Secretary of State Audit Report

Kate Brown, Secretary of State

Gary Blackmer, Director, Audits Division

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, 2009

2010-21
April 2010

http://www.sos.state.or.us/audits/index.html

Office of the Secretary of State

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The Honorable Theodore R. Kulongoski
Governor of Oregon

Dick Pedersen, Director
Oregon Department of Environmental Quality

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, 2009, are included in the Financial Section of this report. We concluded that the financial statements are fairly presented in accordance with accounting principles generally accepted in the United States of America.

Auditing standards also require us to review the CWSRF program's internal control and compliance with applicable laws and regulations. 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 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, as of and for the year ended June 30, 2009, as listed in the table of contents. These financial statements are the responsibility of the CWSRF program'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 CWSRF program's internal control over financial reporting. 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, 2009, 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, 2009, 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 March 26, 2010, on our consideration of the CWSRF program's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit. That report is separately presented in the Other Report section as listed in the table of contents.

OREGON AUDITS DIVISION

Kate Brown
Secretary of State

March 26, 2010

STATE OF OREGON
DEPARTMENT OF ENVIRONMENTAL QUALITY
CLEAN WATER STATE REVOLVING FUND LOAN PROGRAM
ENTERPRISE FUND
BALANCE SHEET
JUNE 30, 2009

	Loan Fund	Administration	TOTAL
Assets			
Current Assets:			
Cash and Cash Equivalents	$ 14,048,884	$ 6,970,111	$ 21,018,995
Loan Interest Receivable, Net	2,526,468	–	2,526,468
Total Current Assets	16,575,352	6,970,111	23,545,463
Noncurrent Assets:			
Loans Receivable, Net	438,272,058	–	438,272,058
Loan Interest Receivable, Net	5,423,046	–	5,423,046
Deferred Charges	91,879	–	91,879
Total Noncurrent Assets	443,786,983	–	443,786,983
Total Assets	$ 460,362,335	$ 6,970,111	$ 467,332,446
Liabilities and Net Assets			
Current Liabilities:			
Accounts Payable	$ –	$ 18,650	$ 18,650
Payroll Payable	–	79,948	79,948
Compensated Absences Payable	–	36,950	36,950
Loan Disbursements Payable	2,713,801	–	2,713,801
Due to Other Funds	–	16,125	16,125
Bond Interest Payable	195,195	–	195,195
Bonds Payable, Current Portion	930,323	–	930,323
Total Current Liabilities	3,839,319	151,673	3,990,992
Noncurrent Liabilities:			
Compensated Absences Payable	–	3,020	3,020
Bonds Payable, Net of Current Portion	13,991,271	–	13,991,271
Total Noncurrent Liabilities	13,991,271	3,020	13,994,291
Total Liabilities	17,830,590	154,693	17,985,283
Unrestricted Net Assets:	442,531,745	6,815,418	449,347,163
Total Net Assets	442,531,745	6,815,418	449,347,163
Total Liabilities and Net Assets	$ 460,362,335	$ 6,970,111	$ 467,332,446

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, 2009

	Loan Fund	Administration	TOTAL
Operating Revenues			
Loan Interest	$ 12,880,228	$ –	$ 12,880,228
Interest Income on Cash and Cash Equivalents	466,926	138,919	605,845
Loan Fees	–	1,389,799	1,389,799
Total Operating Revenues	13,347,154	1,528,718	14,875,872
Operating Expenses			
Bond Interest	734,899	–	734,899
Other Bond Costs	7,118	–	7,118
Salaries and Benefits	–	937,437	937,437
Services and Supplies	–	168,493	168,493
Indirect Costs	–	185,231	185,231
Bad Debt Expense	159,515	–	159,515
Total Operating Expenses	901,532	1,291,161	2,192,693
Operating Income	12,445,622	237,557	12,683,179
Non-Operating Revenues			
Federal Grants	22,664,942	–	22,664,942
Total Non-Operating Revenues	22,664,942	–	22,664,942
Change in Net Assets	35,110,564	237,557	35,348,121
Net Assets – Beginning	407,421,181	6,577,861	413,999,042
Net Assets – Ending	$ 442,531,745	$ 6,815,418	$ 449,347,163

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, 2009

	Loan Fund	Administration	TOTAL
Cash Flows From Operating Activities:			
Repayments From Loan Interest	$ 9,885,277	$ –	$ 9,885,277
Repayments From Loan Principal	25,015,242	–	25,015,242
Disbursements to Borrowers	(74,267,003)	–	(74,267,003)
Receipts From Loan Fees	–	1,389,799	1,389,799
Receipts From Treasury Interest Credits	466,925	138,919	605,844
Payments to Vendors	–	(153,672)	(153,672)
Payments to Employees	–	(917,330)	(917,330)
Payments for Indirect Cost	–	(183,066)	(183,066)
Net Cash Provided (Used) by Operating Activities	(38,899,559)	274,650	(38,624,909)
Cash Flows from Noncapital Financing Activities:			
Federal Grants	22,664,942	–	22,664,942
Bond Costs	(338)	–	(338)
Principal Payments on Bonds	(877,419)	–	(877,419)
Interest Payments on Bonds	(738,035)	–	(738,035)
Net Cash Provided (Used) by Noncapital Financing Activities	21,049,150	–	21,049,150
Net Increase (Decrease) in Cash and Cash Equivalents	(17,850,409)	274,650	(17,575,759)
Cash and Cash Equivalents – Beginning	31,899,293	6,695,461	38,594,754
Cash and Cash Equivalents – Ending	$ 14,048,884	$ 6,970,111	$ 21,018,995
Reconciliation of Operating Income to Net Cash Provided (Used) by Operating Activities:			
Operating Income (Loss)	$ 12,445,622	$ 237,557	$ 12,683,179
Adjustments to Reconcile Operating Income to Net Cash Provided (Used) by Operating Activities:			
Bond Interest Payments Reported as Operating Expense	738,035	–	738,035
Amortization of Bond Costs	7,118	–	7,118
Amortization of Bond Discount	10,968	–	10,968
Amortization of Bond Premium	(1,342)	–	(1,342)
Loan Interest Receivable	(2,994,952)	–	(2,994,952)
Loans Receivable	(49,741,189)	–	(49,741,189)
Loan Disbursements Payable	648,943	–	648,943
Accounts Payable	–	14,666	14,666
Payroll Payable	–	11,144	11,144
Due to Other Funds	–	2,319	2,319
Bond Interest Payable	(12,762)	–	(12,762)
Compensated Absences Payable	–	8,964	8,964
Total Adjustments	(51,345,181)	37,093	(51,308,088)
Net Cash Provided (Used) by Operating Activities	$ (38,899,559)	$ 274,650	$ (38,624,909)

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, 2009

1. Summary of Significant Accounting Policies

The accompanying financial statements of the State of Oregon Department of Environmental Quality 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).

A. 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 Annual Financial Report is prepared for the U.S. Environmental Protection Agency as an Enterprise Fund of the State of Oregon, which uses the accrual basis of accounting. For the purpose of the State of Oregon's Comprehensive Annual Financial Report (CAFR), the Fund is included as a Governmental Fund – Special

Revenue. Due to differences in basis of accounting, there may be differences between the amounts reported in these financial statements and the State of Oregon's CAFR.

B. Basis of Presentation – Fund Accounting

DEQ programs and accounts are organized by "funds", each of which is a separate accounting entity. Each major program utilizes a separate set of self-balancing accounts to record the assets, liabilities, net assets, revenues and expenses of their activities. DEQ's CWSRF loan program is classified as a proprietary fund. Proprietary funds contain two types of funds: Enterprise Funds and Internal Service Funds. The CWSRF loan program is accounted for in an Enterprise Fund. Enterprise Funds account for operations that are financed and operated in a manner similar to private business enterprises.

C. Measurement Focus and Basis of Accounting

The basic 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, regardless of the timing of the related cash flow. All revenues and expenses of the Fund are considered to be operating revenues and operating expenses, with the exception of grant income which is considered to be non-operating revenue. 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.

D. 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.

E. Loans Receivable

Loans are funded by Federal capitalization grants, State matching funds, general obligation bonds, loan repayments and fund earnings. The CWSRF 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. As of June 30, 2009, the allowance for doubtful accounts is zero; however, the balance of one non-performing loan was charged to the allowance account and subsequently written off as a bad debt expense in the amount of $159,515. Management believes this was an isolated occurrence as historical evidence indicates that defaults are unusual and infrequent. Therefore the allowance account has been left at zero, as there is no reasonable evidence to assume other borrowers will default.

F. 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.

G. Deferred Charges

The Deferred Charges 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 $91,879 represents the unamortized issuance costs of three bond issues (1997A, 2000A and 2008A). There is presently no related arbitrage liability.

H. Long-Term Obligations

Long term obligations of the Fund consist of bonds issued to provide the required State matching funds for the federal capitalization grants, and the non-current portion of compensated absences. Bonds issued on behalf of the CWSRF are reported on the Balance Sheet net of the related premium and/or discount. Bond premium, discount and issuance costs are amortized over the life of the bond issues. Bond premium and discount are reported in the Statement of Revenues, Expenses and Changes in Fund Net Assets as bond interest expense. Bond issuance costs are reported as Other Bond Costs.

I. 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, 2009, the book balance of cash and cash equivalents was $21,018,995 and the bank balance was $21,011,266. The Office of the State Treasurer maintains the Oregon Short-Term Fund (OSTF), an investment pool available for use by state agencies and local governments. The Fund uses the OSTF for all deposits.

A bank depository that holds public fund deposits in excess of amounts insured or guaranteed is required to pledge collateral with a value at least equal to its maximum liability and as otherwise prescribed in ORS 295.001 to 295.108. The maximum liability for a well capitalized bank depository is 10 percent of the greater of: all public funds held by the bank depository as shown on the most recent treasurer report; the average of the balances of public funds held by the bank depository as shown on the last four immediately preceding treasurer reports; or an amount otherwise prescribed in ORS 295.001 to 295.108. The maximum liability for an adequately capitalized bank depository is 25 percent of the greater of: all public funds held by the bank depository as shown on the most recent treasurer report; the average of the balances of public funds held by the bank depository as shown on the last four immediately preceding treasurer reports; or an amount otherwise prescribed in ORS 295.001 to 295.108. The maximum liability for an undercapitalized bank depository is 110 percent of the greater of: all public funds held by the bank depository or the average of the balances of public funds held by the bank depository as shown on the last four immediately preceding treasurer reports. In addition, the State Treasurer may require any bank depository that holds public funds to pledge collateral with a value not less than 110 percent of the greater of all public funds held by the bank depository or the average of the balances of public funds held by the bank depository as shown on the last four immediately preceding treasurer reports.

All deposits in the OSTF are with financial institutions participating in the FDIC's Transaction Account Guarantee Program. Under that program, through December 31, 2009, all noninterest-bearing transaction accounts are fully guaranteed by the FDIC for the entire amount in the account. Coverage under the Transaction Account Guarantee Program is in addition to and separate from the coverage available under the FDIC's general deposit insurance rules. Consequently, the bank balance of the OSTF at June 30, 2009 is fully insured.

The custodial credit risk for deposits is the risk that, in the event of a bank failure, the State Treasurer will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. The Fund does not have a policy regarding custodial credit risk for deposits; however, the insurance and collateral requirements for deposits in the OSTF are established by banking regulations and Oregon law.

Further details of the investments and a copy of the OSTF audited annual financial report may be obtained by writing to the Oregon State Treasury, 350 Winter Street NE, Suite 100, Salem, Oregon 97301-3896 or located at the following website: http://www.ost.state.or.us/About/Investment/Default.asp#OSTF.

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% of the bond rate for 5 year loans to 65% 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, 2009 is as follows:

Total Loan Disbursements, To Date	$ 643,823,000
Loan Disbursements Payable, 6/30/2009	2,713,801
Less: Total Principal Repayments	(208,105,228)
Less: Uncollectible Balances	(159,515)
Total Loans Receivable, 6/30/2009	$ 438,272,058

The Department determined that the remaining amount owed on one of its loans was not collectible as the borrower was in default, and, as such, should be removed from the amount shown above as Loans Receivable. The amount of this loan was originally $228,499 and principal payments totaling $68,984 have been received from this borrower, leaving an outstanding balance of $159,515. Repayment of the remaining $159,515 balance is not reasonably expected, and thus the CWSRF loan program created an allowance for the amount, and subsequently wrote off the amount at year end. As of June 30, 2009, the allowance account balance was zero. Charges made to the allowance account and then written off totaled $159,515. For the year then ended June 30, 2009, bad debt expense totaled $159,515.

During the fiscal year, one borrower requested a modification of their loan agreement. Management does not believe the request for modification requires an allowance or indicates an impairment of loan receivable, as the borrower has no prior history of default with the Department. Principal payments have been cut in half for a temporary period beginning December 1, 2008 and ending June 1, 2012. Remaining principal payments under the modification are larger, as the life of the loan and the amount borrowed remain unchanged. However, the Department will receive additional interest and fee income as a result of the modification.

4. Bonds Payable

In July 2003, EPA agreed to the use of the CWSRF Fund assets to pay the principal and interest on 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, 2009:

General Obligation Pollution Control Bonds

	Original Issue				Bonds Outstanding				
Series	Due Dates	Interest	Range	Amount	Beginning Balance	Increases	Decreases	Ending Balance	Due Within One Year
1997 A	1998 – 2018	3.80%	5.00%	$8,000,000	$4,980,000		$390,000	$4,590,000	$410,000
2000 A	2001 – 2021	4.15%	5.50%	8,000,000	6,095,000		330,000	5,765,000	350,000
2008A	2009 – 2028	2.00%	4.50%	4,800,000	4,800,000		157,419	4,642,581	170,323
		Total		$20,800,000	$15,875,000		$877,419	$14,997,581	$930,323

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

The following table summarizes the amounts necessary to pay all future bonded debt principal and interest requirements as of June 30, 2009 for each year during the next five-year period ending June 30, 2014, and in five year increments thereafter.

Years Ending June 30	Bond Principal	Bond Interest	Total Debt Service
2010	$ 930,323	$ 692,036	$ 1,622,359
2011	973,064	650,499	1,623,563
2012	1,023,226	605,395	1,628,621
2013	1,078,387	556,655	1,635,042
2014	1,128,548	504,863	1,633,411
2015 - 2019	5,961,452	1,628,552	7,590,004
2020 - 2024	2,591,613	562,141	3,153,754
2025 - 2028	1,310,968	121,319	1,432,287
TOTALS:	$ 14,997,58	$ 5,321,460	$ 20,319,041

5. Changes In Long-Term Liabilities

The liability for compensated absences is calculated based on the vacation accrual at June 30, 2009, for each employee whose duties include CWSRF related activities. 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 CWSRF fund, and also includes the unamortized amounts of bond discount or premium.

The long term liability activity for the year ended June 30, 2009 was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance	Due Within One Year
Bond Principal	$15,875,000	$ -	$ 877,419	$14,997,581	$ 930,323
Issuance Premium	25,506	-	1,343	24,163	-
Less: Issuance Discount	(111,118)	-	(10,968)	(100,150)	-
Total Bonds Payable	15,789,388	-	867,794	14,921,594	930,323
Compensated Absences	31,006	36,530	27,566	39,970	36,950
Long Term Liabilities	$15,820,394	$ 36,530	$ 895,360	$14,961,564	$ 967,273

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 Oregon Public Employees Retirement System (PERS) provides retirement plans for the Fund's employees. PERS is administered by the Public Employees Retirement Board under the guidelines of Oregon Revised Statutes, as required by ORS chapter 238 and 238A. PERS issues a separate, publicly available, audited annual financial report that may be obtained from the Fiscal Services Division, Public Employees Retirement System, P.O. Box 23700, Tigard, Oregon 97281-3700.

<u>PERS Pension</u>
The Fund'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 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 Fund is required by State 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 2009 was 6.54%. Employer contributions for the years ending June 30, 2009, 2008, and 2007 were $34,768, $28,355 and $43,688, respectively, equal to the required contributions for each year.

Public employees hired on or after August 29, 2003, become part of OPSRP, unless membership was previously established in the Oregon Public Employees 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.

<u>Oregon Public Service Retirement Plan (OPSRP)</u>
The 2003 Oregon Legislature created the Oregon Public Service Retirement Plan (OPSRP), also a cost-sharing multiple-employer defined benefit pension plan. The Pension Program is administered by the Public Employees Retirement Board under the guidelines of Oregon Revised Statutes, chapter 238A. The OPSRP pension plan has two components: the Pension Program (defined benefit) and the Individual Account Program (defined contribution). Employees hired after August 28, 2003, participate in OPSRP after completing six months of service. The Pension Program provides a monthly pension benefit is payable for life as well as death and disability benefits as established by ORS Chapter 238A.
The Fund 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 2009 was 8.03%. The Fund has permanently assigned CWSRF employees, hired after August 28, 2003, and therefore is required to contribute to OPSRP Pension Program. Employer contributions for the years ending June 30, 2009 and 2008 were $6,405 and $351, respectively, equal to the required contribution amount. The Fund was not required to make such contributions for the fiscal year ended June 30, 2007.

Beginning January 1, 2004, PERS members became part 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. All covered employees are required by State statute to contribute 6% of their salary to the plan. Current law permits State agencies to pay the 6% member contributions for their employees. The amount contributed by DEQ for the years ending June 30, 2009, 2008, and 2007 were $36,683, $28,641 and $30,165, respectively, equal to the required contributions for each year.

8. Other Post Employment Benefit Plans

The Fund's 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) as established by ORS 238 and the Public Employees Benefit Board

(PEBB) as established by ORS 243. A copy of the audited annual financial report may be obtained from Fiscal Services Division, Public Employees Retirement System, P.O. Box 23700, Tigard, Oregon 97281-3700.

Retirement Health Insurance Account

The Retirement Health Insurance Account (RHIA) is a cost-sharing multiple-employer OPEB plan which 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 Fund 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, 2009 was 0.37%, which is embedded within the total PERS contribution rate. Combined employer contributions for the years ended June 30, 2009, and 2008, were approximately $288, and $212, respectively, equal to the required contributions each year. The Fund was not required to make such contributions for the fiscal year ended June 30, 2007.

The Oregon Legislature has the sole authority to amend the benefit provisions and funding policy for the RHIA plan.

Retiree Health Insurance Premium Account

The Retiree Health Insurance Premium Account (RHIPA) is a single-employer OPEB plan that 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 Fund 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, 2009 was 0.10%, which is embedded within the total PERS contribution rate. The Fund's actual contribution for the year ended June 30, 2009, and 2008, was approximately $78 and $57, respectively, which was equal to the actuarial required contribution. The Fund was not required to make such contributions for the fiscal year ended June 30, 2007.

The Oregon Legislature has the sole authority to amend the benefit provisions and funding policy for the RHIPA plan.

Public Employees Benefit Board Plan

The Public Employees Benefit Board (PEBB) plan is an agent multiple-employer plan which offers medical, dental and vision benefits to eligible retired employees. Chapter 243 of the Oregon Revised Statutes assigns PEBB the authority to establish and amend the benefit provisions of the PEBB Plan. The PEBB Plan allows qualifying retired employees to continue their healthcare on a self-pay basis until eligible for Medicare, usually at age 65. 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 $40.1 million for the fiscal year ended June 30, 2009. The Fund's portion of this liability was not specifically identified.

9. Commitments

As of June 30, 2009 the CWSRF has active loan agreements in the amount of $236,855,855 and has disbursed a total of $163,208,949 in cash to these active borrowers. The amount of undisbursed loan commitments is, therefore, $73,646,906.

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 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.

11. Subsequent Events

On November 12, 2009, the Department issued $4,890,000 in general obligation bonds (2009 Series A), to match federal grant money for the CWSRF loan program.

OTHER REPORT

Office of the Secretary of State

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The Honorable Theodore R. Kulongoski
Governor of Oregon

Dick Pedersen, Director
Department of Environmental Quality

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, 2009, and have issued our report thereon dated March 26, 2010. 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.

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.

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 or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

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
Secretary of State

March 26, 2010

About the Secretary of State Audits Division

The Oregon Constitution provides that the Secretary of State shall be, by virtue of her 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.

Audit Team

Kelly L. Olson, CPA, Audit Manager
David Terry, CPA, CIA
John Turgesen

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

internet: http://www.sos.state.or.us/audits/index.html

phone: 503-986-2255

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

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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