Secretary of State Audit Report

Kate Brown, Secretary of State

Gary Blackmer, Director, Audits Division

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, 2009

2010-26
June 2010

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

Office of the Secretary of State

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Deputy Secretary of State

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The Honorable Theodore R. Kulongoski
Governor of Oregon

Tim McCabe, Director
Oregon Business Development Department

This report presents the results of our audit of the Special Public Works Fund and Water Fund of the Oregon Economic and Community Development Department, now known as the Oregon Business Development Department (department), for the year ended June 30, 2009.

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 department's internal controls of the Special Public Works Fund and Water Fund and compliance with applicable laws and regulations, contracts and grant agreements. Our report on the results of those reviews is included in the Other Reports section of this report. We noted no instances of noncompliance that are required to be reported under *Government Auditing Standards.* 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 identified a material weakness and 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
Director

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INDEPENDENT AUDITOR'S REPORT

We have audited the accompanying financial statements of the Special Public Works Fund and Water Fund, enterprise funds of the State of Oregon, Economic and Community Development Department, as of and for the year ended June 30, 2009, as listed in the table of contents. These financial statements are the responsibility of State of Oregon, Economic and Community Development 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 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 opinion.

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 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 Special Public Works Fund and Water Fund 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 June 4, 2010, on our consideration of the internal control over financial reporting of 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit. That report is separately presented in the Other Reports section as listed in the table of contents.

OREGON AUDITS DIVISION

Kate Brown
Secretary of State

June 4, 2010

STATE OF OREGON
OREGON ECONOMIC AND COMMUNITY DEVELOPMENT DEPARTMENT
SPECIAL PUBLIC WORKS FUND AND WATER FUND
ENTERPRISE FUNDS
BALANCE SHEET
JUNE 30, 2009

	SPWF	WF	TOTAL
Assets			
Current Assets:			
Cash and Cash Equivalents	$ 64,011,954	$ 20,986,735	$ 84,998,689
Securities Lending Collateral	32,606,333	12,361,139	44,967,472
Investments	549,696	98	549,794
Interest Receivable	8,448,854	3,288,018	11,736,872
Due From Other Funds	42,618	6,275	48,893
Total Current Assets	105,659,455	36,642,265	142,301,720
Noncurrent Assets:			
Cash and Cash Equivalents - Restricted	7,631,591	6,582,640	14,214,231
Investments - Restricted	6,115,457	2,175,049	8,290,506
Deferred Charges	1,887,109	637,721	2,524,830
Advances to Other Funds	-	100,000	100,000
Loans Receivable (net)	262,857,387	88,645,559	351,502,946
Total Noncurrent Assets	278,491,544	98,140,969	376,632,513
Total Assets	$ 384,150,999	$ 134,783,234	$ 518,934,233
Liabilities and Net Assets			
Current Liabilities:			
Accounts Payable	$ 1,269,358	$ 619,625	$ 1,888,983
Interest Payable - Bonds	2,382,758	984,463	3,367,221
Obligations Under Securities Lending	32,606,333	12,361,139	44,967,472
Due to Other Governments	295,810	77,292	373,102
Bonds Payable	6,580,000	3,155,000	9,735,000
Trust Funds Payable	208,243	-	208,243
Compensated Absences Payable	48,005	16,025	64,030
Total Current Liabilities	43,390,507	17,213,544	60,604,051
Noncurrent Liabilities:			
Bonds Payable	116,294,033	50,486,029	166,780,062
Trust Funds Payable	151,067	218,285	369,352
Compensated Absences Payable	23,644	7,892	31,536
Net Obligations for Other Post-Employment Benefits	13,037	4,518	17,555
Total Noncurrent Liabilities	116,481,781	50,716,724	167,198,505
Total Liabilities	159,872,288	67,930,268	227,802,556
Net Assets			
Restricted for Debt Service	3,226,632	1,052,890	4,279,522
Restricted for Transportation-Eligible Projects	5,033,468	-	5,033,468
Restricted for Infrastructure Projects	2,006,774	6,000,000	8,006,774
Unrestricted	214,011,837	59,800,076	273,811,913
Total Net Assets	224,278,711	66,852,966	291,131,677
Total Liabilities and Net Assets	$ 384,150,999	$ 134,783,234	$ 518,934,233

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, 2009

	SPWF	WF	TOTAL
Operating Revenues:			
Loan Interest Income	$ 12,133,412	$ 5,211,993	$ 17,345,405
Other Income	410,962	-	410,962
Total Operating Revenues	12,544,374	5,211,993	17,756,367
Operating Expenses:			
Salaries and Wages	1,460,650	475,855	1,936,505
Services and Supplies	405,051	151,968	557,019
Special Payments - Grants	1,569,261	2,603,041	4,172,302
Debt Service	5,523,633	2,507,926	8,031,559
Total Operating Expenses	8,958,595	5,738,790	14,697,385
Operating Income (Loss)	3,585,779	(526,797)	3,058,982
Non-Operating Revenues (Expenses):			
Investment Income	1,198,519	279,253	1,477,772
Investment Expense	(106,370)	(24,655)	(131,025)
Total Non-Operating Revenues (Expenses)	1,092,149	254,598	1,346,747
Income (Loss) Before Transfers	4,677,928	(272,199)	4,405,729
Transfer of Lottery Bond Proceeds	6,449,655	15,000,000	21,449,655
Transfers from (to) Other Funds	29,048	(2,684,391)	(2,655,343)
Change in Net Assets	11,156,631	12,043,410	23,200,041
Net Assets – Beginning	213,122,080	54,809,556	267,931,636
Net Assets – Ending	$ 224,278,711	$ 66,852,966	$ 291,131,677

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, 2009

	SPWF	WF	TOTAL
Cash Flows From Operating Activities:			
Loan Principal Repayments	$ 24,889,012	$ 14,014,533	$ 38,903,545
Loan Interest Received	11,495,718	4,395,606	15,891,324
Payments to Employees for Services	(1,383,728)	(472,804)	(1,856,532)
Payments to Suppliers	(391,443)	(143,969)	(535,412)
Grants Made	(1,400,237)	(2,108,590)	(3,508,827)
Loans Made	(25,383,953)	(12,460,515)	(37,844,468)
Other Receipts (Payments)	(277,129)	(61,550)	(388,679)
Net Cash Provided (Used) by Operating Activities	7,548,240	3,162,711	10,710,951
Cash Flows from Noncapital Financing Activities:			
Proceeds from Bond Sales	20,480,000	12,350,000	32,830,000
Principal Payments on Bonds	(15,340,000)	(10,610,000)	(25,950,000)
Interest Payments on Bonds	(5,708,861)	(2,498,015)	(8,206,876)
Bond Issuance Costs	501,201	162,368	663,569
Transfers from Other Funds, Lottery Bond Proceeds	6,449,655	15,000,000	21,449,655
Transfers from Other Funds	233,755	-	233,755
Transfers to Other Funds	-	(2,616,155)	(2,616,155)
Net Cash Provided (Used) by Noncapital Financing	6,615,750	11,788,198	18,403,948
Cash Flows from Investing Activities:			
Purchases of Investments	(6,114,226)	(2,174,589)	(8,288,815)
Proceeds from Sales and Maturities of Investments	1,874,563	373,693	2,248,256
Interest on Investments and Cash Balances	1,271,296	94,432	1,365,728
Net Cash Provided (Used) in Investing Activities	(2,968,367)	(1,706,464)	(4,674,831)
Net Increase (Decrease) in Cash and Cash Equivalents	11,195,623	13,244,445	24,440,068
Cash and Cash Equivalents – Beginning	60,447,922	14,324,930	74,722,852
Cash and Cash Equivalents – Ending	$ 71,643,545	$ 27,569,375	$ 99,212,920

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, 2009

	SPWF	WF	TOTAL
Reconciliation of Operating Income (Loss) to Net Cash Provided (Used) by Operating Activities:			
Operating Income (Loss)	$ 3,585,779	$ (526,797)	$ 3,058,982
Adjustments to Reconcile Operating Income (Loss) to Net Cash Provided (Used) by Operating Activities:			
Amortization of Bond Issuance Costs	127,540	85,382	212,922
Amortization of Bond Premium and Discount	70,870	36,483	107,353
Reduction in Allowance for Uncollectible Accounts	(410,451)	-	(410,451)
Interest Payments Reported as Operating Expenses	5,325,222	2,386,061	7,711,283
Net Changes in Assets and Liabilities:			
Accounts and Interest Receivable	(637,694)	(816,381)	(1,454,075)
Loans Receivable	(494,941)	1,554,018	1,059,077
Accounts Payable	101,480	11,653	113,133
Due to Other Governments	169,024	494,445	663,469
Trust Funds Payable	(277,640)	(61,550)	(339,190)
Compensated Absences Payable	(10,949)	(603)	(11,552)
Total Adjustments	3,962,461	3,689,508	7,651,969
Net Cash Provided (Used) by Operating Activities	$ 7,548,240	$ 3,162,711	$ 10,710,951
Noncash Investment and Capital and Related Financing Activities:			
Net Change in Fair Value of Investments	$ 5,069	$ -	$ 5,069

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, 2009

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. The SPWF and WF statement of revenues, expenses, and changes in fund net assets present increases (e.g. revenues) and decreases (e.g. expenses) in net assets.

Operating revenues and expenses generally result from providing services to municipalities. Significant operating income includes loan interest received. 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. The SPWF and WF are accounted for as separate programs; therefore, there is no internal activity.

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. The SPWF and WF have continuous spending authority under ORS 285B.455 and 285B.563.

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. The governmental units SPWF and WF provide 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 353 loans totaling $353,426,078. An allowance for uncollectible loans was established in the SPWF to estimate the potential loss from uncollectible loans. As of June 30, 2009 the allowance for uncollectible loans equals $1,923,132. Actual loan losses may vary from estimated amounts. (See Note 11 – Debt Restructuring).

h. Compensated Absences

Employees accrue vacation leave at various accrual rates and may generally be paid for up to a maximum of 250 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 consists 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 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) in 2007. These funds plus any interest accruing on them are restricted for use in SPWF projects meeting requirements of "Transportation-Eligible Projects" as defined by Oregon Revised Statutes applicable to Gas Tax Revenues uses and approved by ODOT.

j. Net Assets

Net Assets are divided into four classifications: Restricted for Debt Service, Restricted for Transportation-Eligible Projects, Restricted for Infrastructure Projects, and Unrestricted.

Restricted for Debt Service is the total of all debt service reserve funds for all outstanding Oregon Bond Bank issues held by the bond trustee until the bond issues are paid in full. "Restricted for Infrastructure Projects" consists of un-disbursed proceeds of Oregon Bond Bank sales, which are restricted for specific loans.

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

2. Cash, Cash Equivalents, and Investments

Deposits: As of June 30, 2009, the book balance of monies held in demand accounts with the State Treasurer was $99,212,920. The bank balance was $99,616,097. The Oregon State Treasurer maintains the Oregon Short-term Fund (OSTF), a cash and investment pool that is available for use by the Department. Because the pool operates as a demand deposit account, deposits in the OSTF are reported on the financial statements as cash and cash equivalents.

A separate financial report for the OSTF is prepared by the Treasurer. Copies of the report may be obtained from the Office of the State Treasurer, Finance Division, 350 Winter Street NE, Suite 100, Salem, Oregon 97301-3896, or from the Treasury's website at http://www.ost.state.or.us/About/Investment.

The custodial credit risk for deposits is the risk that, in the event of a bank failure, the Department's deposits may not be recovered, or the Department will not be able to recover collateral securities that are in the possession of an outside party. The Department does not have a formal policy regarding custodial credit risk for deposits in the Oregon Short Term Fund (OSTF).

Oregon Revised Statutes (ORS) Chapter 295 governs the collateralization of public funds. Bank depositories are required to pledge collateral against any public fund deposits in excess of deposit insurance amounts.

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

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 $1,510,879. 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 $250,000. 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.

<u>Investments</u>: 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.

<u>Concentration of Credit Risk</u>: Concentration of credit risk is the risk of loss attributed to the magnitude of the Department's investment in a single issuer. At June 30, 2009, the Department's investments were in Federal Home Loan Mortgage Corporation, 58.5%; Federal National Mortgage Association, 35.3%; and Bank of New York, 6.2%.

<u>Credit Risk:</u> Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. As of June 30, 2009, $549,794 was invested in the Department's trustee's cash reserve account. The cash reserve account is unrated. The remainder of the Department's investments, $8,290,506, are U.S. Agency Securities. These securities were rated Aaa by Moody's Investor Service. The Department does not have an investment policy concerning Credit Risk.

<u>Interest Rate Risk</u>: Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Department does not have an investment policy concerning Interest Rate Risk.

As of June 30, 2009, the Department had the following investments and maturities:

	Investment maturities less than one year:		
Investment Type:	SPWF	WF	Total
Trustee's Cash Reserve	$ 549,696	$ 98	$ 549,794
U.S. Agency Securities	6,115,457	2,175,049	8,290,506
	$ 6,665,153	$ 2,175,147	$ 8,840,300

Securities Lending: In accordance with State of Oregon investment policies, state agencies may participate in securities lending. The Department is involved in securities lending only with cash balances invested in the Oregon Short Term Fund (OSTF). Details at June 30, 2009 are:

		Allocated to Department:	
	Total OSTF	SPWF	WF
Securities on loan at fair value	$3,843,361,213	$31,938,927	$12,108,124
Cash and securities collateral received	$3,923,673,246	$32,606,333	$12,361,139
Investments of cash collateral at fair value	$3,890,281,485	$32,328,842	$12,255,941

The Office of the State Treasurer has authorized its custodian to act as its agent in the lending of OSTF securities pursuant to a form of loan agreement, in accordance with OSTF investment policies. There have been no significant violations of the provisions of securities lending agreements during the year ended June 30, 2009.

During the year, the State's securities lending agent lent short-term and fixed income securities and received as collateral U.S. dollar-denominated cash. Borrowers were required to deliver cash collateral for each loan equal to not less than 102 percent of the market value of the loaned security. The State did not impose any restrictions during the year on the amount of loans the securities lending agent made on its behalf. The State is fully indemnified by its securities lending agent against losses due to borrower default. There were no losses during the year from failure of borrowers to return loaned securities.

3. Bonds Issued and Outstanding

As of June 30, 2009, Oregon Bond Bank bonds totaling $175,570,000 are outstanding. Bonds Payable reported on the balance sheet are recorded net of original issue discounts and premiums. Bond discounts of $165,428 and bond premiums of $1,110,490 are included in Bonds Payable as of June 30, 2009. The following table summarizes the changes in bonds outstanding during fiscal year 2009.

		Interest Range			Bonds Outstanding				
Series Issued	Due Dates	From	To	Amount	Beginning Balance	Increases	Decreases	Ending Balance	Due Within One Year
1993 Series A	1994 – 2013	2.80%	5.50%	$ 21,610,000	$ 2,660,000	$ –	$ 690,000	$ 1,970,000	$ 700,000
1993 Series B	1998 – 2013	5.75%	7.75%	955,000	370,000	–	60,000	310,000	70,000
1993 Series C	1995 – 2014	3.20%	5.38%	11,815,000	520,000	–	80,000	440,000	80,000
1994 Series A	1996 – 2015	5.00%	6.00%	5,690,000	2,470,000	–	295,000	2,175,000	315,000
1995 Series A	1997 – 2016	3.90%	5.75%	4,755,000	325,000	–	35,000	290,000	35,000
1996 Series A	1998 – 2017	4.10%	5.50%	6,000,000	2,400,000	–	210,000	2,190,000	225,000
1996 Series One	1997 – 2016	3.50%	5.50%	10,665,000	1,025,000	–	105,000	920,000	115,000
1996 Series Two	2000 – 2016	4.20%	5.50%	2,400,000	1,370,000	–	140,000	1,230,000	150,000
1997 Series A	1999 – 2018	3.95%	5.10%	10,520,000	6,685,000	–	535,000	6,150,000	565,000
1998 Series A	1999 – 2023	4.25%	5.00%	6,000,000	4,150,000	–	245,000	3,905,000	270,000
1998 Series B	1999 – 2015	4.10%	4.75%	6,105,000	3,705,000	–	465,000	3,240,000	485,000
1999 Series A	2000 – 2024	4.25%	5.25%	7,050,000	5,120,000	–	390,000	4,730,000	220,000
2000 Series A	2001 – 2025	5.25%	5.63%	47,240,000	15,920,000	–	1,085,000	14,835,000	1,140,000
2000 Series B	2002 – 2026	4.45%	5.50%	34,020,000	26,515,000	–	17,860,000	8,655,000	585,000
2002 Series A	2003 – 2027	3.00%	5.00%	7,850,000	5,825,000	–	375,000	5,450,000	390,000
2002 Series B	2004 – 2028	3.00%	4.75%	28,825,000	23,420,000	–	1,180,000	22,240,000	1,210,000
2003 Series A	2005 – 2029	3.00%	4.63%	25,475,000	22,225,000	–	880,000	21,345,000	890,000
2004 Series A	2006 – 2030	3.00%	4.50%	6,325,000	5,815,000	–	200,000	5,615,000	200,000
2004 Series B	2006 – 2020	3.00%	5.25%	3,365,000	3,060,000	–	120,000	2,940,000	125,000
2007 Series A	2008 – 2025	4.00%	4.38%	26,905,000	26,325,000	–	800,000	25,525,000	830,000
2007 Series B	2008 – 2019	5.13%	6.00%	8,900,000	8,785,000	–	200,000	8,585,000	210,000
2009 Series A	2010 – 2029	3.00%	5.25%	32,830,000	–	32,830,000	–	32,830,000	925,000
		Total		$ 315,300,000	$ 168,690,000	$ 32,830,000	$ 25,950,000	$ 175,570,000	$ 9,735,000

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, 2009:

	Balance 7/01/2008	Additions	Deductions	Balance 6/30/2009	Due within One Year
Trust Funds Payable	$ 925,424	$ 735,223	$ 1,083,052	$ 577,595	$ 208,243
Compensated Absences	107,118	80,880	92,432	95,566	64,030
Bonds:					
Principal	168,690,000	32,830,000	25,950,000	175,570,000	9,735,000
Discount	(188,430)	–	(23,002)	(165,428)	(21,221)
Premium	8,509	1,112,302	10,321	1,110,490	80,615
Total	$169,542,621	$ 34,758,405	$ 27,112,803	$ 177,188,223	$ 10,066,667

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, 2009, for each year during the next five-year period ending June 30, 2014, and in five-year increments for the succeeding periods from July 1, 2014, to June 30, 2034.

Debt Repayment Schedule – Oregon Bond Bank Bonds

Year Ending	Principal	Interest	Total
2010	$ 9,735,000	$ 7,593,799	$ 17,328,799
2011	9,800,000	7,758,540	17,558,540
2012	9,620,000	7,327,210	16,947,210
2013	9,635,000	6,900,400	16,535,400
2014	9,535,000	6,464,678	15,999,678
2015-2019	46,275,000	25,741,869	72,016,869
2020-2024	41,575,000	15,357,092	56,932,092
2025-2029	29,270,000	6,390,254	35,660,254
2030-2034	10,125,000	1,260,524	11,385,524
Total	$ 175,570,000	$ 84,794,366	$ 260,364,366

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, 2009, is $270,000.

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

<u>Oregon Public Employees Retirement System (PERS)</u>

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 2009 was 6.54 percent. Employer contributions for the years ending June 30, 2009, 2008, and 2007 were $63,755, $60,281, and $98,907, 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 for each covered employee's salary for fiscal year 2009 is 8.03 percent. The amount contributed by the Department for the fiscal year ended June 30, 2009, 2008, and 2007, were $20,743, $7,838 and $3,085, 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, 2009, 2008, and 2007, were $73,990, $66,188 and $72,468 respectively, and were equal to the required contributions for the year.

8. Other Postemployment 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).

<u>Retirement Health Insurance Account</u>

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 of 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 ended June 30, 2009 was .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 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 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 covered employee's salary for the fiscal year ended June 30, 2009 was .10 percent which is embedded within the total PERS contribution rate. A copy of the Oregon Public Employees Retirement System annual financial report may be obtained from Fiscal Services Division, PERS, P.O. Box 23700, Tigard, OR 97281-3700.

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. 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 Department's liability for OPEB expenses in SPWF and WF for Fiscal Year 2009 was $8,359, and was allocated to SPWF ($6,121) and WF ($2,238).

9. 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 WF and SPWF programs, the amount of claim settlements did not exceed insurance coverage for each of the past three years.

10. Commitments

The department has awarded, but not distributed, $26.4 million to various WF infrastructure projects, and $49.0 million to SPWF projects within the State of Oregon. These awards are projected to be disbursed within three years. These commitments will be funded from current assets, future non-bond bank loan payments, and an amount to be provided from non-program sources, usually Oregon Lottery Revenue Bonds approved by the Oregon Legislature.

11. Debt Restructuring

The Department has a policy of working with financially troubled clients to keep them financially solvent, while recovering state resources loaned to the client.

At their July 2006 meeting, the Oregon Economic and Community Development Commission approved a debt restructuring of six SPWF loans made at various times to the Port of Brookings Harbor. The Department and the Port have entered into a revised restructuring agreement that revises and extends the debt restructuring previously approved by the Commission. The restructuring agreement requires the Port to make regular payments sufficient to repay each loan principal balance by its scheduled maturity date and allows the Port to defer payment of accrued interest. The Port is expected to make payments on the deferred interest so as to pay all deferred interest by the scheduled maturity date on each loan. Upon the maturity date, of each loan, if any accrued interest remains unpaid, the Department may elect to forgive the unpaid amount. Interest forgiveness, if any, will result in the Port being ineligible for future financing assistance from the Department for a period of 5 years from the date of any instance of interest forgiveness. The total amount of loans outstanding at June 30, 2009 affected by this restructuring is $2,925,264. At June 30, 2009, there is $771,966 in accrued interest to be paid after loan principal has been repaid.

12. Subsequent Events

Bond Call:

The Oregon State Treasurer has called for Optional Redemption of $1,810,000 of outstanding State of Oregon Oregon Bond Bank Revenue Bonds. $945,000 from Series 1998A will be redeemed effective July 1, 2009. $865,000 will be redeemed effective January 1, 2010 as follows: $135,000 from Series 1993A, $140,000 from Series 1996A, $60,000 from Series 1996-1, $105,000 from Series 1997A, $115,000 from Series 1998A and $310,000 from Series 2000A. The Bonds will be redeemed at par, plus accrued interest to the date of redemption. Interest on all Bonds redeemed shall cease to accrue on July 1, 2009 and January 1, 2010, respectively.

The Oregon Legislature passed House Bill 2152, effective July 28, 2009, in the 2009 Regular Session. This bill re-named the Oregon Economic and Community Development Department to the Oregon Business Development Department (Department), and created the Infrastructure Finance Authority (IFA) within the Department. The IFA is governed by the Oregon Infrastructure Finance Authority Board (Board). The SPWF and WF are managed by the IFA.

OTHER REPORTS

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

We have audited the financial statements of the Special Public Works Fund and Water Fund, enterprise funds of the State of Oregon, Economic and Community Development Department, as of and for the year ended June 30, 2009, and have issued our report thereon dated June 4, 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 State of Oregon, Economic and Community Development Department's internal control over financial reporting relating to the Special Public Works Fund 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 State of Oregon, Economic and Community Development Department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of State of Oregon, Economic and Community Development 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 certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

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 deficiencies described in the accompanying Schedule of Findings and Responses to be significant deficiencies in internal control over financial reporting. These deficiencies are listed as 2009-1 and 2009-2.

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, of the significant deficiencies described above, we consider item 2009-1 to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the financial statements of the 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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards.*

The State of Oregon, Economic and Community Development 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 State of Oregon, Economic and Community Development Department's responses and accordingly, we express no opinion on them.

This report is intended solely for the information and use of the State of Oregon, Economic and Community Development Department's management, the Business Development Commission, the Infrastructure Finance Authority 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

Kate Brown
Secretary of State

June 4, 2010

Schedule of Findings and Responses

2009-1 Internal Control over Financial Reporting (Material Weakness)

Department management is responsible for establishing and maintaining financial reporting controls that provide reasonable assurance that financial statements are fairly presented in conformity with generally accepted accounting principles.

The department's controls over its financial reporting process did not always prevent or detect errors. For example, we noted the following:

- Four securities lending accounts and the related note disclosure were missing from the financial statements;
- Note disclosures did not always contain the most recent and applicable information, whether from a change within the agency, a change in reporting standards, or due to error; and
- Some accounts were not properly classified in the statements and related note disclosures were not aligned to the account classifications.

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

Lack of controls over the financial reporting process hinders prevention or early detection of errors in the financial statements and note disclosures.

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:

The Oregon Business Development Department (Department) generally agrees with the audit finding and conclusion.

We will implement procedures to identify relevant account and note disclosure information in the Special Public Works Fund (SPWF) and Water Fund (WF) financial statements. Elements of these procedures will include inquiry of the Oregon Statewide Accounting and Reporting Services (SARS) Department, review of the State of Oregon's Comprehensive Annual Financial Report (CAFR), and acquisition of a current and concise library of professional standards to aid the Department prepare financial statements in accordance with generally accepted standards.

2009-2 Reconciliations

During state fiscal year 2009, the Oregon Economic and Community Development Department (department) received, processed and deposited over $17 million in revenues from loan interest income and other income. To facilitate more efficient accounting, the department has set up specific cash accounts at the Oregon State Treasury. Additionally, the department uses a subsidiary ledger to track the loan balances to municipalities.

State policy recommends agencies reconcile cash accounts on a regular basis and, if an agency uses subsidiary accounting records, reconcile the subsidiary records to the state accounting system. Reconciliations are an important internal control that provides assurance that account balances in the official accounting records are accurate and agree to the actual assets in the custody of the State and to subsidiary accounting records.

We reviewed 23 cash reconciliations and found that the department had not prepared 16 of them (69.6 percent) timely. For example, eight of the reconciliations were prepared over 60 days late, and we noted two reconciliations were not prepared at all. Furthermore, six of the 23 cash reconciliations (26.1 percent) were not reviewed by department management timely, of which three were not reviewed at all. In addition, we found the department did not reconcile its June 2009 loans receivable subsidiary ledger to its account balances in the state accounting system until January 2010.

As a result of late or missing reconciliations, the department was not in compliance with state policy and had less assurance that errors would be detected and corrected in a timely manner. For example, the department collected over $500,000 in loan payments from local governments in June 2009. While these amounts were deposited and recorded with the trustee in June 2009, they were not recorded to the loans and cash accounts in the department's accounting system until January 2010.

We recommend department management comply with state policy and ensure that the necessary reconciliations are prepared and reviewed in a timely manner to provide assurance that cash balances and financial records are complete and accurate.

Agency Response:

We do agree that reconciliations were generally not prepared timely. The Department is implementing use of a new subsidiary ledger, Portfol, to track disbursements of loan and grant awards to municipalities. Portfol is also being used to track repayments of loan principal and interest from municipalities. It was discovered during the year ended June 30, 2009 that the rollover of data from the old subsidiary system to Portfol did not result in fully accurate data being entered into Portfol. Significant time and staff have been devoted to identifying and correcting these errors.

The focus on cleaning Portfol data took priority over reconciliations. We concluded that the Department could not have efficient and effective reconciliations until it had confidence in the data the state accounting system was being reconciled to. That confidence is nearly achieved. It will be achieved by close of the year end June 30, 2010. At that time, expectations of when reconciliations are to be done, who will prepare, and who will review will be documented in writing and circulated among appropriate staff and managers.

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.

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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.