

Report No. 2008-18

June 9, 2008



Charles A. Hibner, Director, Audits Division

Bill Bradbury, Secretary of State

Secretary of State Audit Report

Enterprise Funds of the
State of Oregon

**Oregon Economic and Community
Development Department**

Special Public Works Fund and Water Fund

For the Fiscal Year Ended June 30, 2007

Office of the Secretary of State

Bill Bradbury
Secretary of State

Jean Straight
Deputy Secretary of State



Audits Division

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This report presents the results of our annual audit of the Oregon Economic and Community Development Department's (department) Special Public Works Fund and Water Fund.

As required by auditing standards, we performed the audit to obtain reasonable assurance about whether the financial statements and accompanying notes have been presented fairly by management. Our Independent Auditor's Report and the financial statements for the fiscal year ended June 30, 2007, are included in the Financial Section of this report. We concluded that the financial statements are fairly presented in accordance with accounting principles generally accepted in the United States of America.

Auditing standards also require us to review internal control and compliance with applicable laws and regulations, contracts, and grant agreements relating to the Special Public Works Fund and the Water Fund. Our report on the results of those reviews is included in the Other Reports section of this report. We noted one instance of noncompliance with applicable laws that is required to be reported under *Government Auditing Standards*. Our consideration of internal control was limited to the scope necessary to achieve our audit objectives and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses as defined by generally accepted auditing standards; however, we did identify a control deficiency that we consider a material weakness in internal control over financial reporting.

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

OREGON AUDITS DIVISION

Charles A. Hibner, CPA
Director

TABLE OF CONTENTS

	<u>Page</u>
FINANCIAL SECTION	
Independent Auditor’s Report.....	3
Basic Financial Statements	
Balance Sheet – June 30, 2007	5
Statement of Revenues, Expenses and Changes in Fund Net Assets – For the Fiscal Year Ended June 30, 2007	7
Statement of Cash Flows – For the Fiscal Year Ended June 30, 2007	8
Notes to the Financial Statements.....	11
OTHER REPORTS	
Report on Internal Control over Financial Reporting and on Compliance and Other Matters.....	23

FINANCIAL SECTION

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INDEPENDENT AUDITOR'S REPORT

We have audited the accompanying basic financial statements of the Special Public Works Fund and Water Fund, enterprise funds of the State of Oregon, Economic and Community Development Department (department), as of and for the year ended June 30, 2007, as listed in the table of contents. These financial statements are the responsibility of the department's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the department's internal control over financial reporting relating to the Special Public Works Fund and Water Fund. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 opinions.

As discussed in Note 1, the financial statements of the Special Public Works Fund and Water Fund, enterprise funds of the State of Oregon, Economic and Community Development Department, are intended to present the financial position, and the changes in financial position and cash flows that are attributable to the transactions of the Special Public Works Fund and Water Fund. They do not purport to, and do not, present fairly the financial position of the department or the State of Oregon as of June 30, 2007, the changes in their financial position and their cash flows for the year 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 respective financial position of the Special Public Works Fund and Water Fund as of June 30, 2007, and the respective changes in financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated May 14, 2008, on our consideration of the internal control over financial reporting relating to the Special Public Works Fund and Water Fund and on our tests of compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit. That report is separately presented in the Other Reports section as listed in the table of contents.

OREGON AUDITS DIVISION

Bill Bradbury
Secretary of State

May 14, 2008

STATE OF OREGON
OREGON ECONOMIC AND COMMUNITY DEVELOPMENT DEPARTMENT
SPECIAL PUBLIC WORKS FUND AND WATER FUND
ENTERPRISE FUNDS
BALANCE SHEET
JUNE 30, 2007

	<u>SPWF</u>	<u>WF</u>	<u>TOTAL</u>
Assets			
Current Assets:			
Cash and Cash Equivalents	\$ 72,253,573	\$ 23,656,819	\$ 95,910,392
Interest Receivable	6,905,016	2,121,221	9,026,237
Due from Other Funds	35,957	11,164	47,121
Total Current Assets	<u>79,194,546</u>	<u>25,789,204</u>	<u>104,983,750</u>
Noncurrent Assets:			
Cash and Cash Equivalents - Restricted	5,807,059	1,789,909	7,596,968
Investments – Restricted	2,887,262	376,979	3,264,241
Deferred Charges	1,998,295	669,452	2,667,747
Advances to Other Funds	-	100,000	100,000
Loans Receivable (net)	264,335,530	84,185,138	348,520,668
Total Noncurrent Assets	<u>275,028,146</u>	<u>87,121,478</u>	<u>362,149,624</u>
Total Assets	<u>\$ 354,222,692</u>	<u>\$ 112,910,682</u>	<u>\$ 467,133,374</u>
Liabilities and Net Assets			
Current Liabilities:			
Accounts Payable	\$ 62,664	\$ 5,850	\$ 68,514
Interest Payable – Bonds	2,656,841	1,319,844	3,976,685
Due to Other Governments	1,726	163,829	165,555
Bonds Payable	6,475,000	2,870,000	9,345,000
Trust Funds Payable	784,351	102,728	887,079
Compensated Absences Payable	57,204	16,982	74,186
Total Current Liabilities	<u>10,037,786</u>	<u>4,479,233</u>	<u>14,517,019</u>
Noncurrent Liabilities:			
Bonds Payable	137,015,888	51,571,145	188,587,033
Trust Funds Payable	199,247	218,285	417,532
Compensated Absences Payable	28,175	8,364	36,539
Total Noncurrent Liabilities	<u>137,243,310</u>	<u>51,797,794</u>	<u>189,041,104</u>
Total Liabilities	<u>147,281,096</u>	<u>56,277,027</u>	<u>203,558,123</u>
Net Assets:			
Restricted for Debt Service	1,936,226	491,116	2,427,342
Restricted for State Gas Tax Eligible Projects	4,716,207	-	4,716,207
Restricted for Infrastructure Projects	2,279,793	326,489	2,606,282
Unrestricted	198,009,370	55,816,050	253,825,420
Total Net Assets	<u>206,941,596</u>	<u>56,633,655</u>	<u>263,575,251</u>
Total Liabilities and Net Assets	<u>\$ 354,222,692</u>	<u>\$ 112,910,682</u>	<u>\$ 467,133,374</u>

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

STATE OF OREGON
OREGON ECONOMIC AND COMMUNITY DEVELOPMENT DEPARTMENT
SPECIAL PUBLIC WORKS FUND AND WATER FUND
ENTERPRISE FUNDS
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

	<u>SPWF</u>	<u>WF</u>	<u>TOTAL</u>
Operating Revenues:			
Loan Interest Income	\$ 11,307,544	\$ 3,999,158	\$ 15,306,702
Interest Income on Cash and Cash Equivalents	2,002,515	1,303,535	3,306,050
Investment Income	175,485	77,692	253,177
Net Increase in the Fair Value of Investments	2,790	428	3,218
Other Income	96,455	-	96,455
Total Operating Revenues	<u>13,584,789</u>	<u>5,380,813</u>	<u>18,965,602</u>
Operating Expenses:			
Salaries and Wages	1,408,176	420,875	1,829,051
Services and Supplies	615,014	142,806	757,820
Special Payments - Grants	1,881,720	882,155	2,763,875
Bad Debt Expense	2,148,249	-	2,148,249
Debt Service	5,616,444	2,787,967	8,404,411
Total Operating Expenses	<u>11,669,603</u>	<u>4,233,803</u>	<u>15,903,406</u>
Operating Income (Loss)	1,915,186	1,147,010	3,062,196
Transfers from Other Funds, Lottery Bond Proceeds	24,762,558	-	24,762,558
Transfers from DEQ	20,000	-	20,000
Transfers from ODOT	4,500,000	-	4,500,000
Transfers from (to) Other Funds	(4,500,000)	(2,406,760)	(6,906,760)
Change in Net Assets	<u>26,697,744</u>	<u>(1,259,750)</u>	<u>25,437,994</u>
Net Assets – Beginning	180,243,852	57,893,405	238,137,257
Net Assets – Ending	<u>\$ 206,941,596</u>	<u>\$ 56,633,655</u>	<u>\$ 263,575,251</u>

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

STATE OF OREGON
OREGON ECONOMIC AND COMMUNITY DEVELOPMENT DEPARTMENT
SPECIAL PUBLIC WORKS FUND AND WATER FUND
ENTERPRISE FUNDS
STATEMENT OF CASH FLOWS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

	<u>SPWF</u>	<u>WF</u>	<u>TOTAL</u>
Cash Flows From Operating Activities:			
Loan Principal Repayments	\$ 12,886,978	\$ 9,344,786	\$ 22,231,764
Loan Interest Received	10,304,707	4,127,538	14,432,245
Payments to Employees for Services	(1,390,609)	(412,311)	(1,802,920)
Payments to Suppliers	(640,851)	(144,246)	(785,097)
Grants Made	(1,992,017)	(738,326)	(2,730,343)
Loans Made	(36,088,952)	(5,745,885)	(41,834,837)
Other Receipts (Payments)	(137,829)	23,403	(114,426)
Net Cash Provided (Used) in Operating Activities	<u>(17,058,573)</u>	<u>6,454,959</u>	<u>(10,603,614)</u>
Cash Flows from Noncapital Financing Activities:			
Proceeds from Bond Sales	35,805,000	-	35,805,000
Principal Payments on Bonds	(6,055,000)	(7,795,000)	(13,850,000)
Interest Payments on Bonds	(5,577,326)	(2,894,358)	(8,471,684)
Bond Issuance Costs	(669,549)	-	(669,549)
Transfers from Other Funds	24,762,558	-	24,762,558
Transfers from DEQ	20,000	-	20,000
Transfers from ODOT	4,500,000	-	4,500,000
Transfers to Other Funds	(4,500,000)	(2,406,760)	(6,906,760)
Net Cash Provided (Used) in Noncapital Financing Activities	<u>48,285,683</u>	<u>(13,096,118)</u>	<u>35,189,565</u>
Cash Flows From Investing Activities:			
Purchases of Investments	(10,416,450)	(1,688,941)	(12,105,391)
Proceeds from Sales and Maturities of Investments	9,764,036	2,175,604	11,939,640
Interest on Investments and Cash Balances	2,173,686	1,381,226	3,554,912
Net Cash Provided (Used) in Investing Activities	<u>1,521,272</u>	<u>1,867,889</u>	<u>3,389,161</u>
Net Increase (Decrease) in Cash and Cash Equivalents	32,748,382	(4,773,270)	27,975,112
Cash and Cash Equivalents – Beginning	45,312,250	30,219,998	75,532,248
Cash and Cash Equivalents – Ending	<u>\$ 78,060,632</u>	<u>\$ 25,446,728</u>	<u>\$ 103,507,360</u>

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

STATE OF OREGON
OREGON ECONOMIC AND COMMUNITY DEVELOPMENT DEPARTMENT
SPECIAL PUBLIC WORKS FUND AND WATER FUND
ENTERPRISE FUNDS
STATEMENT OF CASH FLOWS
FOR THE FISCAL YEAR ENDED JUNE 30, 2007

	<u>SPWF</u>		<u>WF</u>		<u>TOTAL</u>
Reconciliation of operating income to net cash provided (used)					
by operating activities:					
Operating Income (Loss)	\$ 1,915,186	\$	1,147,010	\$	3,062,196
Adjustments to Reconcile Operating Income to Net Cash Provided:					
Amortization of Bond Issuance Costs	114,744		65,305		180,049
Amortization of Bond Premium and Discount	60,905		22,267		83,172
Bad Debt Expense	2,148,249		-		2,148,249
Interest Income Reported as Operating Revenue	(2,180,790)		(1,381,654)		(3,562,444)
Interest Payments Reported as Operating Expense	5,440,795		2,700,395		8,141,190
Net Changes in Assets and Liabilities:					
Accounts and Interest Receivable	(1,002,838)		128,379		(874,459)
Loans Receivable	(23,201,975)		3,598,902		(19,603,073)
Accounts Payable	(960,434)		(272,747)		(1,233,181)
Due to Other Governments	(110,297)		143,829		33,532
Claims and Judgements Payable	(5,892)		(4,638)		(10,530)
Trust Funds Payable	(234,283)		23,403		(210,880)
Compensated Absences Payable	958,057		284,508		1,242,565
Total Adjustments	<u>(18,973,759)</u>		<u>5,307,949</u>		<u>(13,665,810)</u>
Net Cash Provided (Used) by Operating Activities	<u>\$ (17,058,573)</u>	\$	<u>6,454,959</u>	\$	<u>(10,603,614)</u>
Noncash Investing and Capital and Related Financing Activities:					
Net Change in Fair Value of Investments	\$ 2,790	\$	428	\$	3,218
Total Noncash Investing and Capital and Related Financing Activities	<u>\$ 2,790</u>	\$	<u>428</u>	\$	<u>3,218</u>

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

STATE OF OREGON
OREGON ECONOMIC AND COMMUNITY DEVELOPMENT DEPARTMENT
SPECIAL PUBLIC WORKS FUND AND WATER FUND
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2007

1. Summary of Significant Accounting Policies

The accompanying financial statements of the Oregon Economic and Community Development Department's Special Public Works Fund (SPWF) and Water Fund (WF) have been prepared in conformity with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB), the Financial Accounting Standards Board (FASB), and the American Institute of Certified Public Accountants (AICPA). SPWF and WF do not apply FASB pronouncements issued after November 30, 1989, unless GASB amends its pronouncements to specifically adopt FASB pronouncements issued after that date.

a. Reporting Entity

A major focus of the Oregon Economic and Community Development Department (Department) is to help communities plan, design and construct municipally-owned infrastructure such as safe drinking water and wastewater systems and community facilities, and to enhance livability and economic prosperity for Oregon. Good public infrastructure is necessary to support current and future business and jobs. The Department achieves these goals, in part, through the SPWF and the WF programs. These financial statements report the financial activity of the SPWF and WF programs. SPWF and WF are part of the State of Oregon reporting entity and are incorporated in Oregon's comprehensive annual financial report.

SPWF was created on July 1, 1985, as a program of the Intergovernmental Relations Division of the then Executive Department. The program was subsequently transferred to the Department on July 1, 1987. The SPWF program operates under the provisions of sections 285B.410 through 285B.482 of the *Oregon Revised Statutes* (ORS). The SPWF program makes loans and grants to municipalities (cities, counties, ports and certain special districts) for the design and construction of municipally-owned infrastructure needed to support industrial and commercial development.

WF was created in 1993 as a program within the Department. The WF program operates under the provisions of ORS sections 285B.560 through 285B.599. The program is primarily intended to provide funding to municipalities to assist in the compliance with the Safe Drinking Water Act and the Clean Water Act. As a result, the WF program makes loans and grants to municipalities for the construction and improvement of water and wastewater collection systems in order to provide Oregon residents with safe drinking water and appropriate wastewater disposal.

b. Basis of Presentation

SPWF and WF programs are accounted for as Enterprise Funds, a GASB proprietary fund type. Enterprise Funds account for operations financed and operated in a manner similar to private business enterprises.

c. Measurement Focus and Basis of Accounting

All proprietary funds are accounted for on a flow of economic resources measurement focus, and are maintained on the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded at the time related liabilities are incurred. All assets and liabilities associated with the operation of the SPWF and WF are included on the balance sheet. Equity is reported as Net Assets. Proprietary fund statements of revenues, expenses, and changes in fund net assets present increases (e.g. revenues) and decreases (e.g. expenses) in net assets.

SPWF and WF distinguish operating revenues and expenses from non-operating revenues and expenses. All revenue is considered operating revenue, with the exception of transfers from or to other funds. All expenses are considered operating expenses except Gain (Loss) on Disposition of Assets. SPWF and WF program revenues include interest earned on loans for infrastructure projects, interest earned on cash and cash equivalents in cash accounts, and interest earned on investments. Operating expenses include salaries and wages, services and supplies, special payments (infrastructure construction grants) and interest paid on Oregon Bond Bank bonds outstanding. All revenues and expenses not meeting these definitions are reported as non-operating revenues and expenses. SPWF and WF net all internal activity within program funds.

d. Budgetary Accounting

The Oregon Legislature approves the State of Oregon's budgets on a biennial basis. Each biennium, the Legislature allocates Lottery funds and Lottery bond proceeds to the Oregon Community Development Fund (CDF). The Oregon Economic and Community Development Commission reviews and approves a biennial Allocation Plan that establishes biennial targets for allocation within the CDF, which includes the SPWF and WF programs. SPWF and WF program expenditures are monitored against approved budgets, quarterly allotments, and cash balances. Limitations lapse at the end of the biennium. The Emergency Board of the Legislature approves any necessary increases in budgets when the Legislature is not in session. SPWF and WF have continuous spending authority under ORS 285B.455 and 285B.563, respectively.

e. Oregon Bond Bank Discounts, Premiums and Issuance Costs

Bond discounts, premiums and issuance costs for proprietary fund types are deferred and amortized over the term of the bonds using the bonds outstanding method. Bond discounts are presented as a reduction to the face amount of bonds payable, premiums are presented as an addition to the face amount of bonds payable, and underwriter's discount and issuance costs are presented as deferred charges. SPWF and WF do not have any liability for Oregon Bond Bank bond arbitrage. Governmental units SPWF and WF provided financing to are responsible for any arbitrage liability incurred on the bonds.

f. Cash, Cash Equivalents, and Investments (Including Restricted)

Cash and cash equivalents consists of cash on hand, cash in managed or investment pools, cash held by the Treasurer in the Oregon Short-Term Fund, and cash and short term investments held by fiscal agents.

Investments are reported on the financial statements at fair value. Changes in the fair value of investments are recognized as investment income (loss) for the year.

g. Receivables

Interest receivable includes interest due on loans to local governments and special districts. Loans Receivable at June 30 consisted of 359 loans totaling \$348,520,668. An allowance for uncollectible accounts was established to estimate the potential loss from uncollectible loans. Actual loan losses may vary from estimated amounts. (See Note 10 – Subsequent Events for loans being restructured).

h. Compensated Absences

Employees accrue vacation leave at various accrual rates and may generally be paid for up to a maximum of 300 hours of accrued vacation leave at termination. Accumulated vacation leave for employees is recorded as an expense and a liability of the SPWF and WF programs as the benefits accrue to the employee. No liability is recorded for accumulated sick pay benefits.

i. Restricted Assets

Restricted assets consist of:

- Cash and investments held by trustees as security for or payment of SPWF and WF Oregon Bond Bank revenue bonds; and
- Cash held by SPWF and WF consisting of proceeds from bond sales on behalf of governmental units within the State of Oregon. Since these proceeds, and interest earned thereon, will ultimately be disbursed to the

Notes to the Financial Statements (continued)
June 30, 2007

governmental units either as reimbursement for project expenditures or for debt service on the bonds, they are classified as restricted assets.

- SPWF holds \$4.5 million of State Gas Tax Revenues transferred from the Oregon Department of Transportation (ODOT). These funds, plus any interest accruing on them, are restricted to use for SPWF projects meeting the requirements of “State Gas Tax Eligible Projects” as defined by Oregon Revised Statutes, applicable to Gas Tax Revenues uses and approved by ODOT.

In the event both restricted and unrestricted assets are available for expenditure, restricted assets would be expended first.

j. Net Assets

Net Assets are divided into four classifications: Restricted for Debt Service, Restricted for Infrastructure Projects, Restricted to Oregon Gas Tax Eligible projects, and Unrestricted. Restricted for Debt Service is the total of all funds held by the bond trustee until the bond issue is paid in full. Restricted for Infrastructure Projects is un-disbursed proceeds of Oregon Bond Bank sales, which are restricted for specific loans. The department last used Debt Service Reserve funds with the 1996A issue; all subsequent bond issues have been insured.

2. Cash, Cash Equivalents, and Investments

Deposits: As of June 30, 2007, the book balance of cash and cash equivalents was \$103,507,360; the bank balance was \$105,646,841. Monies held in demand accounts with the State Treasurer and amounts invested in the Oregon Short Term Fund (OSTF) totaled \$99,333,653. State Treasurer demand deposit accounts and time certificates of deposit of the Short-Term Fund held in the state banks are insured or collateralized in excess of FDIC coverage for a minimum of 25 percent in accordance with statute. Balances in excess of the FDIC insurance and collateral are considered exposed to custodial risk. Custodial risk for deposits is defined as the risk that, in the event of failure of the bank, the OSTF will be unable to recover the total amount of deposits. Since the OSTF is a pool, the Department’s share of the risk is difficult to estimate. More information on the custodial risk of deposits with the OSTF can be obtained from the OSTF financial statements available from the ‘Current OSTF Financial statement’ link at their website:

<http://www.ost.state.or.us/about/boards/ostf/about.htm>. Copies of the report can also be obtained from the Oregon State Treasury, Finance Division, 350 Winter Street, NE, Suite 100, Salem, Oregon, 97301-3896.

Notes to the Financial Statements (continued)
June 30, 2007

Securities held in the Short-Term Fund are held by Oregon State Treasury's agents in the name of the State of Oregon. Earnings on the Short-Term Fund are allocated on daily balances.

The balance of money market accounts held by the Bank of New York (Oregon Bond Bank trustees) as agents for the department totaled \$4,896,701. The funds held by the Bond Trustee are not held in the department's name, but are held in bondholders' names. Each bondholder is insured by FDIC up to \$100,000. The remaining funds are neither insured, nor collateralized and are thus exposed to custodial credit risk. The Department does not have a deposit policy concerning custodial credit risk.

Investments: The Bond Indentures authorize the department to invest in direct obligations of, or obligations guaranteed by, the United States of America: bonds, debentures, notes, participation certificates, or other similar obligations issued by specified Federal Agencies; and direct and general obligations of, or guaranteed by, the State: investments agreements, secured or unsecured, with any institution whose debt securities are rated at least equal to the then existing rating on the bonds by the rating agencies; and deposit on interest-bearing demand deposits, or certificates of deposit secured by obligations described above. These are permissible investments under State statute. Investment Standards for the State of Oregon are set in ORS 293.726 and require funds to be managed as a prudent investor would do.

Custodial Risk: Investments consisting of \$2,464,625 in explicitly guaranteed U.S. government securities were held by the Trust Department of the Bank of New York (Bond Trustees) as the Department's custodial agent and were not registered in the Department's name or insured. The Department does not have an investment policy concerning Custodial Credit Risk.

Interest Rate Risk: Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. All securities have a maturity of less than one year. The Department does not have an investment policy concerning Interest Rate Risk.

3. Bonds Issued and Outstanding:

As of June 30, 2007, Oregon Bond Bank bonds totaling \$198,135,000 are outstanding. Bonds Payable reported on the balance sheet are recorded net of original issue discounts and premiums. Bond discounts of \$212,441 and bond premiums of \$9,475 are included in Bonds Payable as of June 30, 2007. The following table summarizes the changes in bonds outstanding during fiscal year 2007.

Notes to the Financial Statements (continued)
June 30, 2007

OREGON BOND BANK REVENUE BONDS

Series Issued	Due Dates	Interest Range		Amount Issued	Beginning Balance	Bonds Outstanding			Due Within One Year
		From	To			Increases	Decreases	Ending Balance	
1993 Series A	1994 - 2013	2.80%	5.50%	21,610,000	4,520,000		1,180,000	3,340,000	680,000
1993 Series B	1998 - 2013	5.75%	7.75%	955,000	485,000		55,000	430,000	60,000
1993 Series C	1995 - 2014	3.20%	5.38%	11,815,000	680,000		80,000	600,000	80,000
1994 Series A	1996 - 2015	5.00%	6.00%	5,690,000	3,020,000		265,000	2,755,000	285,000
1995 Series A	1997 - 2016	3.90%	5.75%	4,755,000	385,000		30,000	355,000	30,000
1996 Series A	1998 - 2017	4.10%	5.50%	6,000,000	2,805,000		195,000	2,610,000	210,000
1996 Series One	1997 - 2016	3.50%	5.50%	10,665,000	6,255,000		5,130,000	1,125,000	100,000
1996 Series Two	2000 - 2016	4.20%	5.50%	2,400,000	1,635,000		130,000	1,505,000	135,000
1997 Series A	1999 - 2018	3.95%	5.10%	10,520,000	7,650,000		460,000	7,190,000	505,000
1998 Series A	1999 - 2023	4.25%	5.00%	6,000,000	4,615,000		230,000	4,385,000	235,000
1998 Series B	1999 - 2015	4.10%	4.75%	6,105,000	4,575,000		425,000	4,150,000	445,000
1999 Series A	2000 - 2024	4.25%	5.25%	7,050,000	5,620,000		245,000	5,375,000	255,000
2000 Series A	2001 - 2025	5.25%	5.63%	47,240,000	39,415,000		1,650,000	37,765,000	1,745,000
2000 Series B	2002 - 2026	4.45%	5.50%	34,020,000	28,925,000		1,180,000	27,745,000	1,230,000
2002 Series A	2003 - 2027	3.00%	5.00%	7,850,000	6,545,000		350,000	6,195,000	270,000
2002 Series B	2004 - 2028	3.00%	4.75%	28,825,000	25,675,000		1,120,000	24,555,000	1,135,000
2003 Series A	2005 - 2029	3.00%	4.63%	25,475,000	23,905,000		830,000	23,075,000	850,000
2004 Series A	2006 - 2030	3.00%	4.50%	6,325,000	6,185,000		185,000	6,000,000	185,000
2004 Series B	2006 - 2020	3.00%	5.25%	3,365,000	3,285,000		110,000	3,175,000	115,000
2007 Series A	2008 - 2025	4.00%	4.38%	26,905,000		26,905,000		26,905,000	580,000
2007 Series B	2008 - 2019	5.13%	6.00%	8,900,000		8,900,000		8,900,000	115,000
Total				282,470,000	176,180,000	35,805,000	13,850,000	198,135,000	9,345,000

4. Changes in Long-Term Liabilities:

The following table summarizes the changes in long-term liabilities for activities for the fiscal year ended June 30, 2007:

	Balance 7/01/2006	Additions	Deductions	Balance 6/30/2007	Due within One Year
Trust Funds Payable	\$1,515,491		\$210,880	\$1,304,611	\$887,079
Compensated Absences	87,476	110,725	87,476	110,725	74,186
Bonds:					
Principal	176,180,000	35,805,000	13,850,000	198,135,000	9,345,000
Discount	(237,765)		(25,324)	(212,441)	23,870
Premium	10,483		1,008	9,475	967
Total	\$177,555,685	\$35,915,725	\$14,124,040	\$199,347,370	\$10,322,877

Notes to the Financial Statements (continued)
June 30, 2007

5. Debt Service Requirements to Maturity

The following table summarizes the amounts necessary to pay all future bonded debt principal and interest requirements as of June 30, 2007, for each year during the next five-year period ending June 30, 2012, and in five-year increments for the succeeding periods from July 1, 2013, to June 30, 2032.

Debt Repayment Schedule – Oregon Bond Bank Bonds

Year Ending	Principal	Interest	Total
2008	9,345,000	9,032,969	18,377,969
2009	10,010,000	9,155,959	19,165,959
2010	10,390,000	8,706,009	19,096,009
2011	10,505,000	8,230,396	18,735,396
2012	10,380,000	7,739,300	18,119,300
2013-2017	52,330,000	31,172,411	83,502,411
2018-2022	49,170,000	18,574,123	67,744,123
2023-2027	35,550,000	7,144,106	42,694,106
2028-2032	10,455,000	1,301,630	11,756,630
Total	198,135,000	101,056,904	299,191,904

The interest stated above includes coupon interest the Department expects to pay over the life of the bonds outstanding. Coupon interest is paid semiannually on January 1 and July 1. Bond principal is paid January 1.

6. Debt Defeased in Substance

Due to the advanced refunding in July 1993, five bond issues have been considered to be defeased in substance. Two of these, 1991 Series A and 1991 Series B, were called in January 1999. 1992 Series A was called in January 2000, and 1992 Series B was called in January 2001. The amount of 1992 Series C defeased debt outstanding from the 1993 advanced refunding at June 30, 2007, is \$380,000.

7. 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 members became members of the Individual Account Program (IAP) portion of OPSRP. PERS members retain their existing PERS accounts, but member contributions are now deposited in the member's IAP account, not into the member's PERS account. A copy of the Oregon Public

Notes to the Financial Statements (continued)
June 30, 2007

Employees Retirement System annual financial report may be obtained from Fiscal Services Division, PERS, P.O. Box 23700, Tigard, OR 97281-3700.

Oregon Public Employees Retirement System (PERS)

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

The Department is required by statute to contribute actuarially computed amounts as determined by PERS (the agency). Rates are subject to change as a result of subsequent actuarial valuations. The rate of each covered employee's salary for fiscal year 2007 was 8.69 percent. Employer contributions for the years ending June 30, 2007, 2006, and 2005 were \$98,907, \$75,382, and \$45,033, 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 (the agency). Rates are subject to change as a result of subsequent actuarial valuations. The rate for each covered employee's salary for fiscal year 2007 is 4.43 percent. The amount contributed by the Department for the fiscal years ending June 30, 2007, 2006, and 2005 were \$3,085, \$3,909, and \$2,500, respectively.

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. Covered employees are required by State statute to contribute 6.0 percent of their salary to the plan. State agencies currently pay the 6.0 percent member contribution for their employees. The amounts contributed by the Department for the years ending June 30, 2007, 2006, and

Notes to the Financial Statements (continued)
June 30, 2007

2005, were \$72,468, \$57,342, and \$57,367, respectively, and were equal to the required contributions for the year.

8. Risk Financing

The State of Oregon administers property and casualty insurance programs covering State government through its Insurance Fund. The Insurance Fund services claims for: direct physical loss or damage to state property; tort liability claims brought against the State, its officers, employees or agents; workers' compensation; employee dishonesty; and faithful performance coverage for certain positions 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 entity based on its share of services provided in a prior period. The total statewide coverage assessment is based on independent biennial actuarial forecasts and administrative expenses, less carry-forward or equity in the Insurance Fund.

For the Water Fund and Special Public Works programs, the amount of claim settlements did not exceed insurance coverage for each of the past three years.

9. Commitments

The Department has awarded, but not distributed, \$37.6 million to various WF infrastructure projects and \$44.9 million to SPWF projects within the State of Oregon.

10. Subsequent events

Debt Restructuring:

At the July 2006 Commission meeting, the Commission approved a debt restructuring of six SPWF loans made to an Oregon port. The plan involves allowing the port to make principal-only payments on the loan at a rate that will pay off the loan by its scheduled maturity date and to defer payment of accrued interest. Subsequent to paying off the principal, the port will make payments on the deferred interest so as to pay all deferred interest by 2028. The total amount of loans outstanding at June 30, 2007, affected by this restructuring is \$3,081,850, \$1,230,426 of which are unsecured loans. Included in the loan balance is unpaid interest of \$104,748 that was added to the loan balance and not reported as accrued interest. At June 30, 2007, there is \$523,292 in accrued interest to be paid after loan principal has been repaid.

SPWF loans to Union County and Wallowa County for a golf course and a railroad are being restructured. The unpaid balances of these loans at year end are \$2,307,726 and \$1,821,958, respectively.

A loan to an Oregon port is being considered for restructuring due to an escalating repayment schedule that will exceed their repayment ability. The loan balance at year end is \$556,593.

Notes to the Financial Statements (continued)
June 30, 2007

Bond Call:

The Oregon State Treasurer has called for Optional Redemption of \$20,100,000 of outstanding State of Oregon, Oregon Bond Bank Revenue Bonds Series 2000 A. The redemption is to be effective January 1, 2008. The Bonds will be redeemed at a price of one hundred two percent (102%) of their principal amount, plus accrued interest to January 1, 2008. Interest on all Bonds shall cease to accrue on January 1, 2008.

OTHER REPORTS

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

We have audited the basic financial statements of the Special Public Works Fund and Water Fund, enterprise funds of the State of Oregon, Economic and Community Development Department (department), as of and for the year ended June 30, 2007, and have issued our report thereon dated May 14, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the department's internal control over financial reporting relating to the Special Public Works Funds and Water Fund as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the department's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified a deficiency in internal control over financial reporting that we consider to be a material weakness.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control

deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control. We consider the deficiency described in the accompanying Schedule of Findings and Responses to be a material weakness in internal control over financial reporting. This deficiency is listed as 2007-1.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the financial statements of the department's Special Public Works Fund and Water Fund are free of material misstatement, we performed tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed an instance of noncompliance that is required to be reported under *Government Auditing Standards* and is described in the accompanying Schedule of Findings and Responses. This finding is listed as 2007-2.

The department's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Responses. We did not audit the department's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the department's management, the Economic and Community Development Commission, the Governor of the State of Oregon, and the Oregon Legislative Assembly and is not intended to be and should not be used by anyone other than these specified parties.

OREGON AUDITS DIVISION

Bill Bradbury
Secretary of State

May 14, 2008

Schedule of Findings and Responses

2007-1 Internal Controls Over Financial Reporting

Department management is responsible for establishing and maintaining internal controls that provide reasonable assurance of the reliability of financial reporting. Financial reporting relates to the preparation of financial statements that are fairly presented in conformity with generally accepted accounting principles.

The department's controls over its financial reporting process were not sufficient to prevent or detect several significant errors. When aggregated, these errors would have materially misstated the financial statements if they were not corrected. These errors included:

- underlying spreadsheets that had not been completely updated for the current reporting period, resulting in a misclassification of restricted cash;
- one account that was not included in the financial statements;
- a restriction of net assets that was not disclosed;
- investments that were not valued at market value in accordance with generally accepted accounting principles; and
- amounts in several notes to the financial statements that did not agree with the supporting accounting records.

Once we brought these errors to management's attention, department personnel made adjustments to correct the financial statements and notes.

We recommend department management improve internal controls over financial reporting to prevent errors in the financial statements and accompanying notes, and detect and correct errors in a timely manner.

Agency Response: OECD D generally agrees with the findings indicated. While we believe the department made good overall progress toward ensuring adequate internal controls, we failed to provide adequate staff resources to ensure the quality control for the financial statements. The department will improve internal controls over financial reporting by requiring a peer review of the financials and note disclosures.

The department also believes the duties of the Budget Officer and those of the Fiscal Manager should be mutually exclusive, as they require a completely different skill set. We are evaluating FTE resources to separate the Budget Manager and Fiscal Manager responsibilities. The Fiscal Manager position would be required to have the expertise to provide further review and quality control. The department expects to complete this determination by November 2008.

2007-2 Transfer of Funds out of SPWF

The Special Public Works Fund (SPWF) was created by the Legislature for the primary purpose of providing loans to municipalities for the development and repair of public

infrastructure. Moneys in the SPWF include transfers authorized by the Oregon Economic and Community Development Commission (commission) of Lottery funds and Lottery bond proceeds from the Community Development Fund. The Oregon Economic and Community Development Department (department) is responsible for administering the SPWF and may grant, expend, or loan moneys of the SPWF in accordance with state statute. The commission and the department, like most public bodies, are limited to performing actions specifically authorized by legislation and general laws affecting administrative bodies.

In September 2006, the commission appears to have exceeded its statutory authority when it authorized the department to transfer \$4.5 million from the SPWF to the Community Development Fund, which is also under the authority of the commission and the department. Department staff processed the transfer in October 2006. State statute governing permissible uses of the SPWF does not provide express authority for the commission to transfer money out of the SPWF to the Community Development Fund. Specifically, uses of the SPWF are limited to the following:

- Providing municipalities financial or other assistance the department considers appropriate to assist communities with a project;
- Purchasing goods or services related to a project on behalf of the municipality;
- Providing state funds as a match for federal funds available for the administration of the Community Development Block Grant program;
- Financing administrative costs of the department pursuant to ORS 285B.410 to 285B.482;
- Providing annual grants on behalf of a municipality in the form of partial repayment to bondholders of amounts owed; and
- Covering contracts that are issued to guaranty any portion of the obligation of a municipality to finance a development project and that are not sold to the State of Oregon.

Department management stated that because the commission allocated funds from the Community Development Fund to the SPWF, the commission felt they had the authority to “de-allocate” those funds and transfer them back into the Community Development Fund. Department management, however, was not able to refer us to statutes that support this opinion or to legal advice as evidence of the commission’s authority to de-allocate the funds. We inquired of the Department of Justice on this issue, and they stated that the commission very likely did not have the authority to de-allocate SPWF funds and transfer them into the Community Development Fund.

Although the SPWF received additional funds that essentially offset the transfer authorized by the commission, the commission did not comply with state law when it chose to authorize the transfer of funds from SPWF to the Community Development Fund.

We recommend the commission and department management ensure that they operate within their legal boundaries in conducting business of the SPWF.

Agency Response: The department generally agrees the statute does not provide *express* authority for the commission to transfer money out of SPWF. The department did consult with the Department of Justice and Legislative Fiscal Office (LFO) prior to making the recommendation to the Commission. The department based its decision to move forward with the recommendation to the Commission on LFO's conclusion that the legislature intended for the Commission to have the authority to move community development funds around within its legislatively-approved appropriation.

Finally, the department included a full history of the Commission's actions to de-allocate SPWF funds and transfer them to the Community Development Fund with the request for DOJ review of the agreement authorizing the grant to Wallowa Union Railroad Authority. DOJ concluded that the agreement was approved for legal sufficiency.

The department believes the appropriate action now is to pursue statutory changes to clarify legislative intent of the Commission's authority in the 2009 legislative session.

ABOUT THE SECRETARY OF STATE AUDITS DIVISION

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

Directory of Key Officials

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Deputy Director	William K. Garber, MPA, CGFM
Deputy Director	Mary E. Wenger, CPA

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Geoff Hill, CPA
Brian Nava
Eric Groves
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This report, a public record, is intended to promote the best possible management of public resources. Copies may be obtained from:

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The courtesies and cooperation extended by officials and employees of the Oregon Economic and Community Development Department during the course of this audit were commendable and sincerely appreciated.

Auditing to Protect the Public Interest and Improve Oregon Government

