

Oregon

Comprehensive Annual Financial Report

For the Year Ended June 30, 1999



John A. Kitzhaber, M.D.
Governor

Jon Yunker, Director
Department of Administrative Services

John J. Radford, Administrator
State Controller's Division

Report Prepared by:

Statewide Accounting and Reporting Section
State Controller's Division, Department of Administrative Services

Jean Gabriel, CPA, Manager
Jeanne Bock

Lorna Christopherson

Michael Cutler, CPA

Robert Johnson

Donald E. Lew, CPA

Jane Moreland

Sheila Orton, CPA

Karen Sellers

Ronnie Studer

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FOR THE YEAR ENDED JUNE 30, 1999
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December 17, 1999

The Honorable John A. Kitzhaber, M.D.
Governor of the State of Oregon

Citizens of Oregon

We are pleased to provide you with the Comprehensive Annual Financial Report of the State of Oregon for the year ended June 30, 1999, in accordance with Oregon Revised Statute 291.040. We believe the information presented is accurate in all material respects. It is presented in a manner which fairly sets forth the financial position and results of operations of the State, as measured and reported by the financial activity of its various funds. All disclosures necessary to enable the reader to gain an understanding of the State's financial affairs have been included. Responsibility for both the accuracy of the presented data and the completeness and fairness of the presentation, including all disclosures, rests with the management of the State.

We divided this comprehensive report into three sections. The Introductory Section includes this transmittal letter, which contains an overview of the State's economic performance, a review of major initiatives, and summary financial data. The State's organizational chart and a directory of principal officials are also included in this section. The Financial Section includes the general purpose financial statements and accompanying notes as well as required supplementary information. It also includes the independent auditor's report on the general purpose financial statements and the combining fund financial statements and schedules. The Statistical Section includes selected financial, economic, and demographic information, generally presented on a multi-year basis.

This report covers the State's wide range of programs serving Oregon's citizens including education, human resources, public safety, economic and community development, natural resources, transportation, consumer and business services, administrative support, legislative, and judicial programs. The report is prepared for the State reporting entity, which includes all the funds and account groups of the primary government, as well as its component units. Component units are legally separate entities for which the primary government is financially accountable. Accordingly, the Oregon Health Sciences University and SAIF Corporation are component units reported as part of the State reporting entity. You can find more information about the State reporting entity in the notes accompanying the general purpose financial statements.

The Oregon Comprehensive Annual Financial Report has been prepared in accordance with generally accepted accounting principles as set forth by the Governmental Accounting Standards Board, the Financial Accounting Standards Board, the American Institute of Certified Public Accountants, and other recognized standard setting bodies. You will find a summary of significant accounting policies in the notes accompanying the general purpose financial statements.

THE OREGON ECONOMY

Current Conditions

Oregon's economy grew faster than the nation throughout the mid-1990s. The Asian financial crisis slowed the State's growth in 1998. Asia's slow recovery continued to dampen growth in 1999. Oregon was impacted more than the country as a whole by the crisis because of close ties to Asian export markets.

While the first quarter of 1999 saw rapid job growth at an annualized rate of 3.8 percent, the second and third quarters saw only a modest growth of 0.3 percent. On a year over year basis, job growth in the third quarter was 1.6 percent. This is the lowest growth rate since 1991. While 1.6 percent job growth is lower than recent years, it is still a healthy increase and indicates the State's economy is continuing to expand. The slowdown does not indicate that Oregon's economy is in recession or heading into one in the near future.

The most recent Blue Chip Job Growth rankings placed Oregon 22nd in the nation for year over year job growth between August 1998 and August 1999. This is a growth rate of 1.7 percent. U.S. job growth over the same period was 2.2 percent. Oregon's immediate neighbors, California and Washington, grew 2.78 percent and 1.93 percent, respectively, over the same period.

Asian economies are on the mend, but the speed of recovery is slow. As a result, the manufacturing sector continues to show weakness. Manufacturing jobs are down 5,700 from the third quarter of 1998. The lumber and wood products sector lost 1,300 jobs during the third quarter of 1999, a 10.1 percent annualized decline. Non-durable manufacturing lost 1,900 jobs during the third quarter. The main reason for this 11.3 percent annualized decline is reductions in the food processing sector. Specifically, the beverage area was hit by the closing of Blitz-Weinhard brewery. The bankruptcy of Agripac and a depressed fishing industry also adversely impacted this sector.

Non-manufacturing added 3,800 jobs during the third quarter, growing at an annual rate of 1.1 percent. Both transportation services and local governments had large job gains, adding 1,000 and 3,900 jobs, respectively. Local government additions offset flat federal jobs and a 1.9 percent annualized decline in State employment. Education accounts for most of the job gains in local government. Trucking and warehousing job growth remain strong. Construction only grew at a 0.5 percent annual rate during the third quarter, adding 100 jobs.

Future Economic Outlook

Oregon's economy is expected to finish 1999 with job growth slightly below that of the national average, after years of superior economic performance. However, the economy should once again grow faster than the nation in 2000 and 2001 with job growth of 1.9 percent and 2.1 percent, respectively. These are much milder growth rates compared to the rapid expansion of the mid-1990s. Nonetheless, Oregon's economy is likely to continue growing as long as the nation avoids a recession.

Back in the 1980s, if job growth in Oregon was projected to hover around 1.9 to 2.1 percent, this would be heralded as strong economic growth. With the exception of the last two years, Oregon has grown faster than the U.S. since 1985. During the mid-1990s, Oregon grew at nearly twice the national rate. As a result, entering the new millennium growth in the 1.9 to 2.1 percent range will be viewed as a slowdown. Recent history influences our perceptions of the economy. Even with the level of growth expected, Oregon will still be seen as a high growth State since the U.S. economy is expected to grow in the 0.8 to 1.6 percent range.

We expect the State's personal income to finish 1999 with a rise of 5.5 percent. Similar growth of 5.5 percent is expected for personal income in 2000 and a 5.3 percent increase is anticipated in 2001. This will be greater than the national average. Personal income for the U.S. is expected to grow 5.0 percent in 2000 and 4.5 percent in 2001. State wage and salary income will finish 1999 with growth of 6.6 percent. Growth is expected to taper off slightly in 2000 and 2001, with increases of 6.2 percent each year.

Oregon's high technology sector is slowly recovering. A major reason is the increase in demand in the semiconductor industry. Expanding interest in the Internet has increased demand for PCs and the chips that run them. Beyond PCs, telecommunications and hand-held electronic organizers have increased demand for chips also. The high technology sector is expected to recover by mid to late 2001, led by the semiconductor industries.

Three interest rate hikes engineered by the Federal Reserve slowed the finance, insurance and real estate sector in 1999. Job growth will come in at a healthy 1.9 percent in 1999 but only because of the strong first quarter. Job growth in this sector is expected to slow to 1.5 percent in 2000 and to increase to 2.2 percent in 2001.

The lumber and wood products sector has enjoyed increased demand and the accompanied price rises over the past year. However, demand is on the decline due to the rise in mortgage interest rates that slowed housing starts during 1999 and slower population growth. In addition, foreign competition is still intense. The outlook for Oregon's timber industry is for continued industry consolidation and declining employment.

We expect Oregon's construction sector to post mild gains of 1.4 percent in 2000 and 2.1 percent in 2001. Higher interest rates and declining housing starts related to slower population growth are the main reasons for the decline. We project growth for construction jobs to be relatively flat over the next couple of years.

Transportation services are expected to remain strong into 2000, adding 2,400 jobs. Growth is expected to be moderate along with slower growth in wholesale and retail trade.

The State's population is expected to increase from 3.268 million in 1998 to 3.553 million in 2005, an 8.7 percent increase. The fastest growth will occur in the 45-64 year olds and the 18-24 year olds. This is due to the baby boom generation and their children entering these cohorts. The rapid growth in 18-24 year olds through the next five years will place enrollment pressures on community colleges and public universities. The 85 and older group is expected to increase 30.5 percent between 1998 and 2005. In contrast, the 65-74 group is currently declining but is expected to increase in number in 2002.

A national recession is the primary risk to the Oregon economy. As world markets, mainly Asian, continue to recover, this risk is mitigated. Global market growth is the key to the health of high technology, lumber and wood products, and agriculture. The Oregon economy also faces the risk of slowed consumer spending which could be triggered by a sharp stock market correction, rising interest rates and inflation, or a loss of consumer confidence.

We expect Oregon's economic growth rate to move back above the national average in 2000. The State is expected to remain a relatively high growth State through 2005. The primary factors expected to fuel the State's long-term growth are increased exports, recovery in the semiconductor industry, higher commodity prices, continued domestic strength and relatively low business costs.

MAJOR INITIATIVES

Current Year Projects

Oregon dedicated nearly 90 percent of the State General Fund to three principal program areas this past year.

- **Education** - aid to local schools (K-12 and community colleges) and higher education - \$2.1 billion
- **Human resources** - low-income health care (Oregon Health Plan), mental health (State hospital and local facilities), long-term senior care (nursing homes and alternative nursing delivery), temporary assistance to needy families (TANF) and child protection services - \$1.0 billion
- **Public safety** - State prisons, State police and the court system - \$0.5 billion

State law provides that if actual General Fund revenues at the close of the Legislative session exceed forecasted revenues by two percent or more, the excess revenues are refunded to taxpayers. Accordingly, the 1999 Legislature approved excess revenue credits of approximately \$167.3 million for personal income taxpayers. The refunds were paid in late 1999.

The Department of Administrative Services completed the implementation of a new statewide financial reporting system during the year. This system provides for improved budgetary reporting and more effectively uses information from the statewide financial management system. The project enhanced the State's financial reporting and further automated the reporting process.

Future Projects

The 1999-2001 approved budget funded a number of new and ongoing projects. It increased emphasis on three areas identified as challenges for Oregon's future.

- Education. The approved budget includes approximately \$450.0 million for the K-12 schools to help children meet the high standards of the Education Act of the 21st Century. It provides an additional \$73.0 million for universities to help continue the freeze on in-state undergraduate tuition. It also provides for \$3.5 million to expand the Oregon pre-Kindergarten programs.
- Juvenile Crime. In our continuing efforts to keep children from getting into trouble, the approved budget invests \$42.2 million in the High Risk Juvenile Crime Prevention Partnership, alcohol and drug prevention, and early childhood intervention.
- Quality of Life. Maintaining the balance between preserving the quality of life and protecting the economic opportunities we enjoy prompted investment in the 21st Century Community Fund. This fund leverages

existing revenues from both the Oregon Lottery and transportation funds by using them to back bonds to invest in affordable housing, transportation, water, sewer, and main streets.

The 1999-2001 approved budget does not utilize any tobacco settlement funds. Instead, the legislature referred a proposal to the voters to place these monies in a Health Security Fund.

Through the adoption of the 1999-2001 budget, the Legislature addressed a number of issues, including continuation of the Oregon Plan for salmon and watersheds, funding of State parks, and implementation of Ballot Measure 66. Passed by the voters in November of 1998, Ballot Measure 66 amended the Oregon Constitution to dedicate 15 percent of net lottery proceeds to be split between State parks and salmon, watershed, and habitat restoration. The Legislature implemented Ballot Measure 66 by passing a bill that allocates \$86.9 million of these constitutionally dedicated lottery resources.

Year 2000 Issues

The State makes extensive use of computer systems. The year 2000 could cause problems for older computer systems that identify the year with two digits rather than four. These systems could mistake the year 2000 for the year 1900.

The State is actively addressing the year 2000 (Y2K) problem. With the help of outside computer consultants, it is evaluating its computer systems for Y2K compliance, taking corrective actions as needed, and testing the actions taken. The State has also developed contingency plans for dealing with internal and external non-compliance.

All State agencies are actively engaged in the conversion and testing of mission-critical systems. You can find more information on Y2K in the required supplementary information following the notes to the general purpose financial statements.

Service Efforts and Accomplishments

The Oregon Benchmarks continue to help measure the results of State programs and spending compared to standards set for statewide progress and governmental performance. The Benchmarks are based on the idea that Oregon has a better chance for the future if Oregonians agree on the goals set for the State. Benchmarks also place a priority on measuring results rather than activities. They have become an important tool in State government for setting program and budget priorities and for seeking interagency cooperation on broad issues.

FINANCIAL INFORMATION

Internal Control

The management of the State is responsible for establishing and maintaining internal controls. Internal controls are designed to provide reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, that financial transactions are properly executed in accordance with legislative and management authorization, and that transactions are properly recorded and documented. The concept of reasonable assurance recognizes that the cost of an internal control should not exceed the benefit derived from that internal control.

The State has taken steps to enhance its internal controls. We have issued formal policies to monitor the adequacy of the State's internal controls and to encourage active participation of management in establishing and maintaining internal controls. These policies are in accordance with national standards for internal controls. Results demonstrate a continuing commitment by State agencies to maintain and improve their management controls.

Budgetary Controls

The State maintains a system of budgetary controls, which ensures compliance with legal provisions embodied in the biennial budget approved by the Legislature. The development and approval of the biennial budget is the beginning of the financial transaction process. Agency expenditures are monitored daily against approved quarterly allotments and cash balances. Additional information about budgetary controls can be found in the notes accompanying the general purpose financial statements.

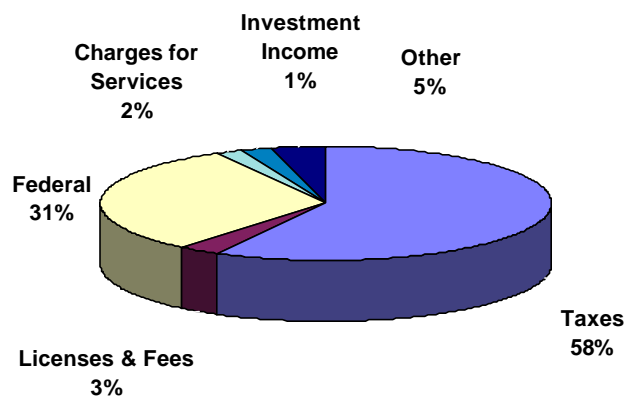
General Government Functions

The State accounts for general governmental activities in four governmental fund types: general, special revenue, debt service, and capital projects. Revenues for general government activities were approximately \$9.7 billion in fiscal year 1999, an increase of 10.2 percent from fiscal year 1998. The amounts of revenue by source and the changes from 1998 are as follows:

General Government Revenues For the Years Ended June 30, 1999 and 1998 (dollars in millions)

Revenue Source	1999	1998	Amount of Change	% Increase (Decrease)
Taxes	\$5,580	\$5,096	\$484	9.5%
Licenses and Fees	311	292	19	6.5%
Federal.....	3,018	2,733	285	10.4%
Charges for Services	223	173	50	28.9%
Fines and Forfeitures.....	70	53	17	32.1%
Rents and Royalties.....	7	7	0	0.0%
Investment Income.....	123	137	(14)	(10.2)%
Sales.....	68	59	9	15.3%
Other.....	<u>267</u>	<u>223</u>	<u>44</u>	19.7%
Total.....	\$9,667	\$8,773	\$894	10.2%

Taxes are the largest source of State revenue. Increased tax revenues from strong personal income growth account for the increase from 1998 to 1999. The following chart shows each revenue source in fiscal year 1999 as a percentage of total general government revenues:

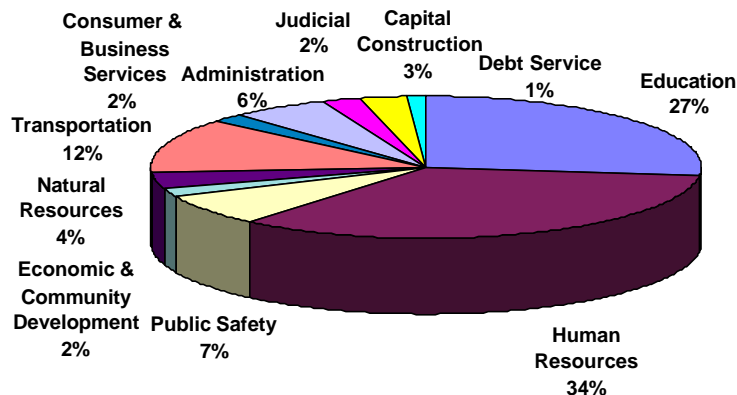


Expenditures for general governmental activities in 1999 were approximately \$9.7 billion, an increase of 7.9 percent over fiscal year 1998. The following shows expenditures by program function and the changes from 1998:

**General Government Expenditures
For the Years Ended June 30, 1999 and 1998
(dollars in millions)**

Expenditures by Program	1999	1998	Amount of Change	% Increase (Decrease)
Education.....	\$2,633	\$2,818	\$(185)	(6.6)%
Human Resources	3,342	2,893	449	15.5%
Public Safety.....	653	570	83	14.6%
Economic and Community Development	219	206	13	6.3%
Natural Resources	388	311	77	24.8%
Transportation.....	1,140	1,082	58	5.3%
Consumer and Business Services.....	233	228	5	2.2%
Administration.....	591	445	146	32.8%
Legislative	27	19	8	42.1%
Judicial.....	183	174	9	5.2%
Capital Construction and Improvements.....	277	168	109	64.9%
Debt Service	37	94	(57)	(60.6)%
Total	\$9,723	\$9,008	\$715	7.9%

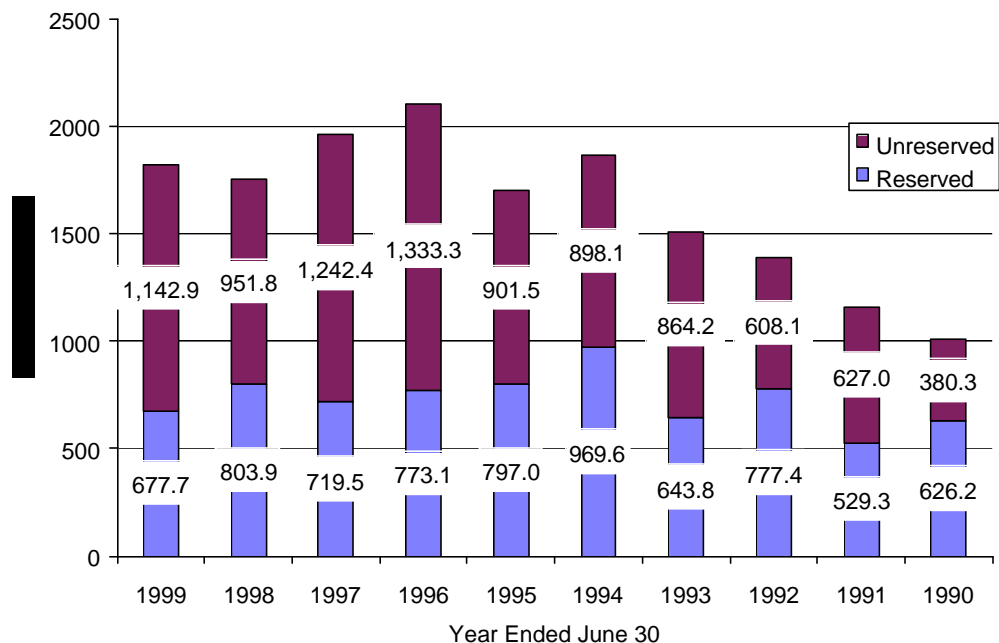
The following chart shows expenditures by each program in fiscal year 1999 as a percentage of total general government expenditures:



Total expenditures increased \$715 million with \$449 million due to funding increases in the human resources program area. Human resources funding increased primarily due to phase-in and rising costs of the Oregon Health Plan. Of the \$146 million increase in administration, \$80 million is for final payment to the SAIF Corporation in settlement of a claim. Rising revenues have funded spending increases without significant tax increases.

As of June 30, 1999, the aggregate fund balance of Oregon's general government funds totaled \$1.8 billion. Of this amount, \$0.7 billion was reserved for various purposes and \$1.1 billion was unreserved. The following graph illustrates the aggregate fund balances of general government funds for the last ten years:

**General Government Funds
Unreserved and Reserved Fund Balances
For the Years Ended June 30, 1999 through 1990**



Proprietary Operations

We account for the activities of a government that are similar to private sector businesses in enterprise and internal service funds. We use enterprise funds to account for services provided to the public for which the revenues derived by the activity will support the services provided. The enterprise fund with the largest revenue in the State is the Oregon State Lottery. The Lottery provides revenue for K-12 education and economic development programs. Approximately \$323.2 million was distributed for education and economic benefits for the year ended June 30, 1999. Other enterprise operations include the Housing and Community Services Fund, the Veterans' Affairs Fund, the Small Scale Energy Fund, the State Hospitals Fund, and the Liquor Control Fund.

We use internal service funds to account for services provided to State agencies. These funds operate on a break-even basis. The State's largest internal service fund is the Central Services Fund under the Department of Administrative Services, whose services include motor pool, facilities, printing, insurance, and telecommunications.

Fiduciary Fund Types

We use fiduciary funds to account for assets held by the State in a trustee capacity or as an agent in a custodial capacity. Trust funds include expendable, nonexpendable, investment, and pension trust funds. Trust agreements establish these funds and specify how they will operate. Both the principal and income of expendable trust funds may be spent. The State's largest expendable trust fund is the Unemployment Insurance Fund that pays unemployment benefits. Only the income portion of nonexpendable trust funds, such as the activities of the Common School Fund, may be spent. The State's pension trust fund is the Public Employees Retirement System, which administers the retirement benefits held in trust for public employees.

We use agency funds to account for assets held in trust for individuals or other entities. An example would be child support payments collected by the State Adult and Family Services Division on behalf of custodial parents.

College and University Funds

The Oregon University System uses college and university fund types to account for the various activities of the system. These include the University of Oregon, Oregon State University, Portland State University, Western Oregon University, Southern Oregon University, Eastern Oregon University, the Oregon Institute of Technology, and the Chancellor's Office.

Account Groups

We report fixed assets associated with governmental type funds in the general fixed assets account group. Long-term debt associated with governmental type funds is reported in the general long-term debt account group.

Debt Administration

The State's debt credit ratings, which are an indication of the State's ability to repay its debt and a reflection of the State's sound financial management, are shown below for the State's most recent general obligation bond issues:

Oregon's Most Recent General Obligation Bond Ratings

Moody's Investors Service	Aa2
Standard & Poor's Rating Group	AA
Fitch Investors Service	AA

For the years ended June 30, 1999 and 1998, the State had debt outstanding as follows:

Debt Outstanding For the Years Ended June 30, 1999 and 1998 (dollars in millions)

	1999	1998	1999 Over (Under) 1998	
			Amount	Percent
General Obligation Bonds	\$2,479.0	\$2,997.6	\$ (518.6)	(17.3)%
Revenue Bonds	1,670.4	1,208.3	462.1	38.2%
Certificates of Participation.....	<u>640.7</u>	<u>665.1</u>	<u>(24.4)</u>	(3.7)%
Totals.....	\$4,790.1	\$4,871.0	\$ (80.9)	(1.7)%

Cash Management

State agencies turn over all monies collected to the State Treasurer, who is responsible for the control of cash and the investment of State funds. The Oregon Investment Council, of which the State Treasurer is a member, establishes investment policy for all State of Oregon funds. To further Oregon's economic growth, the Council's continuing policy has been to invest locally when they can find investments of comparable yield, quality and maturity in-state without damaging portfolio diversity. Fortunately for Oregonians, State-imposed safeguards minimize the dangers of investing in highly leveraged financial instruments, which have been a cause of national concern.

The State Treasurer pools all available cash into the Oregon Short-Term Fund, which invests in a variety of instruments. For the year ended December 31, 1998, the average monthly portfolio balance was \$5.76 billion and the average yield on these investments was 5.5 percent. The State Treasurer also manages separate investments for the Oregon Public Employees Retirement Fund, the Industrial Accident Fund, the Local Government Investment Pool, and numerous smaller funds such as the Insurance Fund and the Common School Fund.

The federal Cash Management Improvement Act of 1990 requires that the federal government advance cash to the State in a timely manner. Conversely, the State must not draw federal cash in advance of needs. The State established policies and procedures to comply with this act when it became effective in 1993.

Risk Management

The Department of Administrative Services, through the Insurance Fund, provides for the State's self-insurance programs and for the administration, investigation, and settlement of claims against the Insurance Fund. We explain this more fully in the notes accompanying the general purpose financial statements. In accordance with legislative directives, the Insurance Fund must operate on an actuarially sound basis.

OTHER INFORMATION

Independent Audit

The Audits Division of the Secretary of State has audited the financial records, books of account, and transactions of the State of Oregon and its component units for the year ended June 30, 1999. Their opinion is included in the Financial Section of this report.

In addition to meeting the requirements set forth in Oregon Revised Statutes 297.210, the audit was designed to meet the standards of the federal Single Audit Act of 1996 (as amended) and the related U.S. Office of Management and Budget Circular A-133. These federal standards require that the audit be planned and performed in a manner to obtain reasonable assurance that the State has complied with federal program requirements. The Single Audit Report is a separate report and will be available in early 2000. It includes the Schedule of Expenditures of Federal Awards, the Federal Compliance Report, the Internal Control Report, and the Schedule of Findings and Questioned Costs.

Awards

The Government Finance Officers Association of the United States and Canada (GFOA) sponsors the Certificate of Achievement for Excellence in Financial Reporting. The Certificate of Achievement is a prestigious national award, recognizing conformance with the highest standards for preparation of State and local government financial reports. GFOA awarded the Certificate of Achievement to the State of Oregon for its Comprehensive Annual Financial Report for the year ended June 30, 1998.

To earn a Certificate of Achievement, a government unit must publish an easily readable and efficiently organized comprehensive annual financial report, whose contents conform to program standards. The report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is only valid for a period of one year. The State of Oregon has received a Certificate of Achievement for each of the last seven years. We believe our current report conforms to the Certificate of Achievement program requirements, and we are submitting it to the GFOA. We are committed to this effort and intend to maintain a highly qualified and professional staff to make Oregon's certification possible in the future.

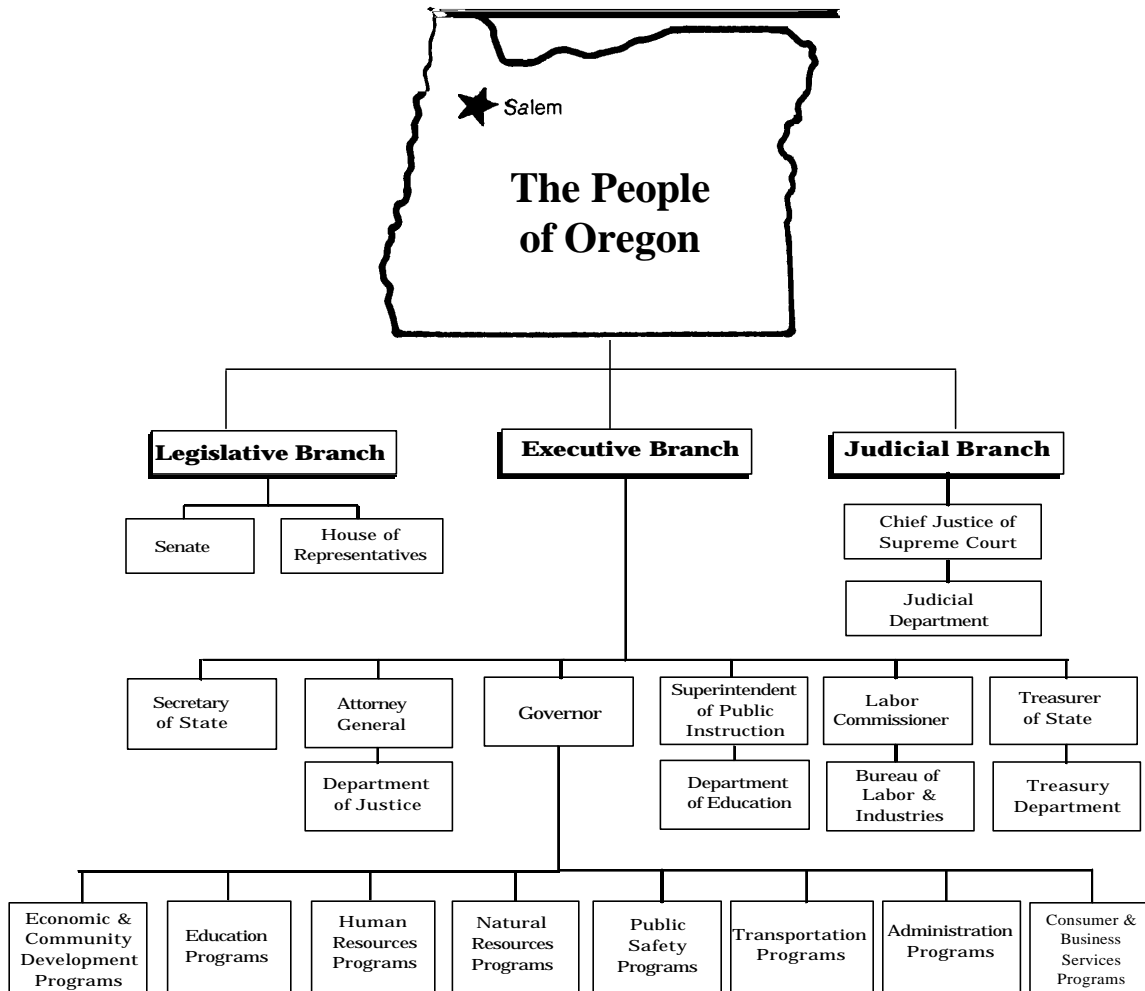
Acknowledgements

The State Controller's Division takes great pride in the preparation of the Oregon Comprehensive Annual Financial Report. We greatly appreciate the professionalism, commitment, and effort of the Statewide Accounting and Reporting Section and the other individuals involved. We also want to thank all State agencies for their continuing support in planning and conducting the financial operations of the State in a professionally responsible and progressive manner. Without the participation and cooperation of the agencies' fiscal units, the preparation of this report could not have been possible. In addition, we appreciate the contributions of the Office of Economic Analysis, the Budget and Management Division, the Finance Division of the Oregon State Treasury, and the staff of the Secretary of State Audits Division.

Respectfully submitted,

John J. Radford, Administrator
State Controller's Division
State of Oregon

STATE OF OREGON ORGANIZATION CHART



Principal State Officials



EXECUTIVE

John A. Kitzhaber, M.D., *Governor*

Phil Keisling, *Secretary of State*

James A. Hill, Jr., *State Treasurer*

Hardy Myers, *Attorney General*

Jack Roberts, *Commissioner, Labor and Industries*

Stan Bunn, *Superintendent of Public Instruction*

LEGISLATIVE

Brady Adams, *Senate President*

Lynn Snodgrass, *Speaker of the House of Representatives*

JUDICIAL

Wallace P. Carson, Jr., *Chief Justice of the Supreme Court*

“To Serve Our Public Well”

Mission of Oregon State Service

Certificate of Achievement for Excellence in Financial Reporting

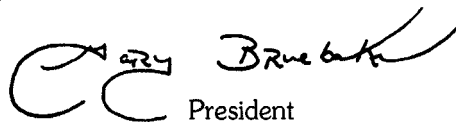
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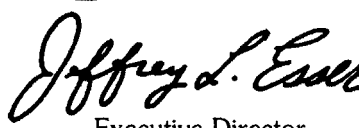
State of
Oregon

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 1998

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.




President


Executive Director