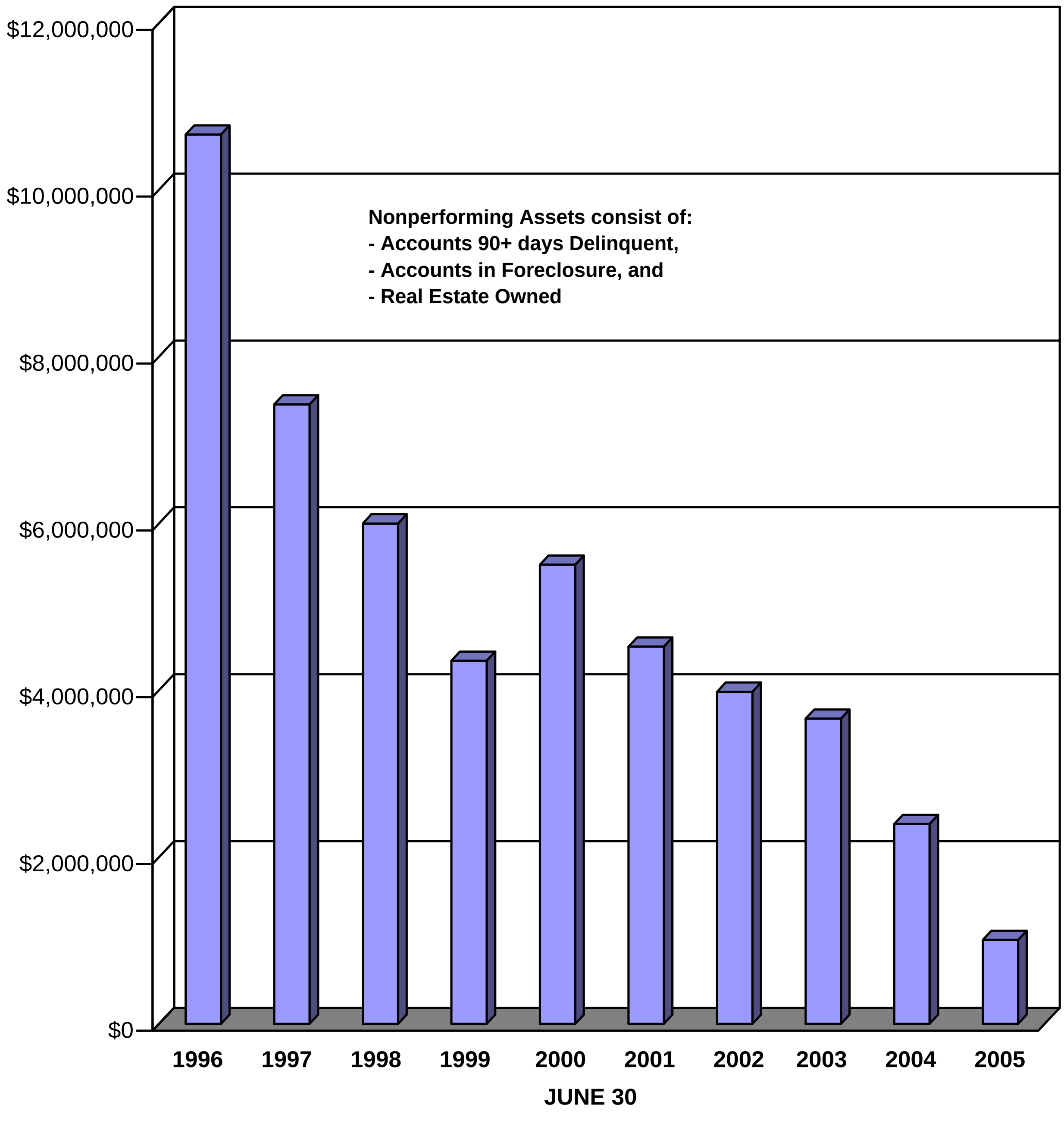
OUTSTANDING LOAN AND CONTRACT ACCOUNTS BY COUNTY AS OF JUNE 30, 2005



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

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

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

We have audited the financial statements of the Oregon Department of Veterans' Affairs (department), as of and for the year ended June 30, 2005, and have issued our report thereon dated October 28, 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. The financial statements of the Oregon Department of Veterans' Affairs as of June 30, 2004, were audited by other auditors whose report dated November 5, 2004, expressed an unqualified opinion on those statements.

<u>Compliance</u>

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, and bylaws, 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 over financial reporting 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 internal control over financial reporting and its operation that we consider 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.

Merina & Company, LLP

Merina & Company, LLP
West Linn, Oregon
October 28, 2005

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
503-373-2373, FAX 503-373-2362, TTY 503-373-2217

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