

**Oregon Business Development Department, State of Oregon
Special Public Works Fund (SPWF) and Water Fund (WF), Enterprise Funds**

**Annual Financial Report
Year ended June 30, 2014**

**Oregon Business Development Department, State of Oregon
Special Public Works Fund (SPWF) and Water Fund (WF), Enterprise Funds**

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Year ended June 30, 2014**

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Financial Section



Independent Auditor's Report

The Honorable Kate Brown, Governor of Oregon
Sean M. Robbins, Director, Oregon Business Development Department
Oregon Business Development Commission
Infrastructure Finance Authority Board

Report on the Financial Statements

We have audited the accompanying financial statements of the Special Public Works Fund and Water Fund, enterprise funds of the State of Oregon, Business Development Department, as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise the Special Public Works Fund and Water Fund basic financial statements, as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Special Public Works Fund and Water Fund, enterprise funds of the State of Oregon, Business Development Department, as of June 30, 2014, and the respective changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1, the financial statements of the Special Public Works Fund and Water Fund, enterprise funds of the State of Oregon, Business Development Department, are intended to present the financial position, the changes in financial position and cash flows that are only attributable to the Special Public Works Fund and Water Fund. They do not purport to, and do not, present fairly the financial position of the Oregon Business Development Department or the State of Oregon as of June 30, 2014, the changes in their financial position, or their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 18, 2015, on our consideration of the Oregon Business Development Department's internal control over financial reporting relating to the Special Public Works Fund and Water Fund and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Oregon Business Development Department's internal control over financial reporting and compliance.

Office of the Secretary of State, Audits Division

State of Oregon
March 18, 2015

Basic Financial Statements

Oregon Business Development Department, State of Oregon
Special Public Works Fund (SPWF) and Water Fund (WF), Enterprise Funds
Statement of Net Position (Dollars in thousands)
June 30, 2014

	<u>SPWF</u>	<u>WF</u>	<u>Total</u>
Assets			
Current assets:			
Cash and cash equivalents	\$ 63,121	23,413	86,534
Investments	10,253	-	10,253
Securities lending collateral	5,012	1,527	6,539
Interest receivable	5,004	2,047	7,051
Accounts receivable	18	11	29
Total current assets	<u>83,408</u>	<u>26,998</u>	<u>110,406</u>
Noncurrent assets:			
Cash and cash equivalents - restricted	2,774	1,567	4,341
Loans receivable (net)	189,700	88,402	278,102
Total noncurrent assets	<u>192,474</u>	<u>89,969</u>	<u>282,443</u>
Deferred Outflows of Resources	-	-	-
Total Assets and Deferred Outflows of Resources	<u>275,882</u>	<u>116,967</u>	<u>392,849</u>
Liabilities			
Current liabilities:			
Accounts payable	27	8	35
Interest payable - bonds	1,277	674	1,951
Obligations under securities lending	5,012	1,527	6,539
Due to other governments	5	-	5
Bonds payable	2,630	1,360	3,990
Compensated absences payable	63	32	95
Pension-related debt	5	2	7
Total current liabilities	<u>9,019</u>	<u>3,603</u>	<u>12,622</u>
Noncurrent liabilities:			
Bonds payable	54,924	29,547	84,471
Compensated absences payable	33	16	49
Net obligation for other post-employment benefits	23	9	32
Pension-related debt	171	70	241
Total noncurrent liabilities	<u>55,151</u>	<u>29,642</u>	<u>84,793</u>
Deferred Inflows of Resources	-	-	-
Total Liabilities and Deferred Inflows of Resources	<u>64,170</u>	<u>33,245</u>	<u>97,415</u>
Net position			
Restricted for debt service	1,497	893	2,390
Unrestricted	210,215	82,829	293,044
Total net position	<u>\$ 211,712</u>	<u>83,722</u>	<u>295,434</u>

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

Oregon Business Development Department, State of Oregon
Special Public Works Fund (SPWF) and Water Fund (WF), Enterprise Funds
Statement of Revenues, Expenses, and
Changes in Fund Net Position (Dollars in thousands)
Year ended June 30, 2014

	<u>SPWF</u>	<u>WF</u>	<u>Total</u>
Operating revenues			
Loan interest income	\$ 7,837	3,643	11,480
Other revenue	96	-	96
Total operating revenues	<u>7,933</u>	<u>3,643</u>	<u>11,576</u>
Operating expenses			
Salaries and wages	1,384	708	2,092
Services and supplies	351	163	514
Special payments - grants	1,842	1,735	3,577
Bond interest	2,619	1,448	4,067
Total operating expenses	<u>6,196</u>	<u>4,054</u>	<u>10,250</u>
Operating income (loss)	1,737	(411)	1,326
Nonoperating revenue (expense)			
Investment income (loss)	630	122	752
Other interest expense	(11)	(5)	(16)
Investment expense	(5)	(1)	(6)
Net nonoperating revenue	<u>614</u>	<u>116</u>	<u>730</u>
Income (loss) before transfers & special items	2,351	(295)	2,056
Transfers			
Transfers from other funds	345	8,954	9,299
Transfers to other funds	(9,231)	(6,540)	(15,771)
Net transfers from (to) other funds	<u>(8,886)</u>	<u>2,414</u>	<u>(6,472)</u>
Increase (decrease) in net position	<u>(6,535)</u>	<u>2,119</u>	<u>(4,416)</u>
Beginning net position	219,135	82,051	301,186
Change in accounting principle	(888)	(448)	(1,336)
Beginning net position - restated	<u>218,247</u>	<u>81,603</u>	<u>299,850</u>
Ending net position	<u>\$ 211,712</u>	<u>83,722</u>	<u>295,434</u>

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

Oregon Business Development Department, State of Oregon
Special Public Works Fund (SPWF) and Water Fund (WF), Enterprise Funds
Statement of Cash Flows (Dollars in thousands)
Year ended June 30, 2014

	<u>SPWF</u>	<u>WF</u>	<u>Total</u>
Cash flows from operating activities			
Loan principal repayments	\$ 19,840	8,224	28,064
Loan interest received	7,848	3,681	11,529
Payments to employees	(1,340)	(701)	(2,041)
Payments to suppliers	(335)	(1,122)	(1,457)
Other receipts	20	-	20
Program loans & special payments	(19,422)	(12,313)	(31,735)
Net cash provided (used) in operating activities	<u>6,611</u>	<u>(2,231)</u>	<u>4,380</u>
Cash flows from noncapital financing activities			
Principal payments on debt	(3,530)	(3,912)	(7,442)
Interest payments on debt	(2,701)	(1,527)	(4,228)
Transfers from other funds	345	8,954	9,299
Transfers to other funds	(9,231)	(6,540)	(15,771)
Net cash provided (used) in noncapital financing activities	<u>(15,117)</u>	<u>(3,025)</u>	<u>(18,142)</u>
Cash flows from investing activities			
Interest earned	372	120	492
Purchase of investments	(10,000)	-	(10,000)
Net cash provided (used) in investing activities	<u>(9,628)</u>	<u>120</u>	<u>(9,508)</u>
Net increase (decrease) in cash and cash equivalents	(18,134)	(5,136)	(23,270)
Beginning cash and cash equivalents	<u>84,029</u>	<u>30,116</u>	<u>114,145</u>
Ending cash and cash equivalents	<u>\$ 65,895</u>	<u>24,980</u>	<u>90,875</u>

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

**Oregon Business Development Department, State of Oregon
Special Public Works Fund (SPWF) and Water Fund (WF), Enterprise Funds
Statement of Cash Flows (Dollars in thousands)
Year ended June 30, 2014**

	<u>SPWF</u>	<u>WF</u>	<u>Total</u>
Reconciliation of operating income to net cash provided by operating activities			
Operating income (loss)	\$ 1,737	(411)	1,326
Adjustments:			
Interest payments reported as noncapital financing	2,689	1,521	4,210
Decrease (increase) in assets			
Interest receivable	468	38	506
Accounts receivable	8	4	12
Due from other funds	50	-	50
Loans receivable	2,513	(2,354)	159
Allowance for uncollectible accounts	(786)	-	(786)
Increase (decrease) in liabilities			
Accounts payable	9	(965)	(956)
Interest payable	(70)	(74)	(144)
Due to other governments	3	-	3
Compensated absences payable	(11)	8	(3)
Net obligation payable	1	2	3
Total adjustments	<u>4,874</u>	<u>(1,820)</u>	<u>3,054</u>
Net cash provided (used) in operating activities	\$ <u>6,611</u>	<u>(2,231)</u>	<u>4,380</u>
Noncash investing and capital and related financing activities			
Net Change in fair value of investments	253	-	253

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

Oregon Business Development Department, State of Oregon
Special Public Works Fund (SPWF) and Water Fund (WF), Enterprise Funds
Notes to the Basic Financial Statements (Dollars in thousands)
Year ended June 30, 2014

Note 1 - Summary of Significant Accounting Policies

The accompanying financial statements of the Oregon Business 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).

All applicable GASB pronouncements have been applied including: GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities* and GASB Statement No. 67 *Financial Reporting for Pension Plans – an amendment of GASB No. 25*.

The implementation of statements No. 65 and No. 67 did not have a material financial impact on the financial statements of the SPWF or WF.

1.A - THE REPORTING ENTITY

A major focus of the Oregon Business Development Department (the Department) is to help communities plan, design and construct municipally-owned infrastructure such as safe drinking water systems, wastewater systems, and community facilities; and to enhance livability and economic prosperity for Oregon. 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 (CAFR).

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 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.

1.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.

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1.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, any deferred outflows of resources, liabilities, and any deferred inflows of resources associated with the operation of the SPWF and WF are included on the statement of net position. Assets, plus deferred outflows of resources, less liabilities, less deferred inflows of resources, equals net position.

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

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.

1.D - BUDGETARY ACCOUNTING

The Oregon Legislature approves the State of Oregon's budget on a biennial basis. 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.

1.E - OREGON BOND BANK DISCOUNTS, PREMIUMS AND ISSUANCE COSTS

Bond discounts and premiums are deferred and amortized over the term of the bonds using the straight-line 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; issuance costs are expensed in the period incurred. SPWF and WF do not have any liability for Oregon Bond Bank bond arbitrage. The governmental units to which SPWF and WF provide financing are responsible for any arbitrage liability incurred on the bonds.

1.F - CASH EQUIVALENTS, AND INVESTMENTS (INCLUDING RESTRICTED)

Cash deposits that are held in a cash management or investment pool are classified as cash and cash equivalents when the pool has the general characteristics of a demand deposit account. Cash and cash equivalents consist of: cash and investments held by the Office of the State Treasurer in the Oregon Short-term Fund; and moneys held in money market funds held by a trustee.

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Investments are reported at fair value. The fair value of publicly traded debt and equity securities in active markets is determined by the custodian's pricing agent using nationally recognized pricing services. Investments consist of investments held by the Office of the State Treasurer in the Oregon Intermediate Term Pool. Changes in the fair value of investments are recognized as investment income (loss) in the current year.

1.G - RECEIVABLES

Receivables are amounts due representing revenues earned or accrued in the current period. Interest receivable includes interest due on loans to local governments and special districts. Loans Receivable at June 30 consisted of approximately 254 loans totaling \$279,880. An allowance for uncollectible loans was established in the SPWF to estimate the potential loss from uncollectible loans. As of June 30, 2014 the allowance for uncollectible loans equals \$1,778. Actual loan losses may vary from estimated amounts.

1.H - INTRAFUND TRANSACTIONS

Intrafund balances (due to/from other funds and advances to/from other funds) and intrafund activity (transfers to/from other funds) within each fund in the financial statements have been eliminated.

1.I - COMPENSATED ABSENCES

Employees accumulate earned but unused vacation and sick leave benefits. Accumulated vacation leave for employees is recorded as an expense and a liability of the SPWF and WF programs as benefits accrue to the employee. A liability for unpaid accumulated sick leave is not recorded. Employees are not paid for unused sick leave benefits when employees leave Department service.

1.J - 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.

1.K - NET POSITION

Net position is presented in two classifications: Restricted for Debt Service, and Unrestricted.

Restricted for Debt Service is the total of all debt service reserve funds for outstanding Oregon Bond Bank issues held by the bond trustee until the bond issues are paid in full.

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

Note 2 - Cash and Cash Equivalents

At June 30, 2014, cash and cash equivalents consist of:

Office of the State Treasurer, Oregon Short-Term Fund (OSTF)	\$	86,534
Money market funds held by BNY Mellon, trustee		4,341
		<u>90,875</u>

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Cash and cash equivalents are displayed in the financial statements as follows:

Current assets		
Cash and cash equivalents	\$	86,534
Noncurrent assets		
Cash and cash equivalents – restricted		4,341
		<u>90,875</u>

2.A - DEPOSITS

As of June 30, 2014, the book balance of monies held in demand accounts in the OSTF was \$86,534. The bank balance was \$86,294. The Oregon State Treasurer maintains the OSTF, a cash and investment pool that is available for use by the Department.

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.oregon.gov/treasury/Divisions/Investment/Pages/Oregon-Short-Term-Fund-\(OSTF\).aspx#stat](http://www.oregon.gov/treasury/Divisions/Investment/Pages/Oregon-Short-Term-Fund-(OSTF).aspx#stat)

2.B - CUSTODIAL CREDIT RISK

The custodial credit risk for deposits is the risk that, in the event of a bank failure, the Department will not be able to recover deposits or 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. However, banking regulations and Oregon law establish the insurance and collateral requirements for deposits in the 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. ORS Chapter 295 provides the statutory authority for the Public Funds Collateralization Program (PFCP). The PFCP is an application created by the Oregon State Treasury to facilitate bank depository, custodian, and public official compliance with ORS Chapter 295.

Where interest-bearing balances within the OSTF exceed the Federal Deposit Insurance amount of \$250, the balances are covered by collateral held in the PFCP. As of June 30, 2014, 5 percent of OSTF demand deposits were covered by FDIC insurance, and 95 percent of OSTF deposits were collateralized under the PFCP.

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 BNY Mellon (Oregon Bond Bank trustee) as agents for the Department totaled \$4,341. 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. The remaining funds are neither insured, nor collateralized and are thus exposed to custodial credit risk.

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Special Public Works Fund (SPWF) and Water Fund (WF), Enterprise Funds
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Note 3 - Investments

The Bond Indentures authorize the Department to invest in direct obligations of, or obligations guaranteed by, the United States of America: bonds, debentures, notes, participation certificates, or other similar obligations issued by specified Federal Agencies; and direct and general obligations of, or guaranteed by, the State: investments agreements, secured or unsecured, with any institution whose debt securities are rated at least equal to the then existing rating on the bonds by the rating agencies; and deposit on interest-bearing demand deposits, or certificates of deposit secured by obligations described above. These are permissible investments under State statute ORS 285B.455 which allows moneys in the SPWF to be invested as provided by ORS 293.701 to 293.857. 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. At June 30, 2014, the Department reported investments in SPWF of \$10,253, which includes \$253 of unrealized gains reported as investment income.

3.A - CONCENTRATION OF CREDIT RISK

Concentration of credit risk is the risk of loss attributed to the magnitude of the Department's investment in a single issuer. The Department does not have a policy concerning concentration of credit risk. Investments are with the Oregon Short-Term Fund (OSTF), BNY Mellon Cash Reserve Accounts, and Oregon Intermediate Term Pool (OITP).

At June 30, 2014, Oregon Short Term Fund (OSTF) and BNY Mellon Cash Reserve Accounts were not exposed to concentration of credit risk. Oregon Intermediate Term Pool (OITP) guidelines provide that the maximum that may be invested in any one issuer, as a percentage of the total investments is five percent, excluding the OSTF, U.S. Treasuries or U.S. Federal Agencies or instrumentalities. The OITP may invest up to 100 percent in those securities. On June 30, 2014, the OITP did not hold investments with any one issuer that exceeded these limits.

3.B - CREDIT RISK

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The Department does not have a policy concerning credit risk. Investments are with the Oregon Short-Term Fund (OSTF), BNY Mellon Cash Reserve Accounts, and Oregon Intermediate Term Pool (OITP).

At June 30, 2014, Oregon Short Term Fund (OSTF) and BNY Mellon Cash Reserve Accounts were not exposed to credit risk. Oregon Intermediate Term Pool (OITP) guidelines require that all investments meet minimum ratings requirements at the time of purchase. Minimum required ratings are subject to investment type as dictated by the guidelines.

Corporate notes must be rated investment grade or higher at time of purchase. Commercial paper is required to have a minimum short-term credit rating at the time of purchase from S&P of A-3, Moody's of P-3, or Fitch of F-3. Foreign government securities are required to have a minimum credit rating from S&P of AA-, Moody's of Aa3, or Fitch of AA-. Structured securities such as asset-backed and mortgage-backed securities must be rated AAA at the time of purchase.

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Guidelines allow securities downgraded below investment grade to be retained at the Senior Investment Officer's discretion. Rating groups were determined using the lowest actual rating from S&P, Moody's or Fitch, and are shown below:

Investment Type	<u>Credit Rating</u>	<u>Investment Maturities</u>				
		<u>Reported Amount</u>	<u>Less Than One Year</u>	<u>One to Five Years</u>	<u>Six to Ten Years</u>	<u>Over Ten Years</u>
Cash and Equivalents:						
Invested in the Oregon Short-Term Fund	Not Rated	286	286	-	-	-
Cash held at State Street Bank	Not Rated	-	-	-	-	-
Investments:						
Asset-Backed Securities	AAA	630	-	630	-	-
Commercial Mortgage-backed Securities	AAA	1,067	-	-	-	1,067
U.S. Agency Residential Mortgage-backed Securities	Not Rated	424	-	-	-	424
U.S. Agency Debt	AA	602	-	213	389	-
Municipal Debt	AA	279	-	161	118	-
	A	350	-	350	-	-
Corporate Debt	AA	277	-	277	-	-
	A+	78	-	78	-	-
	A	2,176	156	2,020	-	-
	BBB	4,084	199	3,725	160	-
Total		<u>10,253</u>	<u>641</u>	<u>7,454</u>	<u>667</u>	<u>1,491</u>

3.C - INTEREST RATE RISK

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 a policy concerning interest rate risk. Investments are with the Oregon Short-Term Fund (OSTF), BNY Mellon Cash Reserve Accounts, and Oregon Intermediate Term Pool (OITP).

At June 30, 2014, Oregon Short Term Fund (OSTF) and BNY Mellon Cash Reserve Accounts were not exposed to interest rate risk. Oregon Intermediate Term Pool (OITP) portfolio guidelines require that the portfolio's modified duration, a measure of interest rate risk, shall not exceed three years. The duration for the OITP at June 30, 2014 was 1.86 years. The maximum maturity for any single investment should not be greater than 10.25 years from settlement date, with exceptions for asset-backed securities, mortgage-backed securities, and

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commercial mortgage-backed securities. These securities use weighted average life (WAL) as a proxy for maturity and are limited to a WAL of five years, or less, at the time of purchase.

3.D - SECURITIES LENDING

The Department's cash balances are invested in the Oregon Short-Term Fund (OSTF). The OSTF is a cash and investment pool managed by the Office of the State Treasurer (Treasury).

The State of Oregon (State) participates in securities lending transactions in accordance with State investment policies. Treasury has, through a Securities Lending Agreement, authorized State Street Bank and Trust Company (State Street) to lend the State's securities pursuant to a form of loan agreement. Both the State and borrowers maintain the right to terminate all securities lending transactions on demand. There were no significant violations of the provisions of securities lending agreements during the year ended June 30, 2014.

During the year, State Street had the authority to loan short-term, fixed income, and equity securities and to receive as collateral U.S. dollar and foreign currency cash, U.S. government and agency securities, and foreign sovereign debt of Organization of Economic Cooperation and Development countries. Borrowers were required to deliver collateral for each loan equal to not less than 102 percent of the market value of the loaned U.S. securities, international fixed income securities, or 105 percent in the case of international equity. The custodian did not have the ability to pledge or sell collateral securities absent a borrower default, and the State did not impose any restrictions during the fiscal year on the amount of the loans the custodian made on its behalf. The State is fully indemnified against losses due to borrower default by its custodian. There were no losses during the year from the failure of borrowers to return loaned securities and no recoveries of amounts from prior losses.

State Street, as lending agent, has created a fund to reinvest cash collateral received on behalf of the OSTF and Oregon state agencies other than PERS. As permitted under the fund's Declaration of Trust (Declaration), participant purchases and redemptions are transacted at \$1 per unit ("constant value") based on the amortized cost of the fund's investments. Accordingly, the securities lending collateral held and the obligation to the lending agent are both stated at constant value on the statement of net position.

The fair value of investments held by the fund is based upon valuations provided by a recognized pricing service. These funds are not registered with the Securities and Exchange Commission, but the custodial agent is subject to the oversight of the Federal Reserve Board and the Massachusetts Commissioner of Banks. No income from the funds was assigned to any other funds.

The maturities of investments made with cash collateral did not generally match the maturities of the securities loaned. Since the securities loaned are callable on demand by either the lender or borrower, the life of the loans at June 30, 2014, is effectively one day. On June 30, 2014, the State had no credit risk exposure to borrowers because the amounts the State owes to borrowers exceed the amounts borrowers owe the State.

Collateral received, securities on loan, and investments of cash collateral are:

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	<u>Total OSTF</u>	<u>SPWF</u>	<u>WF</u>
Cash collateral received			
for the securities on loan	\$ 1,024,899	\$ 5,012	\$ 1,527
Fair value of all securities on loan	1,004,307	6,763	2,508
Fair value of all investments made			
with cash collateral received	611,685	4,119	1,528

The securities on loan from the OSTF in total included:

	<u>Percent</u>	
U.S. Treasury securities	88.91	%
U.S. Agency securities	5.50	
Domestic fixed income securities	5.59	
	<u>100.00</u>	

Note 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, 2014:

	<u>July 1, 2013</u>	<u>Increase</u>	<u>Decrease</u>	<u>June 30, 2014</u>	<u>Due in one year</u>
Bonds payable					
Principal	\$ 95,900	-	(7,435)	88,465	3,990
Premium	26	-	(1)	25	-
Discount	(31)	-	2	(29)	-
Total bonds payable	<u>95,895</u>	<u>-</u>	<u>(7,434)</u>	<u>88,461</u>	<u>3,990</u>
Compensated absences	147	-	(3)	144	95
Net obligation for post-employment benefits	31	1	-	32	-
Pension-related debt	256	-	(8)	248	7
	<u>\$ 96,329</u>	<u>1</u>	<u>(7,445)</u>	<u>88,885</u>	<u>4,092</u>

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Note 5 - DEBT SERVICE REQUIREMENTS TO MATURITY

Future maturities of principal and interest as of June 30, 2014:

Year(s) ending June 30	Principal	Interest	Total
2015	\$ 3,990	\$ 3,902	\$ 7,892
2016	4,145	3,755	7,900
2017	4,310	3,599	7,909
2018	4,405	3,435	7,840
2019	4,560	3,263	7,823
2020-2024	24,665	13,353	38,018
2025-2029	28,075	7,327	35,402
2030-2034	13,830	1,738	15,568
2035-2039	485	19	504
Total	\$ 88,465	\$ 40,391	\$ 128,856

Note 6 - BONDS ISSUED AND OUTSTANDING

As of June 30, 2014, Oregon Bond Bank revenue bonds totaling \$88,465 are outstanding. Bond proceeds are lent to Oregon local governments (borrowers) to fund eligible SPWF and WF projects. Security for bond payment is primarily from repayment of these loans made to the Department by the borrowers. These bonds are not general obligations of the State of Oregon. Bonds payable reported on the statement of net position are recorded net of original issue premiums and discounts. Bond premiums of \$25 and bond discounts of \$29 are included in Bonds Payable as of June 30, 2014. The following table summarizes the changes in bonds outstanding during fiscal year 2014:

Series	Due January 1	Interest Rates	Original Issue	July 1 2013	Increase	Decrease	June 30 2014	Due in one year
2003 A	2005-29	3.00-4.63	25,475	13,660	-	(1,705)	11,955	730
2004 A	2006-30	3.00-4.50	6,325	3,655	-	(2,625)	1,030	50
2007 A	2008-32	4.00-4.38	26,905	21,985	-	(975)	21,010	1,010
2007 B	2008-32	5.13-6.00	8,900	7,660	-	(270)	7,390	290
2009 A	2010-34	3.00-5.25	32,830	28,945	-	(1,055)	27,890	1,090
2010 A	2011-35	2.00-5.71	21,555	19,995	-	(805)	19,190	820
			\$ 121,990	95,900	-	(7,435)	88,465	3,990

Note 7 - Employee Retirement Plans

7.A - PLAN DESCRIPTION

The Oregon Public Employees Retirement System (PERS) provides retirement plans for Department employees. PERS is administered by the Public Employees Retirement Board (Board), as required by Oregon Revised Statutes (ORS) chapters 238 and 238A. Copies of the Oregon Public Employees Retirement System annual financial reports may be obtained at:

http://www.oregon.gov/pers/Pages/section/financial_reports/financials.aspx.

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7.B - OREGON PUBLIC EMPLOYEES RETIREMENT SYSTEM (PERS)

The Department's employees who were plan members before August 29, 2003, participate in the Oregon Public Employees Retirement System (PERS), a cost-sharing multiple-employer defined benefit pension plan. The PERS has two tiers of benefits. Employees hired before January 1, 1996 are in Tier One. Tier One employee benefits are reduced if retirement occurs prior to age 58 with fewer than 30 years of service. Tier Two members are eligible for full benefits at age 60. Tier Two does not have the Tier One assumed earnings rate guarantee. The PERS retirement allowance is payable monthly for life and may be selected from several retirement benefit options as established by ORS chapter 238. Options include survivorship benefits and lump sum distributions. The PERS also provides death and disability benefits.

7.C - OREGON PUBLIC SERVICE RETIREMENT PLAN (OPSRP)

The 2003 Oregon Legislature created the Oregon Public Service Retirement Plan (OPSRP), also a cost-sharing multiple-employer plan. OPSRP is part of PERS and is administered by the PERS Board. OPSRP is a hybrid pension plan with two components: the Pension Program (defined benefit) and the Individual Account Program (defined contribution). Department employees hired after August 28, 2003 participate in OPSRP after completing six months of service. The OPSRP Pension Program provides a monthly pension payable for life as well as death and disability benefits as established by ORS chapter 238A.

Beginning January 1, 2004, PERS members became members of the Individual Account Program (IAP) portion of OPSRP. PERS members retain their existing PERS accounts, but member contributions are now deposited in the IAP account rather than into the member's PERS account. All covered employees are required by state statute to contribute a percentage of their salary to the IAP. Current law permits employers to pay the employee contribution, which the Department does.

7.D - PLAN RATES

For the PERS Pension and the OPSRP Pension, the Department must contribute actuarially computed amounts as determined by the Board. The funding policies provide for monthly employer contributions. Rates are subject to change as a result of subsequent actuarial valuations.

The required contribution rates as a percentage of subject salary are:

Year ended June 30	PERS	OPSRP	IAP
2014	9.00%	7.45%	6.00%
2013	9.55%	8.05%	6.00%
2012	9.55%	8.05%	6.00%

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7.E - ANNUAL PENSION COST

The annual pension cost is the actual contribution to PERS (which equals the required contribution) plus the 6% employee contribution which the Department has agreed to pay. The annual pension cost for the year ended June 30, 2014 and the two preceding years are:

Year ended June 30	PERS	OPSRP	IAP
2014	\$ 90	\$ 74	\$ 60
2013	80	67	50
2012	79	66	49

Note 8 - Other Postemployment Benefit Plans

8.A - PLAN DESCRIPTION

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). Copies of the Oregon Public Employees Retirement System annual financial reports may be obtained at:

http://www.oregon.gov/pers/Pages/section/financial_reports/financials.aspx

8.B - 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 \$60¹ 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 plan was closed to new entrants hired on or after August 29, 2003.

The Department is required by statute to contribute actuarially computed amounts as determined by PERS. For Tier One and Tier Two members, the Department contributed 0.08% of PERS-covered salary to fund the normal cost portion of RHIA benefits. The Department also contributed 0.49% of all PERS-covered salary to amortize the unfunded actuarial accrued liability. These rates are embedded within the total PERS and OPSRP Pension Employer Rates.

The Department's contributions for the years ended June 30, 2014, 2013, and 2012 did not exceed \$5 per year in each fiscal year. The actual contribution equaled the annual required

¹This amount represents actual dollars and is not rounded to thousands

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

8.C - 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 plan was closed to new entrants hired on or after August 29, 2003.

The Department is required by statute to contribute actuarially computed amounts as determined by PERS. For Tier One and Tier Two members, the Department contributed 0.09% of PERS-covered salary to fund the normal cost portion of RHIPA benefits. The Department also contributed 0.20% of all PERS-covered salary to amortize the unfunded actuarial accrued liability. These rates are embedded within the total PERS and OPSRP pension employer rates.

The Department's contributions for the years ended June 30, 2014, 2013, and 2012 did not exceed \$3 per year in each fiscal year. The actual contribution equaled the annual required contribution.

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

8.D - 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 does not issue a separate, publicly available financial report.

Chapter 243 of the Oregon Revised Statutes assigns PEBB the authority to establish and amend the benefit provisions of the PEBB plan. As the administrator of the PEBB plan, PEBB has the authority to determine postretirement benefit increases and decreases.

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8.E - OPEB OBLIGATION

The Department's liability for OPEB expenses in SPWF and WF for fiscal year 2014 was \$1 and \$1, respectively.

Note 9 - RISK FINANCING

The State of Oregon's Department of Administrative Services Risk Management Section (Risk Management) administers the State's property, liability, and workers' compensation insurance program. Risk Management has found it more economical to manage the risk of loss internally and, therefore, minimizes the purchase of commercial insurance policies to the extent possible.

The monies set aside by Risk Management under Chapter 278 of the Oregon Revised Statutes are used to service the following risks: 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 required by law to be covered and other key positions.

As a state agency, the Department participates in the self-insured property and liability program. Risk Management allocates the cost of claims and claims administration by charging an assessment to each State entity, based on its share of losses. Statewide risk charges are based on independent biennial actuarial forecasts and division expenses, less any available fund balance from the prior biennium.

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

Note 10 - COMMITMENTS

The Department has signed contracts to fund various SPWF and WF projects. The amount of money committed but not disbursed at June 30, 2014 is:

	SPWF	WF	Total
\$	8,041	25,460	33,501

Money for these projects is expected to be disbursed within three years. These commitments will be funded from current assets, future non-bond bank loan payments, and any amount provided from non-program sources, such as Oregon Lottery Revenue Bonds approved by the Oregon Legislature.

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Note 11 - CHANGES IN ACCOUNTING PRINCIPLE

For the fiscal year ended June 30, 2014, the Department implemented two new accounting standards issued by the Governmental Accounting Standards Board (GASB):

GASB Statement No. 65, Items Previously Reported as Assets and Liabilities identifies the specific items previously reported as assets and liabilities that should be reclassified and reported as deferred outflows of resources, deferred inflows of resources, outflows of resources, or inflows of resources. Additionally, No. 65, requires that debt issuance costs previously amortized, be expensed in the period incurred. As a result issuance costs of \$1,336 were written off during fiscal year 2014.

GASB Statement No. 67, Financial Reporting for Pension Plans (an amendment to GASB Statement No. 25), is to improve the financial reporting by state and local governmental pension plans. For defined benefit pension plans, this Statement establishes standards of financial reporting for separately issued financial reports, specifies the required approach to measuring the pension liability of employers for benefits provided through the pension plan (the net pension liability), and details the required note disclosures. No adjusting entries were made to the financial statements as a result of GASB Statement No. 67.

Other Report



Independent Auditor's 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*

The Honorable Kate Brown, Governor of Oregon
Sean M. Robbins, Director, Oregon Business Development Department
Oregon Business Development Commission
Infrastructure Finance Authority Board

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Special Public Works Fund and Water Fund, enterprise funds of the State of Oregon, Business Development Department, as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise the Special Public Works Fund and Water Fund basic financial statements, and have issued our report thereon dated March 18, 2015.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Oregon Business Development Department's internal control over financial reporting (internal control) related to the Special Public Works Fund and Water Fund to determine the audit procedures that are appropriate in the circumstances 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 Oregon Business Development Department's internal control. Accordingly, we do not express an opinion on the effectiveness of the Oregon Business Development Department's internal control.

A deficiency in internal control 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 and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these

limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify a deficiency in internal control, described in the accompanying schedule of findings and responses that we consider to be a significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Oregon Business Development Department's financial statements of the Special Public Works Fund and Water Fund are free from 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*.

Oregon Business Development Department's Response to Findings

The Oregon Business Development Department's response to the finding identified in our audit is described in the accompanying schedule of findings and responses. The Oregon Business Development Department's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Office of the Secretary of State, Audits Division

State of Oregon
March 18, 2015

Findings and Responses

Improve Controls over Check Remittances

Management is responsible for establishing and maintaining adequate internal control, which includes processes designed to provide reasonable assurance that management's objectives are achieved and assets are safeguarded. The state has established suggested procedures over cash, which can provide strong controls over cash receipts. Some of the fundamental rules for attaining control over cash receipts include:

- establishing control over cash receipts immediately;
- restrictively endorsing checks when collected; and
- designating two persons (dual custody) to open mail remittances at designated times.

We noted two points of risk in the department's procedures for opening mail remittances. First, the department had designated only one person to sort incoming mail into (1) general mail, and (2) items known to contain remittances. This person was responsible for opening mail only if routing was unknown; however, the opened mail sometimes contained remittances. Secondly, the department designated only one person to open mail remittances and to endorse, log, and scan the checks for deposit. By not ensuring dual custody of cash receipts, there is a heightened risk that errors could occur or receipts could go missing, especially during high volume periods. During fiscal year 2014, the department received approximately \$23 million in checks; approximately \$15 million of which were received in November alone. Management indicated that limited staff resources contributed to this condition.

We recommend department management examine its cash receipts patterns and implement dual custody procedures at appropriate times.

Oregon Business Development Department's Response

The Department generally agrees with the audit finding and recommendation.

During November and December each year, the Department receives a high volume of receipts in the mail due to the annual invoicing of the infrastructure loans. Although a high volume of receipts is being received, due to the limited staff resources available, only one staff has been designated to sort incoming mail and another to open the remittances and endorse, log and scan checks for deposit. Although dual custody of mail remittances has not existed, Fiscal does have other detective controls in place to mitigate the risk. Cash is not being received in the mail and the majority of checks received are loan payments. The Infrastructure Accountant is responsible for reconciling loans monthly and sending notices to loan clients when payments are one month past due.

We do agree that the margin of error increases with a higher volume of remittances during annual peak times. Therefore, we will implement procedures to ensure dual custody of remittances from November 1 through January 31 of each year. In conjunction, we will implement procedures to ensure that more than one person is charged with the task of sorting, opening and routing incoming mail during those peak times as well.