Report No. 2009-16

July 14, 2009

Kate Brown, Secretary of State　　Gary Blackmer, Director, Audits Division

Secretary of State Audit Report

Enterprise Fund of the State of Oregon

Department of Environmental Quality
Clean Water State Revolving Fund Loan Program

For the Fiscal Year Ended June 30, 2008

Office of the Secretary of State

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811 SW 6th Avenue
Portland, OR 97204-1390

This report presents the results of our audit of the Department of Environmental Quality (department), Clean Water State Revolving Fund (CWSRF) loan program.

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, 2008, are included in the Financial Section of this report. We concluded that the CWSRF 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 over financial reporting and compliance with applicable laws, regulations, contracts, and grant agreements relating to CWSRF. Our report on the results of those reviews is included in the Other Report section of this report. 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. We did identify a control deficiency that we consider to be a significant deficiency 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

Gary Blackmer

Gary Blackmer
Director

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FINANCIAL SECTION

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INDEPENDENT AUDITOR'S REPORT

We have audited the accompanying financial statements of the Clean Water State Revolving Fund (CWSRF) program, an enterprise fund of the State of Oregon, Department of Environmental Quality (department), as of and for the year ended June 30, 2008, 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 related to CWSRF. 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 opinion.

As discussed in Note 1, the financial statements of the CWSRF program, an enterprise fund of the State of Oregon, Department of Environmental Quality, are intended to present the financial position, and the changes in financial position and cash flows that are attributable to the transactions of the CWSRF program. They do not purport to, and do not, present fairly the financial position of the State of Oregon as of June 30, 2008, the changes in its financial position and its 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 financial position of the CWSRF program as of June 30, 2008, and the respective changes in financial position and cash flows thereof 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 June 22, 2009, on our consideration of internal control over financial reporting related to CWSRF and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit. That report is separately presented in the Other Report section as listed in the table of contents.

OREGON AUDITS DIVISION

Kate Brown

Kate Brown
Secretary of State

June 22, 2009

STATE OF OREGON
DEPARTMENT OF ENVIRONMENTAL QUALITY
CLEAN WATER STATE REVOLVING FUND LOAN PROGRAM
ENTERPRISE FUND
BALANCE SHEET
JUNE 30, 2008

	Loan Fund	Administration	TOTAL
Assets			
Current Assets:			
Cash and Cash Equivalents	$ 31,899,293	$ 6,695,461	$ 38,594,754
Loan Interest Receivable	2,633,489	–	2,633,489
Due from Other Funds	–	1	1
Total Current Assets	34,532,782	6,695,462	41,228,244
Noncurrent Assets:			
Loans Receivable	388,530,869	–	388,530,869
Loan Interest Receivable	2,321,074	–	2,321,074
Deferred Expenses	98,960	–	98,960
Total Noncurrent Assets	390,950,903	–	390,950,903
Total Assets	$ 425,483,685	$ 6,695,462	$ 432,179,147
Liabilities and Net Assets			
Current Liabilities:			
Accounts Payable	$ 300	$ 3,985	$ 4,285
Payroll Payable	–	68,804	68,804
Compensated Absences Payable	–	27,566	27,566
Loan Disbursements Payable	2,064,858	–	2,064,858
Due to Other Funds	–	13,806	13,806
Bond Interest Payable	207,958	–	207,958
Bonds Payable	877,419	–	877,419
Total Current Liabilities	3,150,535	114,161	3,264,696
Noncurrent Liabilities:			
Compensated Absences Payable	–	3,440	3,440
Bonds Payable	14,911,969	–	14,911,969
Total Noncurrent Liabilities	14,911,969	3,440	14,915,409
Total Liabilities	18,062,504	117,601	18,180,105
Unrestricted Net Assets:	407,421,181	6,577,861	413,999,042
Total Net Assets	407,421,181	6,577,861	413,999,042
Total Liabilities and Net Assets	$ 425,483,685	$ 6,695,462	$ 432,179,147

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

STATE OF OREGON
DEPARTMENT OF ENVIRONMENTAL QUALITY
CLEAN WATER STATE REVOLVING FUND LOAN PROGRAM
ENTERPRISE FUND
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS
FOR THE FISCAL YEAR ENDED JUNE 30, 2008

	Loan Fund	Administration	TOTAL
Operating Revenues			
Loan Interest Income	$ 11,666,401	$ –	$ 11,666,401
Interest Income on Cash and Cash Equivalents	1,905,587	279,338	2,184,925
Loan Fees	–	1,380,050	1,380,050
Total Operating Revenues	13,571,988	1,659,388	15,231,376
Operating Expenses			
Bond Interest	616,034	–	616,034
Other Bond Costs	7,116	–	7,116
Salaries and Benefits	–	739,460	739,460
Services and Supplies	–	144,192	144,192
Indirect Costs	–	147,043	147,043
Total Operating Expenses	623,150	1,030,695	1,653,845
Operating Income/Change in Net Assets	12,948,838	628,693	13,577,531
Net Assets – Beginning	394,472,343	5,949,168	400,421,511
Net Assets – Ending	$ 407,421,181	$ 6,577,861	$ 413,999,042

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

STATE OF OREGON
DEPARTMENT OF ENVIRONMENTAL QUALITY
CLEAN WATER STATE REVOLVING FUND LOAN PROGRAM
ENTERPRISE FUND
STATEMENT OF CASH FLOWS
FOR THE FISCAL YEAR ENDED JUNE 30, 2008

	Loan Fund	Administration	TOTAL
Cash Flows From Operating Activities:			
Loan Interest Repayments	$ 10,880,404	$ –	$ 10,880,404
Loan Principal Repayments	24,315,809	–	24,315,809
Disbursed to Borrowers	(59,135,735)	–	(59,135,735)
Loan Fees	–	1,380,050	1,380,050
Treasury Interest Credits	1,905,587	279,338	2,184,925
Payments to Suppliers	–	(147,838)	(147,838)
Payments to Employees for Services	–	(726,351)	(726,351)
Other Receipts (Payments)	–	(144,283)	(144,283)
Net Cash Provided (Used) by Operating Activities	(22,033,935)	640,916	(21,393,019)
Cash Flows from Noncapital Financing Activities:			
Proceeds from Bond Issuance	4,762,850	–	4,762,850
Principal Payments on Bonds	(685,000)	–	(685,000)
Interest Payments on Bonds	(582,678)	–	(582,678)
Net Cash Provided by Noncapital Financing Activities	3,495,172	–	3,495,172
Net Increase (Decrease) in Cash and Cash Equivalents	(18,538,763)	640,916	(17,897,847)
Cash and Cash Equivalents – Beginning	50,438,056	6,054,545	56,492,601
Cash and Cash Equivalents – Ending	$ 31,899,293	$ 6,695,461	$ 38,594,754
Reconciliation of Operating Income to Net Cash Provided (Used) by Operating Activities:			
Operating Income	$ 12,948,838	$ 628,693	$ 13,577,531
Adjustments to Reconcile Operating Income to Net Cash Provided (Used) by Operating Activities:			
Interest payments reported as operating expense	582,678	–	582,678
Amortization of Bond Issuance Costs	7,116	–	7,116
Amortization of Bond Discount	10,968	–	10,968
Amortization of Bond Premium	(1,342)	–	(1,342)
Loan Interest Receivable	(785,998)	–	(785,998)
Due from Other Funds	–	(1)	(1)
Loans Receivable	(36,623,085)	–	(36,623,085)
Loan Disbursements Payable	1,803,158	–	1,803,158
Accounts Payable	–	(3,014)	(3,014)
Payroll Payable	–	12,558	12,558
Due to Other Funds	–	2,129	2,129
Interest Payable - Bonds	23,732	–	23,732
Compensated Absences Payable	–	551	551
Total Adjustments	(34,982,773)	12,223	(34,970,550)
Net Cash Provided (Used) by Operating Activities	$ (22,033,935)	$ 640,916	$ (21,393,019)

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

STATE OF OREGON
DEPARTMENT of ENVIRONMENTAL QUALITY
CLEAN WATER STATE REVOLVING FUND LOAN PROGRAM
ENTERPRISE FUND
Notes to the Financial Statements
June 30, 2008

1. Summary of Significant Accounting Policies

Reporting Entity

The Oregon Clean Water State Revolving Fund (CWSRF) was established pursuant to Oregon Revised Statutes 468.423 – 468.440. The purpose of the CWSRF is to provide low interest loans to local governments for constructing wastewater treatment facilities, implementing nonpoint source pollution management plans, and the design and implementation of estuary management plans. The loan repayment period is a maximum of 20 years, and all repayments, including interest and principal, must be credited to the State Revolving Fund.

The CWSRF program is administered by the State of Oregon's Department of Environmental Quality (DEQ). The CWSRF program consists of several funds to record loan and related activity and an administrative fund that collects loan fees and pays the operating costs of the program, and are collectively referred to as the Fund. DEQ's primary responsibilities for the CWSRF include obtaining capitalization grants from the U.S. Environmental Protection Agency (EPA), soliciting potential interested parties for loans, negotiating loan agreements with local communities, reviewing and approving payment requests from loan recipients, monitoring the loan repayments, and conducting inspection and engineering reviews to ensure compliance with all applicable laws, regulations, and program requirements.

DEQ charges the Fund for staff time spent on CWSRF activities, and the Fund pays those expenses from the Administration fund. The charges include the salaries and benefits of the employees, as well as indirect costs allocated to the Fund. The rate of indirect cost is negotiated annually with the EPA.

The Fund financial statements and notes are presented for the U.S. Environmental Protection Agency. The Fund is included in the Oregon basic financial statements as a special revenue fund which uses the modified accrual basis of accounting. Due to differences in reporting methods, there may be differences between the amounts reported in these financial statements and the Oregon basic financial statements.

Measurement Focus and Basis of Accounting

The financial statements for the Fund are presented as an enterprise fund. As such, the Fund is accounted for using the flow of economic resources measurement focus and is maintained on the accrual basis of accounting, in accordance with State policy (OAM 15.40.00). Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded at the time the liabilities are incurred. All revenues and expenses of the Fund are considered to be operating revenues and operating expenses.

All assets and liabilities associated with the operations of the Fund are included on the balance sheet. The State has elected to follow the accounting pronouncements of the Governmental Accounting Standards Board (GASB), as well as statements issued by the Financial Accounting Standards Board on or before November 30, 1989, unless the pronouncements conflict with or contradict GASB pronouncements. The State, however, does not apply FASB pronouncements issued after November 30, 1989.

Cash and Cash Equivalents

All monies of the Fund are deposited with the Office of the State Treasurer, which is responsible for maintaining these deposits in accordance with Oregon law. The Fund considers all such deposits to be cash and cash equivalents. Interest earnings on these deposits are received by the Fund on a monthly basis. The Fund has no other cash deposits or investments.

Loans Receivable

Loans are funded by Federal capitalization grants, State matching funds, general obligation bonds, loan repayments and fund earnings. The SRF monies are disbursed to borrowers on a cost reimbursement basis. When borrowers have incurred qualifying expenses, they request a loan disbursement from the Fund, and at that time a disbursement is made and recorded in the Fund accounting records. Interest begins accruing when funds are disbursed to the borrower. After the project is complete, repayment begins with an interest only payment. Full repayment must be received by the Fund within 20 years of project completion. There is no provision for uncollectible accounts, as all repayments are current. There have been no loan defaults in the program since its inception. It should be noted, however, that there is one borrower that is currently in default of the loan terms and DEQ and the Oregon Department of Justice are working with that borrower to minimize any potential loss to the Fund. There is no provision for loss recorded at June 30, 2008, because there is the expectation of recovery and any future loss amount is not reasonably determinable at this time

Capital Assets

Capital assets are those assets costing $5,000 or more and having a useful life of at least one year, under State policy (OAM 15.60.10). Capital assets must be capitalized and reported in the accounting records at historical cost, and depreciated over the useful life of the asset. The CWSRF loan program currently has no capital assets.

Deferred Expenses

The Deferred Expense that is shown on the Balance Sheet is the cost of issuing the State match bonds sold to raise the required matching for the federal capitalization grants. These expenses consist of bond issuance costs, and are amortized over the life of the bonds using the straight-line method. The $98,960 represents the unamortized costs of three bond issues (1997A, 2000A and 2008A). There is presently no related arbitrage liability.

Compensated Absences

Employees accumulate earned but unused vacation and sick leave benefits. There is no liability for unpaid accumulated sick leave since the State does not pay any amounts when employees separate from State service. A liability for vacation leave (compensated absences) is accrued when incurred in proprietary funds as employees may be paid for up to a maximum of 250 hours of accrued vacation leave upon separation from State service.

2. Cash and Cash Equivalents

On June 30, 2008, the book balance of cash and cash equivalents was $38,594,754 and the bank balance was $38,602,740. All cash in the Fund is deposited in demand accounts with the State Treasurer who is responsible for maintaining and investing the pooled cash balances in accordance with State laws. State Treasurer demand deposit accounts and time certificates of deposit investments of the Short Term Fund held in state banks are insured or collateralized in excess of FDIC coverage for a minimum of 25 percent in accordance with State statute. ORS 295 requires that depository banks pledge securities with a value of at least 25 percent of uninsured or uncollateralized deposits for the benefit of the State. Deposits in excess of FDIC insurance coverage or the 25 percent statutory requirement are considered exposed to custodial credit risk. The State does not have a formal policy regarding custodial credit risk for deposits. The Fund's share of investment income is based on the average daily balance for the period and is credited to the Fund monthly. Details of the investments can be obtained from the State Treasurer's Office.

3. Loans Receivable

The Fund makes loans to qualified entities at interest rates ranging from zero percent to the market rate (see ORS 468.440). Interest rates vary depending on the length of the loan, the type of loan, and program rules (at OAR 340-054). Rates range from 25 percent of the bond rate for 5 year loans to 65 percent of the bond rate for 20 year loans. Recipients make semiannual or, in some cases, annual payments, generally starting six months after project completion. The detail of loans receivable as of June 30, 2008 is as follows:

Total loan disbursements to date:	$569,555,997
Loan Disbursements Payable, June 30, 2008:	2,064,858
Total principal payments received from borrowers:	(183,089,986)
LOANS RECEIVABLE, June 30, 2008:	$388,530,869

It is our belief that during the fiscal year 2009 it will be necessary to create an allowance for an uncollectible account. One borrower is currently in default of its loan terms and we are working with this borrower and the state Department of Justice to try to recover as much on this loan as is reasonably possible. However, we are not confident that the borrower will be able to pay the balance owed. The current outstanding balance on this loan is $198,680, and the amount that may be uncollectible as well as the timing of any collection is still unknown

4. Bonds Payable

In July 2003 EPA agreed to the use of the CWSRF Fund assets to pay the principal and interest on the general obligation bonds that were previously issued by the State to provide the 20 percent state matching funds as required by the Clean Water Act. The following table summarizes bonds outstanding as of June 30, 2008:

General Obligation Pollution Control Bonds

	Original Issue	Interest Range			Bonds Outstanding				
Series	Due Dates	From	To	Amount	Beginning Balance	Increases	Decreases	Ending Balance	Due Within One Year
1997 A	1998 – 2018	3.80%	5.00%	8,000,000	5,350,000	–	370,000	4,980,000	390,000
2000 A	2001 – 2021	4.15%	5.50%	8,000,000	6,410,000	–	315,000	6,095,000	330,000
2008A	2009 – 2028	2.00%	4.50%	4,800,000	–	4,800,000	–	4,800,000	157,419
		Total		20,800,000	11,760,000	4,800,000	685,000	15,875,000	877,419

The bond interest rates noted above differ depending on the term of the individual bond. Thus, those bonds with the longest term yield the highest interest rate.

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, 2008 for each year during the next five-year period ending June 30, 2013, and in five year increments thereafter:

Years Ending June 30	Bond Principal	Bond Interest	Total Debt Service
2009	$ 877,419	$ 738,035	$ 1,615,454
2010	930,323	692,036	1,622,359
2011	973,065	650,499	1,623,564
2012	1,023,226	605,395	1,628,621
2013	1,078,387	556,655	1,635,042
2014-2018	6,280,161	1,929,673	8,209,834
2019-2023	3,109,839	648,825	3,758,664
2014-2018	1,602,581	186,387	1,788,968
Total	$ 15,875,000	$ 6,007,505	$ 21,882,505

5. Changes in Long-Term Liabilities

The liability for compensated absences is calculated based on the vacation accrual as of June 30, 2008 for each employee whose duties normally include SRF related activities. Employees who are not considered to be part of the SRF program, or who perform only occasional benefit to the SRF program, are excluded from this calculation. Data for this calculation is obtained at year end from DEQ's Payroll Department.

Bonds payable includes amounts payable on bonds issued to benefit the SRF fund, and also includes the unamortized amounts of bond discount and/or premium.

Following is a summary of these long-term liabilities:

	Balance at 6/30/2007	Increases	Decreases	Balance at 6/30/2008	Due Within One Year
Bonds Payable	11,760,000	4,800,000	685,000	15,875,000	877,419
Issuance Premium	–	26,848	1,342	25,506	–
Issuance Discount	122,086	–	10,968	111,118	–
Total Bonds Payable	11,637,914	4,826,848	675,374	15,789,388	877,419
Compensated Absences	30,455	28,117	27,566	31,006	27,566
Total Long–Term Liabilities	11,668,369	4,854,965	702,940	15,820,394	904,985

6. Loan Fees

In order to support administration and project management costs, loan fees are assessed on loans originating after 1992. A fee of 0.5 percent is assessed on the outstanding loan principal balance and is collected annually, beginning with the second loan payment. Fees are deposited to a separate Treasury account and will be used only for administrative and project management costs. Also, fees on planning loans are not assessed, in order to encourage Oregon communities to complete more planning.

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). The OPSRP pension plan has two components: the Pension Program (defined benefit) and the Individual Account Program (defined contribution). PERS member contributions go into the Individual Account Program (IAP) portion of OPSRP. PERS members retain their existing PERS accounts, but member contributions are deposited in the member's IAP account, not into the member's PERS account. PERS issues a separate, publicly available financial report that includes audited financial statements and required supplementary information. That report may be obtained by writing to the Fiscal Services Division, Public Employees Retirement System, P.O. 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 (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 2008 was 5.45 percent for the first half-year and 6.54 percent for the second half. Employer contributions for the years ending June 30, 2008, 2007, and 2006 were $28,355, $43,688 and $40,031, respectively, equal to the required contributions for each year.

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

The department is required by statute to contribute actuarially computed amounts as determined by PERS (the agency). Rates are subject to change as a result of subsequent actuarial valuations. The rate of each covered employee's salary for fiscal year 2008 was 8.03 percent. The department now has permanently assigned CWSRF employees hired on or after August 29, 2003 and as such is required to contribute to OPSRP Pension Program. Employer contributions for the year ending June 30, 2008 were $351, equal to the required contribution amount. DEQ was not required to make such contributions for the fiscal years ended June 30, 2006 or June 30, 2007.

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 contributions for their employees. The amount contributed by DEQ for the years ending June 30, 2008, 2007, and 2006 were $28,641, $30,165 and $27,639, respectively, equal to the required contributions for each year.

8. Other Post-Employment Benefit Plans

Department employees may be eligible to participate in health insurance plans and other benefit plans after retirement, collectively known as Other Postemployment Benefits (OPEB). OPEB plans are offered through the Public Employees Retirement System (PERS) and the Public Employees Benefit Board (PEBB).

Retirement Health Insurance Account

The Retirement Health Insurance Account (RHIA) is a cost-sharing multiple-employer OPEB plan established by ORS 238.420. The plan provides a payment of up to $60 toward the monthly cost of health insurance for eligible PERS members. To be eligible for the RHIA subsidy, the member must: (1) have eight years or more of qualifying service in PERS at the time of retirement or receive a disability allowance as if the member had eight years or more creditable service in PERS, (2) receive both Medicare Parts A and B coverage, and (3) enroll in a PERS-sponsored health insurance plan.

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 the fiscal year end June 30, 2008 was 0.37 percent, which is embedded within the total PERS contribution rate.

Retiree Health Insurance Premium Account

The Retiree Health Insurance Premium Account (RHIPA) is a single-employer OPEB plan established by ORS 238.415. The plan provides for payment of the average difference between the health insurance premiums paid by retired state employees, under contracts entered into by the PERS Board, and the health insurance premiums paid by state employees who are not retired. Retired state employees are qualified to receive the RHIPA subsidy if they had eight or more years of qualifying service in PERS at the time of retirement or are receiving a disability pension calculated as if they had eight or more years of qualifying service, but are not eligible for federal Medicare coverage.

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 employee's covered salary for the fiscal year ended June 30, 2008 was 0.10 percent, which is embedded within the total PERS contribution rate. A copy of the Oregon PERS annual financial report may be obtained from Fiscal Services Division, PERS, P.O. Box 23700, Tigard, Oregon 97281-3700.

Public Employees Benefit Board Plan

The Public Employees Benefit Board (PEBB) plan is an agent multiple-employer plan established by ORS 243. The plan offers medical, dental and vision benefits to eligible retired employees. Retired employees not eligible for Medicare are eligible for PEBB coverage if the retiree is receiving a service or disability benefit from PERS or another state system, is eligible to receive a retirement allowance from PERS and has reached the earliest retirement age under ORS Chapter 238, or is eligible to receive a service allowance or pension under any system offered by the state and has attained the earliest retirement age under that system. The PEBB Plan funding policy provides for contributions at amounts sufficient to fund benefits on a pay-as-you-go basis. Active employees do not make contributions. Participating retirees pay their own monthly premiums based on a blended premium rate since retirees are pooled together with active employees for insurance rating purposes. PEBB activity is reported as part of the State of Oregon's annual report and does not issue a separate financial report.

The State of Oregon's liability was $20.3 million for the fiscal year ended June 30, 2008. DEQ's portion of this liability was not specifically identified.

9. Commitments

The CWSRF loan program has active loan agreements in the amount of $233,585,082 as of June 30, 2008, and has disbursed a total of $118,462,817 in cash to these active borrowers. The amount of undisbursed loan commitments is, therefore, $115,122,265.

10. Risk Financing

The State Services Division of the Department of Administrative Services administers property and casualty insurance programs covering State government. It is the policy of the division to minimize purchases of commercial insurance for most of the risks of losses to which the State is exposed, as it believes it is more economical to manage the State's risks internally. For accounting purposes, the division sets aside assets for actuarially forecasted losses in the Insurance Fund, an internal service fund. The Insurance Fund, established under Chapter 278 of the *Oregon Revised Statutes*, services claims for the following kinds of risks: direct physical loss or damage to State property; tort liability claims brought against the State, its officers, employees, or agents; inmate injury; workers' compensation; and employees, elected officials, and members of commissions and boards for honesty and faithful performance. The Insurance Fund is backed by commercial policies, such as an excess property policy with a limit of $400 million and a blanket commercial excess bond with a limit of $20 million. The division purchases commercial insurance for specific insurance needs not covered by the Insurance Fund.

All State agencies, commissions, and boards participate in the Insurance Fund. The division allocates the cost of servicing insurance claims and payments by charging an assessment to each State entity based on its share of services provided in a prior period. The total statewide assessment for each coverage is based on independent biennial actuarial forecasts and division expenses, less any available fund balance in the Insurance Fund from the prior biennium.

The division purchases workers' compensation insurance for the State from SAIF Corporation. The Insurance Fund reimburses SAIF Corporation for the State's workers' compensation claim costs and service fees.

The CWSRF loan program participates in this risk financing program through DEQ, which, as a State agency, is a participant. Settlements have not exceeded insurance coverage in each of the past three years.

OTHER REPORT

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

We have audited the financial statements of the Clean Water State Revolving Fund (CWSRF) program, an enterprise fund of the State of Oregon, Department of Environmental Quality (department), as of and for the year ended June 30, 2008, and have issued our report thereon dated June 22, 2009. 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 CWSRF 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 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 significant deficiency.

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. We consider the deficiency described in the accompanying schedule of findings and responses to be a significant deficiency in internal control over financial reporting.

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.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies, and accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that the significant deficiency described above is not a material weakness.

Compliance and Other Matters

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

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

OREGON AUDITS DIVISION

Kate Brown

Kate Brown
Secretary of State

June 22, 2009

Schedule of Findings and Responses

2008-1 Internal Controls Over Financial Reporting

Department management is responsible for establishing and maintaining internal control over financial reporting relating to the Clean Water State Revolving Fund (CWSRF). Controls over financial reporting help ensure that the CWSRF's financial statements and accompanying note disclosures are complete, accurate and prepared in accordance with generally accepted accounting principles.

As reported in the prior year, we found that the department does not have adequate internal controls over its CWSRF's financial reporting. The department's program staff initiates, authorizes, records and processes year-end adjustments and prepares the CWSRF financial statements without any review procedures being performed of their work prior to submitting the financial statements to the U.S. Environmental Protection Agency. Without an effective review process in place, department management cannot be assured that the CWSRF's financial statements and accompanying note disclosures are complete, accurate and prepared in accordance with generally accepted accounting principles. During the current year audit, we found that the department had omitted a required note disclosure and had improperly classified bond-related costs.

We recommend department management implement adequate review processes over year-end adjustments and financial reporting prior to submitting the CWSRF financial statements to the U.S. Environmental Protection Agency.

Agency's Response: *CWSRF loan program management agrees with this finding. DEQ acknowledges this review was not completed for fiscal year 2008 financial statements. CWSRF loan program staff and our Business Office staff will coordinate to ensure this review process is completed beginning with the CWSRF financial statements for the fiscal year ending June 30, 2009. The CWSRF loan program has already spoken with DEQ Business Office key personnel, and it has been agreed that the Business Office will perform a review of the CWSRF financial statements and accompanying documentation prior to issuance of those financial statements. This should help to ensure that the CWSRF financial statements are fairly stated and are prepared in accordance with accounting principles generally accepted in the United States.*

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.

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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 Department of Environmental Quality during the course of this audit were commendable and sincerely appreciated.

Auditing to Protect the Public Interest and Improve Oregon Government

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