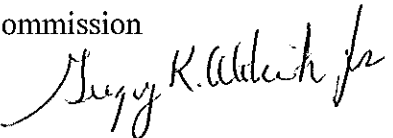


State of Oregon
Department of Environmental Quality

Memorandum

Date: Aug. 15, 2014

To: Environmental Quality Commission

From: Dick Pedersen, Director 

Subject: Agenda item M, Informational item: DEQ's Annual Financial update
Aug. 27-28, 2014, EQC meeting

Purpose of item DEQ staff will present the agency's annual financial update, review and discuss the report with the commission.

Background The commission has three financial performance measures as part of its 15 best practice measures. These measures require the commission to periodically review key financial information and audit findings, appropriately account for resources and assure that DEQ adheres to accounting rules and other relevant financial controls. An additional key performance measure requires the commission to approve DEQ's biennial budget.

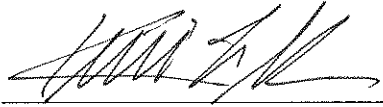
The annual financial update contains audit findings, information on financial monitoring and compliance, as well as additional key financial information for the agency and programs. The update also references the DEQ FY 2013 Annual Financial Report, which is posted on the Electronic Municipal Market Access website run by the Municipal Securities Rulemaking Board. This report is a detailed annual financial statement required to be publicly posted to meet municipal bond public disclosure laws. The DEQ Fiscal Year 2013 Annual Financial Report is also included as attachment B.

EQC involvement DEQ has presented budget updates during regular commission meetings in 2014, and provided the commission with a brief update on the 2013-15 Operating Budget status, which is also covered in the Annual Financial Update. In addition to this report, DEQ will finish a legislative budget development presentation and ask the commission to certify the 2015-17 DEQ Agency Request Budget as separate agenda items.

Attachments A. DEQ's 2014 Annual Financial Update
B. DEQ's 2014 Annual Financial Report

Approved:

Division:



Report prepared by: James Roys
Financial Services Manager



Department of Environmental Quality

Annual Financial Update to the Environmental Quality Commission

August 28, 2014

Executive Summary

The 2005 legislature directed the Department of Administrative Services and the Legislative Fiscal Office to develop a measure for boards and commissions having governance oversight to use in evaluating their own performance. Because the EQC is included in the Department of Environmental Quality's budget and because it hires DEQ's executive director, DAS and LFO deemed the EQC to have governance oversight and identified it as one of the boards and commissions that should have a performance measure.

On December 14, 2006, the EQC adopted the "percent of total best practices met by the commission" as the performance standard. The measure is an annual self-assessment against 15 best practices for boards and commissions, as laid out by DAS and customized to the EQC.

Three of the 15 best practices are financial management practices measures that rely on the Agency reporting to Commission on a periodic basis. This Annual Financial Update consolidates reporting into a single periodic report that covers audits, on-going compliance, and key financial indicators.

I. Audit Highlights/Summary

The financial audits conducted by the Oregon Secretary of State's Office have concluded that the Department's selected financial accounts were fairly stated in accordance with generally accepted accounting principles in relation to the statewide financial statements. Division of Audits also completed the compliance and financial statement audit of the Clean Water State Revolving Fund (CWSRF). CWSRF is substantially in compliance with federal regulations.

DEQ is currently finalizing the 2014 Small Purchase Order Transaction System review and conducting a risk-based review of the agency's permitting systems.

II. State Economic Forecast Summary

The [May 2014 update](#) to the Oregon state economic forecast indicates the state of Oregon continues to grow in both the economy and jobs; that the growth, which original started out in the Portland Metro area has spread to other parts of the state; but that the growth continues to be projected to be at a slower rate than in past recoveries. Tax revenues continue to grow along with the growing economy, but Lottery revenues have not returned to pre-recession patterns and the state economist is uncertain as to whether this might reflect an underlying change in how people view spending discretionary dollars on gambling. This trend seems to extend beyond states lottery gambling, as reflect in economic data from Las Vegas that indicates that the number of Las Vegas visitors is recovering, but gambling revenues remain flat.

The ten-year projection in the growth of state revenues from General and Lottery funds is expected to only maintain pace with structural cost increases, meaning that funding will only be available for current levels of service without the ability to fund new services. Although still early in the 2015-17 budget development cycle, current forecast indications are that projected General and Lottery fund revenues for the 2015-17 biennium will fall short by 2% of fully funding the current level of state government services when adjusted for cost increases in 2015-17.

The Commission will be continue to be briefed on the budget development process regularly in the coming months, including the completion of a more detailed briefing on the 2015-17 Agency Request

Budget at the August commission meeting, so that information will not be repeated within this report.

III. Internal DEQ Financial Highlights

The slow growth economic recovery continues to be reflected in DEQ Fee receipts, which also continue to recover slowly. With construction activity once again growing, the hardest hit fee funded activities within DEQ, on-site sewage treatment permitting and storm water permitting, are seeing some revenue improvements, but the results are not consistent across the state. Other permitting activity fees have dropped as some facilities have ceased operations and others have reduced outputs, both in terms of economic production and pollutants. The solid waste tipping fees have dropped as consumer, construction, and manufacturing wastes have all declined. In all of these cases, the timing and magnitude of recovery are uncertain, with a component of not just *when* activity will return to pre-recession levels, but also *if* activity will return to pre-recession levels.

As revenues have declined and flattened out, DEQ has reduced its legislative budgets, from 790 full time equivalent staff in the original DEQ 2009-11 legislative budget, down to 711 FTE in 2011-13 legislative budget and then to 705 FTE for 2013-15. At the start of the 2013-15 biennium, DEQ reevaluated the affordable staffing level for the biennium and brought the planned level down to 680 FTE in the DEQ budget execution plan, with detailed affordability levels for each of the agencies main activities, which we call operating subprograms.

The Key Financial Information indicates that the budget execution plan for DEQ is on solid ground and the Department's cautionary practices will ensure that finances will be appropriately managed during the 2013-15 biennium. That assessment doesn't translate directly to program operations, where the ongoing economic uncertainty, reduced fee receipts, and long term shortage of funding at the state level continue to impact the Department's ability to fully deliver its environmental services.

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I. Audits

Detailed audit reports from the Secretary of State's office are sent directly to the Environmental Quality Commission and the DEQ Director at the time of issuance. For those reports already issued, the findings are summarized in this section.

A. Completed Audits

1. Secretary of State Annual Statewide Financial Audit FY2013

The Secretary of State annual statewide financial audit report issued for the year ending June 30, 2013 concluded that for the segment of the financial accounts audited were fair presentation in accordance with generally accepted accounting principles in relation to the statewide financial statements (CAFR). There were no major findings or reportable conditions.

2. Secretary of State Audit of Capitalization Grants for the Clean Water State Revolving Fund (CWSRF)

The Secretary of State federal compliance audit of the Capitalization Grants for the Clean Water State Revolving Fund for the years ending June 30, 2012 did not detect any material deficiencies in internal control over federal compliance.

3. Secretary of State Opinion Audit of Financial Statements and Internal Controls for Capitalization Grants for the Clean Water State Revolving Fund (CWSRF) for FY2012

The auditors concluded that CWSRF's financial statements are fairly presented in accordance with accounting principles generally accepted in the United States of America. No deficiencies were noted in internal control over financial reporting.

4. EPA Program Evaluation Report for Oregon's Clean Water State Revolving Fund (FY 2012):

EPA determined that DEQ has an effective CWSRF program and demonstrates continuing commitment to its success and improvement. Their review noted two items that needed additional attention: comparing the Davis Bacon federal wage determination with wages actually paid at one project and developing a fee account protocol to ensure proper deposits of fee payments.

5. Internal Audit of Small Purchase Order Transaction System (SPOTS) card program for Fiscal Year 2013.

Overall, Internal Audits determined DEQ's oversight of the SPOTS program meets requirements established by the Oregon Accounting Manual (OAM) 55.30.00 and SPOTS-related policies and procedures.

B. Audits Currently Underway

- 1. Secretary of State Annual Statewide Financial Audit for the year ending June 30, 2014.** Audits segments of DEQ's financial accounts. For FY 2014, the audits are first looking at internal controls, then will decide the specific areas to be covered, which during the last audit included cash, loans receivable, licenses and fees, federal

revenue, and salaries/wages.

2. **Secretary of State Opinion Audit of Financial Statements and Internal Controls for Capitalization Grants for the Clean Water State Revolving Fund (CWSRF) for FY2013**
3. The Agency also performs **internal audits**, with the following internal audits currently underway:
 - a) Small Purchase Order Transactions System (SPOTS) compliance and transaction audit for Fiscal Year 2014 Compliance on Solid Waste fees.

C. Audit Plan for FY2015 and Beyond

1. **Secretary of State Annual Audit of Federal Programs for year ending June 30, 2014.**
2. **Secretary of State Annual Opinion Audit of CWSRF financial statements for year ending June 30, 2014.**
3. The plan for future internal audits is being updated in conjunction with process and measure development for the agency's Outcome Based Measure initiative.

II. Compliance and Monitoring

In the execution of its daily financial operations and on-going financial planning and control, DEQ:

- Employs adequate internal controls such as segregation of duties, signature authority processes, graduated procurement authorization, determination of affordability prior to filling positions, etc.;
- Monitors all relevant state and federal accounting requirements to ensure on-going compliance;
- Accounts at fund levels consistent with statutory limits;
- Employs detailed cost and time accounting systems to capture staff time and related costs; and
- Monitors actual costs against legislative adopted budget and operating budget plans.

The results of these efforts on an Agency wide basis are contained in the detailed audit reports sent to the EQC and summarized in the Audit section of this report. The monitoring to assess the financial management controls and health of the subprogram units is summarized in the Key Financial Information section of this report.

Because DEQ sells municipal bonds, it is required to publicly post an annual financial report that provides basic financial statements and supplemental information to meet public disclosure laws. The [DEQ FY 2013 Annual Financial Report](#) is posted on the Electronic Municipal Market Access (EMMA) website run by the Municipal Securities Rulemaking Board.

III. Key Financial Information

As discussed in the Compliance and Monitoring section, the department uses numerous accounting and cash management tools to manage the day-to-day financial operations of the agency. For longer term financial planning, usually tied to the state biennial budget period, the department uses two principal tools for planning and executing the budgets: the Operating Budget and periodic forecasts.

The Operating Budget is DEQ's budget execution plan, prepared at the beginning of the biennium by updating the Legislatively Approved Budget with current revenue and cost estimates, assessing the planned workload in each activity, and calculating the surplus or deficit in funding balances expected at the end of the biennium. For activities that are estimate to run a deficit ending balance, or have a positive ending balance that is significantly below that required for ongoing cash management requirements, the program then adjusts the Operating Budget to try to bring ending balances back into alignment. Adjustments can include:

- Reallocating fungible general fund or federal grant funds between activities
- Shifting staff assignments out of underfunded activities and into activities with available funding
- Identifying positions that must be maintained vacant for the all or part of the biennium
- Revising/reducing planned capital outlay and contract expenditures
- In extreme cases, laying off staff

Following completion of the Operating Budget, the department develops a forecast every six months to continue monitoring execution of the budget. These forecasts combine the detailed, actual to date spending and revenues with a forecast for the remainder of the biennium. The forecast updates projected staffing levels and other spending plans, followed by another round of adjustments or mid course corrections to bring each activity into alignment with desired ending fund balances. The department prepares more frequent forecast updates (every three months) for those activities requiring corrective actions.

This schedule means that the key financial information presented in this section will vary depending on the year of the report. The first report of the biennium, delivered in even numbered years, provides a summary of the department's Operating Budget execution plan. The second report, delivered in odd numbered years, covers the forecast 18 months into the current biennium.

The Key Financial Information reports that follow provide a high level summary of the Operating Budget status, including a comparison of FTE levels from the Legislative Approved Budget (LAB), the Operating Budget, and the first nine months of the biennium. The reports also provide a stoplight chart assessment of the financial status of the Operating Budget for each subprogram unit, with the rating based principally on the projected ending balance in the plan at the end of the 2013-15 biennium:

- a. Green (good, within acceptable limits)
- b. Yellow (caution)
- c. Red (danger, requires action)

The stoplight ratings help alert management to activities requiring extra attention, and DEQ procedure is to increase monitoring frequency on red rated subprogram units, including forecasts every 3 months instead of the usual 6-month interval. While an operating subprogram forecasted to have a deficit is always cautionary, some of DEQ's activities that are funded by

fees or other funds must maintain minimum balances for cash management purposes. In those cases, an operating subprogram that is forecast to have a positive cash balance at the end of the biennium may still be assessed as yellow (caution) or red (requires action) if that positive balance is insufficient to meet ongoing cash management needs in the 2013-15 biennium.

In developing the Operating Budget for the 2013-15 biennium, DEQ management and financial staff completed the initial evaluation in October 2013, but noted that funding uncertainties regarding a 2% holdback of General Fund, potential pay raise spending authority (limitation) and General Fund appropriation, and the level of Federal budget sequestration cuts made it difficult to plan. The "worst case" scenario of no additional general fund coupled with a 12% federal sequestration funding cut resulted in operating budget shortfalls in several water quality activities that could not be resolved without vacating filled positions. In the Agency Management program, the operating budget noted that while the program had sufficient cash to fund the proposed work, it did not have sufficient legislative spending authority, once again potentially requiring a reduction to the proposed plan.

Because of the high level of uncertainty, DEQ leadership decided to postpone any reduction actions in these two areas pending the outcome of the February 2014 legislative session and the expectation that some Federal budget deal would be reached by that time. During this time period, DEQ also held off filling any but the most critical positions as they became vacant to allow for additional flexibility should the worst case scenario become reality.

The federal budget sequestration reductions were ultimately only about ½ of the worse case estimate, the amount of the General Fund holdback was reduced to 1.5%, and additional budget authority and GF appropriation was provided to help with negotiated pay and benefits cost increases. After updating the October operating budget for these factors and taking account for additional vacancy savings achieved during the interim, the April 2014 update to the Operating Budget plan now indicates both the Water Quality and Agency Management issues were resolved.





At the agency summary level, the operating budget column represents the estimated level of affordable FTE at 669 FTE, which is 36 FTE below the Legislatively Approved Budget. Actual FTE averaged 611 for the first nine months of the biennium, impacted in part by a hiring chill that was in effect from November 2013 to the end of March 2014 pending the outcome of the budget issues discussed above. DEQ is now gradually making progress in filling affordable vacant positions, bringing FTE up to 618 in June 2014, but is also experiencing an increase in turnover as the economy improves as well as an increase in retirements among the relatively older workforce the agency employs.

One key in understanding the stoplight assessment of each DEQ operating subprogram is that the rating *only assesses the financial health* of the Operating Budget execution plan for the 2013-15 biennium. The stoplight assessment and the affordable levels of FTE do not indicate the ability or inability of the specific operating subprograms to adequately meet program objectives, timeliness, or key performance measures. The drop in many of the DEQ program fees, and subsequent reduction in affordable FTE affects each subprogram differently, with some subprograms experiencing a reduction in workload with the drop in fees (such as with onsite septic and storm water permits) and others seeing no real change of workload (such as with solid waste tipping fee).

DEQ also will not typically allow the Operating Budget execution plan to be finalized with a red summary rating, since creating a workable 2013-15 execution plan for each activity is a key goal of the process. As a result, only a very small number of operating subprograms have yellow, or cautionary, ratings and no activity is shown as red.










Detailed information can be provided to the Commission on any or all of the Subprogram units. The Department also welcomes any suggestion for future changes so that this report can better meet the needs of the Commission.

A. Agency Summary Report

		Qualitative Affordability	Legislative Adopted Budget	Operating Budget	Actuals Avg. (Jul13 - Mar14)	
		FTE			NOTES	
Air Quality Total		221.92	209.02	197.10		
Water Quality Total		212.46	208.84	191.46		
Land Quality Total		190.99	175.55	153.64		
Agency Management		79.50	75.34	69.74		
Agency Total		704.86	668.75	611.94		

The operating budget column represents the estimated level of affordable FTE, which is 36 FTE below the Legislatively Approved Budget. Actual FTE averaged 612 for the first nine months of the biennium, impacted in part by a hiring chill that was in effect from December 2013 to the end of March 2014 as a result of both federal and state funding uncertainties, that have since been resolved.

B. Air Quality Operating Budget Report

	Qualitative Affordability	Legislative Adopted Budget	Operating Budget	Actuals Avg. (Jul13-Mar14)	
		FTE			NOTES
ACDP Permits		29.69	30.11	31.21	Higher than normal work demands are putting pressure on ACDP balances even with the 20% fee increase. Expect some of the FTE will move to Title V later in the biennium.
Title V Permits		35.23	29.70	25.07	Title V relies heavily on an emissions fee to fund the program. With plant shut downs and reduced emissions, revenues are down significantly compared to the amount anticipated in the legislative budget. Holding vacancies to ensure an adequate ending balance to fund the program through 2015-2017 and avoid a fee increase.
Area/Mob OF		1.50	1.84	1.02	Includes OR Low Emission Vehicle program and the Tanker Certification program. Planned hiring in the Low Emission Vehicle program has been delayed. Expect hiring and FTE in line with operating budget in the coming quarter.
Area Mobile GF/FF/Agency-Wide Infrastructure		29.82	25.22	20.09	Work includes: air toxics, clean fuel program, open burning, general air quality complaints, a portion of criteria pollutant monitoring, planning and technical support and agency and program administration. In recent months, actual FTE are running close to operating budget and we expect that trend to continue.
Asbestos		6.20	6.24	6.20	Asbestos charging is in line with the operating budget.
GHG Reporting		2.00	1.65	1.09	A vacant position is currently being recruited and will bring the program in line with the operating budget for the biennium.
Special Federal Grants		5.67	9.19	8.18	Includes fine particulate and air toxics monitoring grants and administration of diesel grants. Laboratory overhead charges are more than the amounts provided by the federal monitoring grants. Must subsidize this operating subprogram with GF.
Revenue Agreements		1.00	0.43	0.50	Includes agreements for Forest Service/BLM monitoring and field burning monitoring (seasonal).
Vehicle Inspection		110.81	104.64	103.74	VIP FTE running close to operating budget.
Air Quality Total		221.92	209.02	197.10	

Subprogram Unit Summaries:

The Operating Budget Execution Plan for all Subprogram units is currently within acceptable financial limits for 2013-15, with implementation for the first 9 months of the biennium under planned for most units.

C. Water Quality Operating Budget Report

		Qualitative Affordability	Legislative Adopted Budget	Operating Budget	Actuals Avg. (Jul13-Mar14)	
		FTE				NOTES
Wastewater Permitting	●	66.14	64.47	61.41		Under implementing primarily due to turnover. The program has recently filled several vacancies and is recruiting for others.
WQ Operator Certification	●	2.38	2.23	2.65		BTD FTEs include work on replacing licensing software. If that work is completed soon, we expect the FTE to return to a level close to or below the operating budget.
TMDL & Oregon Plan	●	31.24	27.35	20.83		The operating budget includes three Integrated Water Resources positions and two biomonitoring positions that phase in. Several other TMDL vacancies are in recruitment.
WQ Ambient Monitoring	●	30.11	31.91	30.49		The July to March period includes the summer months when the laboratory uses seasonal employees.
WQ Program Support	●	13.17	11.91	9.65		FTE that the program projected would charge to Program Support are charging to other sub-programs, including Wastewater Permitting and Onsite. These FTE include regional executive management and support staff and Regional Solutions Team staff.
WQ Data Management	●	5.00	3.93	3.46		The agency is dedicating fewer FTE than planned to Exchange Network Grants.
WQ Standards & Assessments	●	5.79	5.66	4.96		Standards & Assessments has been carrying a vacancy that was built into the operating budget, and plans to hire staff in FY2015.
Ground Water	●	5.16	5.67	4.24		Groundwater has two positions that were authorized in the 2013-15 Legislatively Adopted Budget that phase in.
401 Certification-Dredge & Fill	●	5.00	4.97	3.05		The 401 Dredge & Fill sub-program has been filling new positions that were authorized in the 2013-15 Legislatively Adopted Budget.
401 Certification - Hydro	●	3.00	1.88	1.89		The operating budget includes FTE to work on cost reimbursement projects. Only two positions in the program are currently filled. Other positions should only charge to 401 Hydro if work and revenue is available.

	Ending Balance Assessment	Legislative Adopted Budget	Operating Budget	Actuals Avg. (Jul13-Mar14)	
		FTE			NOTES
CW State Revolving Fund Administration	●	15.01	15.95	13.94	The CWSRF sub-program has had two vacancies that are being filled.
DW Assessments & Implementation	●	5.10	4.60	4.39	
On-Site Systems Permitting	●	13.00	12.95	13.88	The Onsite program has been paying for marginally more Business Systems Development staff (mostly for replacing the licensing software), Regional Solutions Team, and compliance and enforcement staff than anticipated in the operating budget.
Underground Injection Control	●	1.75	2.58	2.39	
NPS Implementation 319 Grants	●	5.95	7.83	8.16	
DW & Laboratory Certification	●	1.00	0.20	0.71	
Receipts Authority	●	3.66	4.76	5.36	
Water Quality Total		212.46	208.84	191.46	

Subprogram Unit Summaries:

The Operating Budget Execution Plan for all Subprogram units is currently within acceptable financial limits, with implementation for the first 9 months of the biennium under planned for most units.

Continued uncertainty in revenues and the high level review of the statewide approach that currently results in some Counties implementing the program in their jurisdictions while and Oregon DEQ implements in others have caused the On-Site activity to be assigned a yellow (cautionary) rating, requiring increased monitoring throughout the biennium.

D. Land Quality Operating Budget Report

		Qualitative Affordability	Legislative Adopted Budget	Operating Budget	Actuals Avg. (Jul13-Mar14)	
		FTE				NOTES
Materials Management	●	44.04	42.23	37.90		One position was recently filled, three others in various stages of position description refinement for recruitment. Program working on funding options for implementing the 2050 Vision.
Materials Management - e-Cycles	●	2.67	2.10	1.22		Actual FTE less than budget due to prolonged vacancy, soon to be in recruitment.
Hazardous Waste	●	29.91	28.60	23.84		Operating budget less than LAB due to positions on assignment in other programs, 2 HQ positions recently filled not yet reflected in actuals and 1 position left vacant due to work.
Orphan - Cleanup	●	2.75	2.62	2.60		
Orphan - SW	●	0.20	0.21	0.09		
Cleanup - Dry Cleaners	●	2.21	1.95	2.39		Contract spending cut significantly to balance operating budget. Revenue decline is caused primarily by industry shifts, not economy. Program is working on generating cost recovery revenue through insurance policies held by site owners.
Cleanup - Non-Dedicated	●	61.25	54.65	47.12		Operating budget continues to be implemented at a level that sustains funding through cost recovery projects. One position currently in recruitment. Some shift of cost recovery efforts to spills.
Cleanup - Dedicated	●	0.55	0.35	0.00		
Spills	●	11.60	11.69	12.34		Increased cost recovery efforts above budget. Some reduction of marine oil spill planning efforts due to revenue shortfall.
Tanks - LUST	●	21.14	17.87	11.94		5 positions held vacant due to reduced revenue and pending decisions about workload. One vacant position recently filled after reclass. Currently recruiting for one position.
Tanks - UST	●	11.02	9.91	11.39		
Tanks - Heating Oil	●	3.65	3.37	2.81		Revenues have recovered somewhat since recession. Options to fill part time NRS3 position are being discussed.
Land Quality Total		190.99	175.55	153.64		

Subprogram Unit Summaries:

The Operating Budget Execution Plan for all Subprogram units is currently within acceptable financial limits for 2013-15, with implementation for the first 9 months of the biennium under planned for most units.

Some of the difference between the Legislatively Adopted Budget and Operating Budget FTE is due to FTE budgeted but not currently being charged to LQ activity. This has occurred as the result of the number infrastructure positions that were historically budgeted in LQ at a time when the LQ program made up a much larger percentage of the total program FTE in the DEQ budget. DEQ is starting to address this issue, as well as some internal shifting between operating subprograms within LQ, in its 2015-17 Agency Request Budget.

E. Cross Program Operating Budget Report

Subprogram Unit Summaries:

The Cross Program Operating Subprograms were moved to other program areas as a result of the elimination of Cross Program as a budget structure in the 2013-15 Legislatively Adopted Budget.


F. Agency Management Operating Budget Report

	Qualitative Affordability	Legislative Adopted Budget	Operating Budget	Actuals Avg. (Jul'13 - Mar'14)	
		FTE			NOTES
Office of the Director (w/ OPA)	●	8.50	6.88	7.21	Position moved from Communication and Outreach to OD as part of reorganization
Administration	●	11.00	11.75	9.03	4 positions moved from OD as part of reorganization
Financial Services	●	24.50	21.44	20.47	Positions vacant longer than anticipated due to hiring freeze
Human Resources	●	8.50	8.40	6.78	
Information Technology	●	14.00	12.84	12.04	Position vacant longer than anticipated due to hiring freeze
Business Systems	●	12.00	11.18	8.64	
AM All	●	1.00	2.85	5.57	Extra FTE due in part to CEM IT Project
Agency Management		79.50	75.34	69.74	

Subprogram Unit Summaries:

The Operating Budget Execution Plan for all Subprogram units is currently within acceptable financial limits for 2013-15, with implementation for the first 9 months of the biennium under planned for most units. The AM All operating subprogram is comprised of agency management funded activity performed by staff assigned to sections outside of agency management and ran higher than anticipated for the first nine months due to peak workload on the CEM systems development project, which is expected to taper off.

Several changes we implemented in the operating subprograms since the last report, including the elimination of the Office of Communication and Outreach and the shifting of a small number of positions as part of the reorganization. The Agency Management portions of the new Office of Policy and Analysis (OPA) are now included with the Office of the Director



Oregon Department of Environmental Quality

An Agency of the State of Oregon



Annual Financial Report

For the Fiscal Year Ended
June 30, 2013

Report Prepared By:
Central Services Division

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FINANCIAL SECTION

BASIC FINANCIAL STATEMENTS

The basic financial statements include interrelated sets of financial statements as required by the Governmental Accounting Standards Board (GASB). The sets of statements include:

- Government-Wide Financial Statements
- Fund Financial Statements
 - Governmental Funds
 - Proprietary Funds
 - Fiduciary Funds

The Oregon Department of Environmental Quality (Department) is an Agency of the State of Oregon and therefore is not required to present the Government-Wide Financial Statements. These statements are presented in the State of Oregon's Comprehensive Annual Financial Report (CAFR). The notes to the basic financial statements are included to provide information that is essential to a user's understanding of the basic financial statements.

General Fund

The General Fund accounts for all activities not accounted for by other funds of the Department. Principal sources of revenue are fines and forfeitures, which are used for payment of Agency expenditures.

Environmental Management Fund

The Environmental Management Fund accounts for revenue from licenses and fees, grants, lottery, interest, agreements and other miscellaneous sources. Certain grant revenues are passed through to sub-recipients. Other revenues are used for the payment of Agency expenditures.

General Obligation Debt Service Fund

This General Obligation Debt Service Fund was created to service the debt related to the Clean Water State Revolving Loan Program. The debt is backed by the State of Oregon.

	General	Environmental Management	General Obligation Bond	Total Governmental Funds
Assets				
Cash and Cash Equivalents	\$ -	\$ 274,956,716	\$ 1,818,810	\$ 276,775,526
Accounts and Interest Receivable (net)	89,849	4,439,770	-	4,529,619
Due from State General Fund	976,341	-	-	976,341
Due from Other Funds	173,560	2,822,296	-	2,995,856
Due from Other Agencies	-	382,750	-	382,750
Inventories	497,957	1,591,686	-	2,089,643
Prepaid Items	20,790	130,791	-	151,581
Notes and Other Receivables, net	-	-	-	-
Civil Penalties (net)	339,478	1,151,085	-	1,490,563
Loans Receivable (net)	-	374,460,444	-	374,460,444
Total Assets	\$ 2,097,975	\$ 659,935,538	\$ 1,818,810	\$ 663,852,323
Liabilities and Fund Balances				
Liabilities:				
Accounts Payable	\$ 569,694	\$ 1,528,326	\$ -	\$ 2,098,020
Due to Other Funds	670,056	2,325,812	-	2,995,868
Due to Other Agencies	-	3,755,160	-	3,755,160
Due to State General Fund	339,478	-	-	339,478
Trust Funds Payable	-	2,263,128	-	2,263,128
Deferred Revenue	-	2,512,982	-	2,512,982
Total Liabilities	1,579,228	12,385,408	-	13,964,636
Fund Balances:				
Nonspendable	518,747	1,732,477	-	2,251,224
Restricted by:				
Federal Laws and Regulations	-	523,047,670	-	523,047,670
Oregon Constitution	-	249,579	-	249,579
Enabling Legislation	-	45,930,584	-	45,930,584
Debt Covenants	-	60,693,509	1,818,810	62,512,319
Donors and Other External Parties	-	40,370	-	40,370
Committed	-	15,855,941	-	15,855,941
Total Fund Balances	518,747	647,550,130	1,818,810	649,887,687
Total Liabilities and Fund Balances	\$ 2,097,975	\$ 659,935,538	\$ 1,818,810	\$ 663,852,323

	<u>General</u>	<u>Environmental Management</u>	<u>General Obligation Bond</u>	<u>Total Governmental Funds</u>
Revenues:				
Licenses and Fees	\$ -	\$ 39,827,045	\$ -	\$ 39,827,045
Federal Grants	-	19,652,023	-	19,652,023
Interest on Investments	-	10,602,061	10,461	10,612,522
Charges for Services	-	15,055,507	-	15,055,507
Other Revenue	-	720,350	-	720,350
Civil Penalties	514,787	63,886	-	578,673
Total Revenues	<u>514,787</u>	<u>85,920,872</u>	<u>10,461</u>	<u>86,446,120</u>
Expenditures:				
Personal Services	5,786,263	51,591,612	-	57,377,875
Services and Supplies	2,786,679	16,467,628	-	19,254,307
Special Payments	130,577	4,246,870	-	4,377,447
Capital Outlay	79,337	327,904	-	407,241
Debt Service:				
Principal - Bonds	2,144,113	-	2,485,887	4,630,000
Interest - Bonds	643,945	-	871,227	1,515,172
Total Expenditures	<u>11,570,914</u>	<u>72,634,014</u>	<u>3,357,114</u>	<u>87,562,042</u>
Excess (Deficiency) of Revenues Over Expenditures	(11,056,127)	13,286,858	(3,346,653)	(1,115,922)
Other Financing Sources (Uses):				
Transfers In (Operating)	-	17,606,242	3,357,114	20,963,356
Transfers Out (Operating)	(1,086,660)	(19,841,936)	-	(20,928,596)
Transfers In (Other Agencies)	-	6,099,652	-	6,099,652
Transfers Out (Other Agencies)	-	(279,337)	-	(279,337)
Transfers from Other Funds	-	-	-	-
Transfers to Other Funds	-	-	-	-
Transfers Out (State General Fund)	(514,787)	-	-	(514,787)
Long-Term Debt Issued	-	16,950,000	-	16,950,000
Debt Issuance Premium	-	2,763,518	-	2,763,518
Debt Issuance Cost	-	-	-	-
State Appropriations	12,667,484	-	-	12,667,484
Total Other Financing Sources (Uses)	<u>11,066,037</u>	<u>23,298,139</u>	<u>3,357,114</u>	<u>37,721,290</u>
Net Change in Fund Balances	<u>9,910</u>	<u>36,584,997</u>	<u>10,461</u>	<u>36,605,368</u>
Fund Balances - Beginning	502,782	610,901,341	1,808,349	613,212,472
Change in Reserve for Inventories	<u>6,055</u>	<u>63,792</u>	<u>-</u>	<u>69,847</u>
Fund Balances - Ending	<u>\$ 518,747</u>	<u>\$ 647,550,130</u>	<u>\$ 1,818,810</u>	<u>\$ 649,887,687</u>

Enterprise Fund

The Enterprise Fund accounts for certain business-type activities of the Department. Principal sources of revenue are charges for services, which are used for payment of the Enterprise Fund expenditures.

	<u>Enterprise</u>
ASSETS	
Current Assets:	
Cash and Cash Equivalents	\$ 23,413
Accounts and Interest Receivable, net	85,245
Inventories	<u>32,761</u>
Total Current Assets	<u>141,419</u>
Noncurrent Assets:	
Capital Assets:	
Equipment and Machinery	\$ 197,334
Less Accumulated Depreciation	<u>(197,334)</u>
Total Capital Assets (Net of Accumulated Depreciation)	<u>-</u>
Total Noncurrent Assets	<u>-</u>
Total Assets	<u>\$ 141,419</u>
DEFERRED OUTFLOW OF RESOURCES	\$ -
LIABILITIES	
Current Liabilities:	
Accounts Payable	\$ 27,389
Due to Other Funds	<u>18</u>
Total Current Liabilities	<u>27,407</u>
Total Liabilities	<u>\$ 27,407</u>
DEFERRED INFLOW OF RESOURCES	\$ -
NET POSITION	
Unrestricted	<u>\$ 114,012</u>
Total Net Position	<u>\$ 114,012</u>

	<u>Enterprise</u>
Operating Revenues:	
Charges for Services	\$ -
Other Revenue	250,133
	<u>250,133</u>
Total Operating Revenues	<u>250,133</u>
Operating Expenses:	
Salaries and Wages	\$ 185,080
Services and Supplies	29,714
	<u>214,794</u>
Total Operating Expenses	<u>214,794</u>
Operating Income (Loss)	35,339
Transfers Out	<u>(34,758)</u>
Increase in Net Position	581
Total Net Position beginning of year	<u>113,431</u>
Total Net Position end of year	<u><u>\$ 114,012</u></u>

	Enterprise
Cash Flows from Operating Activities:	
Receipts from Customers and Users	\$ 202,536
Payments to Employees	(170,936)
Payments to Suppliers	(32,294)
Payments to Other Funds for Services	
Net Cash Provided (Used) by Operating Activities	(694)
Cash Flows from Noncapital Financing Activities:	
Transfers from Other Funds	-
Transfers to Other Funds	(34,758)
Advances from Other Funds	-
Federal Grants	-
Net Cash Provided (Used) by Noncapital Financing Activities	(34,758)
Net Cash Provided (Used) by Capital and Related Financing Activities	-
Net Cash Provided (Used) by Investing Activities	-
Net Increase (Decrease) in Cash and Cash Equivalents	(35,452)
Cash and Cash Equivalents - Beginning	58,865
Cash and Cash Equivalents - Ending	\$ 23,413
Reconciliation of Operating Income to Net Cash Provided (Used) by Operating Activities:	
Operating Income (Loss)	\$ 35,339
Adjustments to Reconcile Operating Income to Net Cash Provided (Used) by Operating Activities:	
Depreciation Expense	
(Increase) Decrease in Accounts Receivable, net	(47,597)
(Increase) Decrease in Inventories	(554)
Increase (Decrease) in Due To Other Funds	10
Increase (Decrease) in Accounts Payable	12,108
Increase (Decrease) in Compensated Absences	
Total Adjustments	(36,033)
Net Cash Provided (Used) by Operating Activities	\$ (694)

Agency Fund

The Agency Fund accounts for resources held by the Department in a purely custodial capacity.

	Agency Fund
Assets	
Cash and Securities Held in Trust	<u>\$ 405,990</u>
Total Assets	<u><u>\$ 405,990</u></u>
Liabilities	
Trust Funds Payable	<u>\$ (405,990)</u>
Total Liabilities	<u><u>\$ (405,990)</u></u>

1. **Summary of Significant Accounting Policies**

The accompanying financial statements of the State of Oregon Department of Environmental Quality have been prepared in conformity with Generally Accepted Accounting Principles (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB), the Financial Accounting Standards Board (FASB) and the American Institute of Certified Public Accountants (AICPA).

A. Reporting Entity

The Department of Environmental Quality (DEQ) is an agency of the State of Oregon. Its mission is to be an active leader in restoring, maintaining and enhancing the quality of Oregon's air, water and land.

The administration of both federal and state laws is translated into action through Oregon Administrative Rules (OAR) adopted by the Environmental Quality Commission (EQC or Commissioners). The EQC is a five-member citizen commission whose members are appointed by the Governor subject to confirmation by the Senate. The Commissioners serve four-year terms but may be removed by the Governor. Commissioners may be reappointed but may not serve more than two consecutive terms. In addition to adopting rules, the Commission also establishes policy (subject to legislative mandate) and appoints a Department Director (reference ORS Chapter 468). The adopted rules for the Department are found in OAR Chapter 340, Divisions 11 - 180.

As required by GAAP, these financial statements present all the fund types of DEQ. These financial statements do not include any financial activities of any other Departments of the State of Oregon.

B. Basis of Presentation – Fund Accounting

The Department's programs are organized by "funds", which are considered a separate accounting entity with a self-balancing set of accounts and presented as either major or non-major funds. The following funds are established for the purpose of accounting for specific activities or attaining certain objectives in accordance with applicable laws, regulations, restrictions or limitations:

Governmental Fund Types

- (1) The **General Fund** (Major Fund) accounts for all financial resources and transactions not accounted for in another fund. It accounts for general governmental operations that are financed by legislatively approved appropriations funded from general revenues. It includes debt service provided by General Fund appropriation.
- (2) The **Environmental Management Fund** (Major Fund) accounts for the proceeds of specific revenue from permits, fees and other sources that finance specified activities as required by law or administrative regulations.

- (3) The **General Obligation Bond Fund** (Major Fund) accounts for the accumulation of resources for and the payment of interest and principal on general governmental obligations.

Proprietary Funds Types

- (4) The **Enterprise Fund** (Major Fund) accounts for certain business-type activities of the Laboratory of the Department.

Fiduciary Funds Types

- (5) The **Agency Fund** is used to account for assets held by the State in a trustee capacity or as an agent for individuals, private organizations, other governments, and/or other funds.

As an agency of the State of Oregon, the Department is not obligated to prepare the Management Discussion and Analysis and Government-Wide Financial Statements, as it is not a stand-alone entity. Capital assets, related accumulated depreciation and long term liabilities, which are required to be reported in Government-Wide Financial Statements but not Governmental Funds, are disclosed in the Notes to the Basic Financial Statements.

C. Measurement Focus and Basis of Accounting

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. Governmental funds use the flow of current financial resources measurement focus and the modified accrual basis of accounting. (Basis of accounting refers to when revenues and expenditures/expenses are recognized in the financial statements.) Under the modified accrual basis, revenues are recognized when they are both measurable and available. Revenues are considered to be available when they are collectible within the current year or soon enough thereafter to pay liabilities existing at the end of the year. For this purpose, the State of Oregon considers revenues to be available if they are collected within 90 days of the end of the current fiscal year. Expenditures are recorded when a liability is incurred, except for unmatured interest on general long-term debt which is recognized when due, and compensated absences which are recognized when the obligations are expected to be liquidated with expendable available financial resources. Federal grant revenue is not recognized until the expenditure is recognized.

Licenses and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. All other revenue items are considered to be measurable and available only when cash is received by the Department.

Agency funds are accounted for on the modified accrual basis of accounting. Agency funds are custodial in nature (i.e., assets equal liabilities) and do not measure the results of operations.

The Department has elected to follow the accounting pronouncements of the Governmental Accounting Standards Board (GASB), as well as statements issued by the Financial Accounting Standards Board on or before November 30, 1989, unless the pronouncements conflict with or contradict GASB pronouncements. The Department, however, does not apply FASB pronouncements issued after November 30, 1989.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenue of the enterprise fund is charges for services to external customers. Operating expense for the enterprise fund include administrative expenses and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

D. Budgetary Data

The Oregon Legislature approves budgets for a biennial period, with the biennium beginning July 1 and ending June 30 of each odd-numbered year. The Oregon Constitution requires the budget to be in balance at the end of each biennium. Expenditures are subject to limitation and limitation lapse at the end of the biennium. Budgets are adopted on the budgetary basis, which differs from generally accepted accounting principles in the treatment of long term debt, receivables, payables, capital assets, and accumulated depreciation. The budgetary schedules are presented as part of the Required Supplementary Information with the necessary reconciliations to generally accepted accounting principles.

E. Cash and Investments

Cash and cash equivalents includes: cash on hand, short term investments with original maturities of three months or less from the date of acquisition, and, other cash equivalents such as change funds and receipts held prior to deposits in the hands of an official or a designated agent. All monies of the Department are deposited with the Office of the State Treasurer, which is responsible for maintaining these deposits in accordance with Oregon law. Interest earnings on these deposits are received on a monthly basis.

Designated investments are made and held by the Oregon State Treasurer and are considered short term in nature. As such, they are reported at cost.

F. Receivables

Receivables are stated net of an allowance for uncollectible amounts. Receivables included are amounts due that represent revenues earned or accrued in the current period. Receivables included in this classification are related to clean water state revolving fund loans, cost recovery projects, interest, civil penalties, amounts due from the federal government or other governments and other miscellaneous receivables.

G. Inventories and Prepaid Expenses

Inventories, which consist primarily of operating supplies, are stated at cost utilizing the first-in, first-out cost valuation method. In governmental fund types, inventories are recorded as expenditures when purchased. Reported inventories in governmental funds are equally offset by a reservation of fund balance since they are unavailable for appropriation.

Certain payments to vendors reflect costs applicable to future accounting periods are recorded as prepaid items in the fund financial statements. Payments made to vendors for services that will benefit periods beyond year end are recorded as prepaid items in the fund financial

statements. In the governmental funds, prepaid items are accounted for using the consumption method and a portion of fund balance equal to the prepaid items has been reserved to indicate that it is not available for appropriation.

H. Capital Assets

Capital assets and depreciation expense used in governmental fund type operations are not reported in the Governmental Funds Balance Sheet under the modified accrual basis of accounting. However, capital assets acquired or constructed by the Department are recorded as expenditures in the appropriate governmental fund and then capitalized at cost in the Department's Government-Wide Reporting Fund, for the purpose of tracking and reporting the assets for the State of Oregon Comprehensive Annual Financial Report (CAFR).

Capital assets are reported at historical cost. Donated capital assets are reported at estimated fair market value at the date of donation. Assets costing less than \$5,000 or having a useful life of less than two years are not capitalized. The costs of normal maintenance and repairs that do not add to the value of assets or significantly extend assets lives are expensed rather than capitalized.

In determining the estimated useful life of assets, the Department considers how the asset will be used and how long it is expected to meet service and technology demands. The Department uses the Internal Revenue Service's table of Estimated Useful Life of Assets as a guide. Property, plant, and equipment of the Department are depreciated using the straight line method over the following estimated useful lives:

<u>Assets</u>	<u>Years</u>
Land Improvements	20
Buildings	10-20
Furniture & Equipment	5-10
Motor Vehicles	5-18
Data Processing Software	3
Data Processing Hardware	5
Leasehold Improvements	10-20

I. Accounts Payable

Accounts payable consist mainly of amounts owed to vendors, state agencies or local entities. During the course of operations, transactions occur between funds for various reasons. Outstanding balances between funds are reported as "due to/from other funds".

J. Compensated Absences

State policy allows employees to accrue vacation leave at various accrual rates with a maximum accumulation of 350 hours per management and classified employee. Employees can be paid up to a maximum of 250 hours of accrued vacation leave at termination. Compensated absences

liabilities are normally liquidated with expendable available resources and a governmental fund liability and expenditure recognized as payments come due each period upon the occurrence of relevant events such as employee resignations and retirements.

K. Rebatable Arbitrage

Internal Revenue Code Section 148(f) requires issuers of tax exempt bonds to rebate investment income earned from bond proceeds that exceed limits established for each bond issue. These limits are based on the bond yield as calculated for federal tax purposes for each bond issue and are subject to certain exceptions. Arbitrage rebate payments are due not later than 60 days after the end of the fifth anniversary of each bond issue (or other date in compliance with IRC Section 148(f)) and every five years thereafter in an amount at least equal to 90 percent of the calculated arbitrage liability. Final arbitrage rebate payments are due not later than 60 days after the final retirement of all bonds in an issue in an amount equal to 100 percent of the calculated liability. The Department records rebatable arbitrage as an expenditure and is reported in the Department's Government-Wide Reporting Fund for use in the State of Oregon Comprehensive Annual Financial Report.

L. Long-term Obligations

Long-term debt and other long-term obligations used in governmental fund type operations are not reported on the Department's Governmental Funds Balance Sheet under the modified accrual basis of accounting. However, the Department's long-term debt and other long-term obligations are recorded as revenues and expenditures in the appropriate funds, but recorded as long term debt and debt payments in the Department's Government-Wide Reporting Fund, for the purpose of tracking and reporting the assets for the State of Oregon Comprehensive Annual Financial Report. Premiums, discounts, and issuances costs are amortized over the life of the bond.

In the fund financial statements, governmental funds recognize bond premiums and discounts, as well as bond issuance costs, in the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issues are reported as other financing sources, while discounts are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as other financing uses.

M. Fund Equity

The difference between assets and liabilities is labeled as "Net Position" on the proprietary fund and fiduciary fund financial statements and as "Fund Balance" on the governmental fund financial statements.

In governmental funds, fund balance is reported in five components: (1) nonspendable, (2) restricted, (3) committed, (4) assigned, and (5) unassigned.

Nonspendable fund balances include amounts that cannot be spent because they are either not in spendable form or they are legally or contractually required to be maintained intact.

Restricted fund balances result from constraints imposed on net assets by law through constitutional provisions or enabling legislation or by parties outside the State, such as creditors, grantors, contributors, or laws or regulations of other governments.

Committed fund balance results from constraints imposed by bills (passed by the Legislature and signed into law by the Governor) that are separate from the authorization to raise the underlying revenue.

Assigned fund balance is the residual amount in governmental funds other than the General Fund. It represents amounts that are constrained by the Department's intent to be used for a specific purpose, but which are neither restricted nor committed.

Unassigned fund balance is the residual amount in the General Fund not included in the previous four categories. Deficit fund balances in other governmental funds are reported as unassigned.

N. Restricted Assets

Certain proceeds of the Department's bond and certificate of participation (COP) issues, as well as certain resources set aside for their repayment, are classified as restricted assets because these resources are segregated and their use is limited by applicable bond covenants or COP financing agreements. Generally, this includes cash and investments set aside for current and future debt service payments. When both restricted and unrestricted resources are available to use, it is the Department's policy to use restricted resources before using unrestricted resources. As of June 30, 2013, cash and cash equivalents restricted totaled \$274,956,715 in the Environmental Management Fund, \$1,818,810 in the General Obligation Bond Fund, \$23,413 in the Enterprise Fund, and \$10,000 in the Agency Fund.

O. Changes in Accounting Principles

For the fiscal year ending June 30, 2013, the Department implemented the provisions of Governmental Accounting Standards Board (GASB) Statement no. 63 (Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position).

2. Deposits and Investments

On June 30, 2013, the book balance of cash and cash equivalents and bank balance was \$276,808,938. Cash in the Department is deposited in demand accounts with the State Treasurer, who is responsible for maintaining and investing the pooled cash balances in accordance with State laws, and invested with the Oregon Short-Term Fund (OSTF). The OSTF is a cash and investment pool that is available for use by all state funds and eligible local governments. State Treasurer demand deposit accounts and time certificates of deposit investments of the Short Term Fund held in state banks are insured or collateralized in excess of Federal Deposit Insurance Corporation (FDIC) coverage for a minimum of 25 percent in accordance with State statute. Because the pool operates as a demand deposit account, each fund's portion of this pool is classified on the Balance Sheet as Cash and Cash Equivalents.

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

Earnings on the OSTF are allocated based on the average daily balance and a variable interest rate periodically determined by the State Treasurer. The earnings are credited to the Fund monthly. Further details of the investments and a copy of the OSTF audited annual financial report may be obtained by writing to the Oregon State Treasury, 350 Winter Street NE, Suite 100, Salem, Oregon 97301-3896 or from their website at <http://www.ost.state.or.us/divisions/investment/index.htm#fund>.

3. Loans Receivable

The Department is part of the Clean Water State Revolving Loan Fund program. This program makes loans to qualified entities at interest rates ranging from zero percent to the market rate (see ORS 468.440). Interest rates vary depending on the length of the loan, the type of loan, and program rules (at OAR 340-054). Rates range from 25% of the bond rate for 5 year loans to 65% of the bond rate for 20 year loans. Recipients make semiannual or, in some cases, annual payments, generally starting six months after project completion. Loans Receivable are long-term and are not expected to be collected within one year of the date of the financial statements.

The balance loans receivable as of June 30, 2013 is as follows:

Loan Receivable	\$ 378,872,228
Less: Allowance for Principal Forgiveness	(4,411,784)
Total Loans Receivable, net	<u>\$ 374,460,444</u>

Conditions under the Federal Stimulus grants received including clauses requiring loan forgiveness. Accordingly, new loans in the fiscal year 2011, included terms for forgiving portions of the loan principal repayments. An allowance account was established, resulting in an associated expense for the loan forgiveness required by the Federal Government. Loan forgiveness expense for the fiscal year ended June 30, 2013 was \$1,879,159.

4. Capital Assets

Capital asset activity for the year ended June 30, 2013 was as follows:

	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
Governmental Activities:				
Capital Assets, Non-depreciable:				
Land	\$ 22,348	\$ -	\$ -	\$ 22,348
Total Capital Assets, Non-depreciable:	<u>22,348</u>	<u>-</u>	<u>-</u>	<u>22,348</u>
Capital Assets, Depreciable:				
Land Improvements	106,966	-	-	106,966
Buildings	49,381	-	-	49,381
Furniture & Equipment	7,218,545	107,703	-	7,326,248
Motor Vehicles	498,900	-	-	498,900
Data Processing Software	6,081,976	1,279,887	-	7,361,863
Data Processing Hardware	2,918,436	48,861	-	2,967,297
Leasehold Improvements	2,782,652	47,222	-	2,829,874
Total Capital Assets, Depreciable	<u>19,656,856</u>	<u>1,483,673</u>	<u>-</u>	<u>21,140,529</u>
Less Accumulated Depreciation for:				
Land Improvements	(58,850)	(4,840)	-	(63,690)
Buildings	(48,837)	(544)	-	(49,381)
Furniture and Equipment	(6,546,764)	(272,663)	-	(6,819,427)
Motor Vehicles	(459,201)	(6,158)	-	(465,359)
Data Processing Software	(6,061,757)	(954,787)	-	(7,016,544)
Data Processing Hardware	(1,979,743)	(86,814)	-	(2,066,557)
Leasehold Improvements	(2,344,937)	(37,086)	-	(2,382,023)
Total Accumulated Depreciation	<u>(17,500,089)</u>	<u>(1,362,892)</u>	<u>-</u>	<u>(18,862,981)</u>
Total Capital Assets, Depreciable, Net	<u>2,156,767</u>	<u>120,781</u>	<u>(-)</u>	<u>2,277,548</u>
Governmental Activities Capital Assets, Net	<u>\$ 2,179,115</u>	<u>\$ 120,781</u>	<u>\$ (-)</u>	<u>\$ 2,299,896</u>

Depreciation expense was charged to fund types as follows:

General Fund Activities	\$ 126,604
Environmental Management Fund Activities	<u>1,236,288</u>
Total Depreciation Expense – Governmental Activities	<u>\$ 1,362,892</u>

5. Leases

Financial reporting and accounting procedures differ between operating leases and capital leases. Operating leases are rental agreements, and payments are chargeable as rent in the services and supplies expenditure account. Capital leases are treated similarly to purchases on contract. The property is capitalized at the present value when the lease is incurred and a corresponding liability is recorded. The Department does not currently have any capital leases recorded.

The Department has entered into various leases for real property and personal property. As the Legislature could disallow necessary funding for particular leases, all lease agreements contain termination clauses that provide for cancellation of the lease as of the end of a biennium. Lease obligations decrease each year because of lease expirations. It is expected these leases will be replaced with leases that have higher rental rates due to inflation. Total current year operating lease expense for the year ended June 30, 2013 was \$4,885,560.

The following schedule summarizes the minimum lease payments for operating leases as of June 30, 2013:

Year Ending June 30	Capital Leases	Operating Leases	Total
2014	\$ -	\$ 4,414,434	\$ 4,414,434
2015	-	4,038,601	4,038,601
2016	-	3,819,432	3,819,432
2017	-	2,577,966	2,577,966
2018	-	543,823	543,823
2019-2023	-	635,164	635,164
Total Future Minimum Lease Payments	\$ -	\$ 16,029,420	\$ 16,029,420

6. Long-Term Debt

General Obligation Bonds

Article XI-H of the State's Constitution authorizes DEQ to issue general obligation bonds. General obligation bonds are secured by the full faith and credit of the State and are not deemed to be the obligation of any specific fund. General obligation pollution control bonds were issued for cleanup projects and to finance the match portion of the Federal Assistance for the Clean Water State Revolving Fund.

The following schedule shows the debt service requirements for general obligation bonds as of June 30, 2013:

<u>Year Ending June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2014	\$ 12,140,000	\$ 1,915,720	\$14,055,720
2015	2,870,000	1,499,620	4,369,620
2016	3,165,000	1,387,707	4,552,707
2017	2,740,000	1,273,720	4,013,720
2018	2,775,000	1,167,895	3,942,895
2019-2023	13,250,000	4,064,335	17,314,335
2024-2028	9,155,000	1,653,499	10,808,499
2029-2033	4,690,000	335,763	5,025,763
Totals	<u>\$50,785,000</u>	<u>\$13,298,259</u>	<u>\$64,083,259</u>

Certificates of Participation

ORS 283.085 to 283.092 authorizes the State of Oregon to enter into financing agreements through the issuances of certificates of participation. The State has issued certificates of participation on the Agency's behalf to provide funds for the acquisition of furniture, equipment and fixtures for the new laboratory.

As of June 30, 2013, all debt service requirements for certificates of participation had been re-paid.:

Changes in Long-term Liabilities

The following table summarizes the long-term liabilities activities that are presented in the governmental reporting fund for purposes of the State CAFR for the year ending June 30, 2013:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Deductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Bonds and Certificates Payable:					
General Obligation Bonds	\$38,350,000	\$16,950,000	\$4,515,000	\$50,785,000	\$12,140,000
Certificates of Participation	115,000	-	115,000	-	-
Less Deferred Amounts:					
Issuance Discount	(28,457)	-	(4,113)	(24,344)	-
Issuance Premium	309,128	2,763,517	82,477	2,990,168	-
Loss on Refunding	(347,375)	(410,327)	(63,615)	(694,087)	-
Total Bonds and Certificates Payable	\$38,398,296	\$19,303,190	\$4,644,749	\$53,056,737	\$12,140,000
Compensated Absences	4,467,106	-	107,369	4,359,737	2,833,829
Pollution Remediation Obligations	5,796,477	1,524,191	-	7,320,668	380,045
Total Long-term Liabilities	<u>\$48,661,879</u>	<u>\$20,827,381</u>	<u>\$4,752,118</u>	<u>\$64,737,142</u>	<u>\$15,353,874</u>

Arbitrage Rebate Liability

The Tax Reform Act of 1986 places restrictions on the nonpurpose investment earnings from the proceeds of qualified tax-exempt issued after August 15, 1986. Specifically, the nonpurpose investment earnings on these bonds are limited to the yield on each individual bond issue (based on the initial offering price to the public). Nonpurpose investment earnings in excess of the bond yield limitations are subject to rebate to the federal government. As of June 30, 2013, the Department's total calculated arbitrage rebate liability was \$0.

7. Pollution Remediation Obligation

GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, establishes accounting and financial reporting standards for pollution remediation obligations. These obligations address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities, including pre-cleanup activities, cleanup

activities, government oversight and enforcement-related activities, and post remediation monitoring. Excluded from the scope of this statement are obligations for pollution prevention and control activities, fines and penalties, landfill closure and post closure care, and other future remediation activities required upon retirement of an asset.

The Department recognizes a pollution remediation obligation when it can reasonably estimate the range of expected cash outlays. At June 30, 2013, the Department recognized an estimated liability of \$7,320,668 for pollution remediation activities. The liability, which is recorded in the governmental reporting fund for purposes of the State CAFR, was recorded at the current value of the costs the Department expects to incur to perform the work.

For many projects, the Department can reasonably estimate the range of expected outlays early in the process because the site is common or similar to other sites for which the Department has experience. In other cases, the estimates are limited to an amount specified in a contract for remediation services or provided by environmental consulting firms. Expected recoveries from responsible or potentially responsible parties and insurance recoveries are included in estimates and reduce the Department's estimated expense. There were no estimable expected recoveries included in the estimated liability for pollution remediation obligations at June 30, 2013.

When new information indicates changes in expected cash outlays, the liability for pollution remediation is adjusted. Adjustments may be the result of price fluctuations resulting from delays in contracting specific remediation jobs, changes in technology, changes in legal or regulatory requirements, and changes in the remediation plan or operating conditions.

Currently, the Department is obligated as a government responsible for sharing costs to cleanup two Superfund sites, former McCormick and Baxter Creosoting Co. (Portland) and the former Taylor Lumber & Treating Inc. (Sheridan). Both sites are contaminated with chemicals used in the wood-treatment industry. Contamination was found in the soil, groundwater, and sediments of adjacent rivers. As a condition of Environmental Protection Agency's (EPA) funding of Superfund site cleanups, States are required to enter into a contract to provide a 10% share of remedial action costs and to fund long-term operations and maintenance after completion of the remedy. The State has a contractual obligation to provide match for both of these sites, but the expected match for the McCormick & Baxter site is already exceeded by state expenditures at the site. The Department will be obligated for long-term monitoring, maintenance, and operation of the site remedies, once the remedies are complete and declared "operational and functional."

In addition to these two sites, there are four other Superfund sites: Northwest Pipe and Casing (Clackamas), Portland Harbor (Portland), Formosa Mine (Douglas County), and Black Butte Mine (Lane County) where there is a possibility of future pollution remediation cost share obligation. In each of these cases, the State has not entered into a contract with EPA, nor have the State and EPA begun discussions of Oregon's contribution and planning of cleanup work has not progressed far enough to make a reasonable estimate of potential obligations. A brief disclosure related to each site follows:

Remedial action was completed on the Northwest Pipe and Casing site, but the groundwater remedy at the site is not functioning as intended and additional contamination has been found. The project has been funded to date by a site-specific fund managed by EPA. There is currently insufficient information to determine whether any additional match will be required by EPA, or if there will be operations and maintenance costs associated with whatever solution is proposed.

For the Portland Harbor site, the State expects that it will be requested by the EPA to pay a share of the Comprehensive Environmental Response Compensation and Liability Act ("CERCLA") orphan share obligations. When the EPA negotiates a settlement with the liable parties for the Portland Harbor Superfund, it may agree to pay some portion of the financial responsibility assigned to potentially responsible parties who are insolvent or defunct, and unaffiliated with any other viable liable party (the "orphan share"). If the EPA assumes some orphan share costs, the State anticipates the EPA will request to the State to agree to pay 10% of any orphan share payment made by EPA, plus the costs of continuing operation and maintenance of the orphan site(s). At this time, whether the State would enter into such an agreement and the amount the State would pay are unknown, and will depend on the outcome of negotiations with the EPA. The Portland Harbor Superfund site is discussed in greater detail in Note 14.

As of June 30, 2013, EPA has not yet determined a course of action for the Formosa Mine and Black Butte Mine sites, nor has State yet agreed to participate by providing matching funds or long-term operations and maintenance

In addition to the Superfund sites, DEQ is voluntarily performing pollution remediation on five site types (listed below) and only two of which result in net obligations recognized.

Alkali Lake: The State of Oregon owns the Alkali Lake site and DEQ has voluntarily completed cleanup of pesticide manufacturing waste disposed by the previous owner before the State had a property interest in the site. Despite the large quantity of toxic materials disposed at the site, DEQ has concluded that it does not present a significant risk to human health or the environment because the waste has been buried and fenced, and the site is remote. Because the remedy chosen leaves a large quantity of contamination at the site, DEQ has obligated itself to maintain fencing and other security measures.

Dedicated fund sites: DEQ is managing investigation and cleanup activities on behalf of responsible parties at several sites, with varying types of pollution. In these cases, the cleanups are financed with responsible party funds paid to DEQ through settlement or other agreements. The State has no legal obligation, other than that included in the agreements, to perform remediation.

Industrial orphan sites: DEQ voluntarily cleans up industrial orphan sites with proceeds of bond sales and recoveries of those expenditures. These orphans are former industrial sites, with varying types of contamination. No state or federal law requires cleanup.

Solid waste orphan sites: DEQ voluntarily cleans up orphans with fee revenues dedicated to this purpose, plus interest accrued. These orphans are solid waste landfills. No state or federal law requires cleanup.

Dry cleaner sites: DEQ cleans up qualifying sites (former or current dry cleaner operations, contaminated with dry cleaning solvents) with revenues from fees on the dry cleaner industry. There is no state or federal law requiring DEQ cleanup of these sites and the State's obligation to clean up can be no greater than revenues realized in the dry cleaner fund.

The Department's cleanup costs for dedicated sites will not exceed cash available from responsible parties, plus earned interest, so no costs estimate was necessary for financial statement purposes. Monitoring, operations, and maintenance costs for the Alkali Lake site are based on environmental

consulting firm estimates, which include a contingency allowance. For other sites in this category, industrial and solid waste orphans and dry cleaner fund financed cleanups; the Department's obligation is to complete the work currently under contract with environmental services firms. The related obligation accrued is based on the remainder of the contracted work with the environmental firms.

8. Interfund Transactions

Interfund balances result from the time lag between dates that interfund goods or services are provided or reimbursable expenditures occur, transactions are recorded in the accounting system, or payments between funds are made. The following schedule summarizes Due To and Due From interfund transactions in the financial statements as of June 30, 2013:

	<u>Due From Other Funds</u>	<u>Due To Other Funds</u>
General Fund	\$173,560	(\$ 670,056)
Environmental Management	2,822,296	(2,325,782)
Enterprise Fund	<u>-</u>	<u>(18)</u>
	<u>\$ 2,995,856</u>	<u>(\$ 2,995,856)</u>

Transfers are used to move revenues from the fund that budget requires to collect them to the fund that budget requires to expend them, move receipts restricted to debt service from the funds collecting the receipts to the appropriate funds, and move unrestricted revenues collected to finance various programs accounted for in the other funds in accordance with budgetary authorizations. The following schedule summarizes Transfers To and From Other Funds in the financial statements as of June 30, 2013:

	<u>Transfers From Other Funds</u>	<u>Transfers To Other Funds</u>
General Fund	\$ -	(\$ -)
Environmental Management Fund	8,012,752	(11,369,866)
General Obligation Bond	3,357,114	(-)
Enterprise Fund	-	(-)
<i>Total Transfers</i>	<u>\$ 11,369,866</u>	<u>(\$ 11,369,866)</u>

9. Employee Retirement Plans

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

PERS Pension

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 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.

Public employees hired on or after August 29, 2003, become part of OPSRP, unless membership was previously established in the Oregon Public Employees Retirement System (PERS). PERS member contributions go into the Individual Account Program (IAP) portion of OPSRP. PERS members retain their existing PERS accounts, but member contributions are deposited in the member's IAP account, not into the member's PERS account.

Oregon Public Service Retirement Plan (OPSRP)

The 2003 Oregon Legislature created the Oregon Public Service Retirement Plan (OPSRP), also a cost-sharing multiple-employer defined benefit pension plan. The Pension Program is administered by the Public Employees Retirement Board under the guidelines of Oregon Revised Statutes, chapter 238A. The OPSRP pension plan has two components: the Pension Program (defined benefit) and the Individual Account Program (defined contribution). Employees hired after August 28, 2003, participate in OPSRP after completing six months of service. The Pension

Program 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 required State employee contributions and the required state employer contributions, shown as a percentage of covered salary, for the PERS multiple-employer plans are as follows: the Employee rate is 6.00%; the PERS Pension Employer rate is 9.55%; and the OPSRP rate is 8.05%.

Combined employer contributions for the years ended June 30, 2013, 2012, and 2011 were \$3,403,346, \$3,522,540, and \$1,093,779 respectively, equal to the required contributions each year.

Beginning January 1, 2004, PERS members became part of the Individual Account Program (IAP) portion of OPSRP. PERS members retain their existing PERS accounts, but member contributions are now deposited in the member's IAP account, not into the member's PERS account. All covered employees are required by State statute to contribute 6% of their salary to the plan. Current law permits State agencies to pay the 6% member contributions for their employees. The amount contributed by DEQ, on behalf of employees, for the years ending June 30, 2013, 2012, and 2011 were \$2,206,548, \$2,298,394, and \$2,345,783, respectively, equal to the required contributions for each year.

In addition to the retirement contributions discussed above, DEQ also contributes to pay for its share of a statewide debt service payment on Pension Obligation Bonds. These payments are treated as part of payroll benefits. Contributions are calculated based on a percentage of subject payroll. The current rate, in place since November 1, 2011, is 6.33% of subject payroll. Employer pension obligation bond contributions for the years ended June 30, 2013, 2012, and 2011 were \$2,321,586, \$2,371,725, and \$2,325,453, respectively, equal to the required contributions each year.

10. Other Post Employment Benefit Plans

The Department's employees may be eligible to participate in health insurance plans and other benefit plans after retirement, collectively known as Other Postemployment Benefits (OPEB). OPEB plans are offered through the Public Employees Retirement System (PERS) as established by ORS 238 and the Public Employees Benefit Board (PEBB) as established by ORS 243. A copy of the audited annual financial report may be obtained from Fiscal Services Division, Public Employees Retirement System, P.O. Box 23700, Tigard, Oregon 97281-3700.

Retirement Health Insurance Account

The Retirement Health Insurance Account (RHIA) is a cost-sharing multiple-employer OPEB plan which provides a payment of up to \$60 toward the monthly cost of health insurance for eligible PERS members. To be eligible for the RHIA subsidy, the member must: 1) have eight years or

more of qualifying service in PERS at the time of retirement or receive a disability allowance as if the member had eight years or more creditable service in PERS, 2) receive both Medicare Parts A and B coverage, and 3) enroll in a PERS-sponsored health insurance plan.

The Department is required by statute to contribute actuarially computed amounts as determined by PERS. Rates are subject to change as a result of subsequent actuarial valuations. The rate of each covered employee's salary for the fiscal year end June 30, 2013 was 0.59%, which is embedded within the total PERS contribution rate. The Department's contribution for the years ended June 30, 2013, 2012, and 2011 were approximately \$216,979, \$226,068, and \$113,379, respectively, which was equal to the actuarial required contribution.

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

Retiree Health Insurance Premium Account

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

The Department is required by statute to contribute actuarially computed amounts as determined by PERS. Rates are subject to change as a result of subsequent actuarial valuations. The rate of each employee's covered salary for the fiscal year ended June 30, 2013 was 0.27%, which is embedded within the total PERS contribution rate. The Department's contribution for the years ended June 30, 2013, 2012, and 2011 were approximately \$99,296, \$61,306, and \$31,277, respectively, which was equal to the actuarial required contribution.

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

Both RHIA and RHIPA are closed to employees hired on or after August 29, 2003, who had not established membership prior to that date.

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.

11. Deferred Compensation

A deferred compensation program was authorized under Internal Revenue Code 457 and Oregon Revised Statute 243.400 to 243.507 established and provided for PERS to administer the Deferred Compensation funds with the Oregon Savings Growth Plan (State Plan). The State Plan is a benefit available to all state employees wherein they may execute an individual agreement with the State for amounts earned by them to be paid at a future date. Participants in the program are not required to pay federal and state income taxes on the deferred earnings until these earnings are received. Participants or their beneficiaries cannot receive the funds until at least one of the following circumstances is met: termination by reason of death/disability, resignation, retirement or unforeseeable emergency. Payments may be made over a period not to exceed the life expectancy of the participant and/or alternate payee.

Monies accumulated by the State Plan have been invested with various financial institutions and insurance companies. Activity of the State Plan is accounted for in a pension trust fund. DEQ incurs no liability associated with this program.

12. Risk Financing

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

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

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

13. Commitments

The Department has made commitments that are to be funded with general funds, federal funds, or lottery funds. These commitments may take the form of grants, loans, or contracts for services. Commitments, in effect as of June 30, 2013, and the anticipated sources of funding, are summarized in the following table:

Purpose	General	Federal	Lottery	Other	Total
Personal Service					
Contracts	\$ 140,266	\$ 143,327	\$ -	\$ 1,748,620	\$ 2,032,313
Grant and Loan					
Commitments	-	1,217,357	-	100,000	1,317,357
Systems Development	-	-	-	65,228	65,228
State Revolving Fund					
Loan Commitments	-	27,082,000	-	88,978,883	116,060,883
Total Commitments	<u>\$ 140,266</u>	<u>\$ 28,442,684</u>	<u>\$ -</u>	<u>\$ 90,892,731</u>	<u>\$ 119,475,781</u>

14. Contingencies

Litigation

DEQ is involved in negotiations related to a non-judicial allocation of costs associated with the investigation and cleanup of sediment contamination in the Portland Harbor. The U.S. Environmental Protection Agency (EPA) has listed a stretch of the lower Willamette River in Portland, Oregon on its National Priorities List (NPL). The boundaries of the Portland Harbor Superfund site have not been finally delineated but could likely include the lower eleven mile stretch of the Willamette River. The Superfund site may also include upland portions of the area where releases of hazardous substances occurred, those releases are not controlled, and the releases pose a threat to the river. There are over 200 parties, private and public, that may eventually bear a share of the costs related to the investigation and clean up of the site. The EPA has not identified any state agency as a potentially responsible party, but the agency will likely participate in a non-judicial allocation of response costs. It is too early in the EPA's remedial action process to estimate the total cleanup costs that may be shared by the liable parties and what portion of that, if any, will be assessed against the State. Initial estimates are that total costs may range from several hundred millions of dollars to almost 2 billion dollars.

The Portland Harbor Superfund site will also involve a separate allocation process for contamination caused injuries to natural resources administered by tribal, federal, and state trustees. Resource inquiries are currently being assessed so that claims may be assessed against the responsible parties. It is too early to estimate what, if any, share of the liability the State may bear for natural resource damage.

The Department may be required to pay a share of the Comprehensive Environmental Response Compensation and Liability Act (CERCLA) orphan share obligations. When the EPA negotiates a settlement with the liable parties for the Portland Harbor Superfund site, it may agree to pay some portion of the financial responsibility assigned to potentially responsible parties that are insolvent or defunct, and unaffiliated with any other viable liable party (the "orphan share"). Under CERCLA,

the Department may be asked to pay 10 percent of any orphan share payment made by the EPA. These potential costs are currently unknown.

Unemployment Benefits

State departments are subject to the Department of Employment Act. State employees who qualify are entitled to benefit payments during periods of unemployment. Each State department is required to reimburse the Department of Employment for benefit payments made to their former employees. There appears to be no practical method of estimating the amount of future benefit payments that may be made to former employees for wage credits earned prior to fiscal year end. Consequently, this potential obligation is not reported in the accompanying financial statements. Expenditures relating to these benefits for the year ended June 30, 2013 totaled \$96,492, while for the period ending June 30, 2012 benefits totaled \$186,964.

REQUIRED SUPPLEMENTARY INFORMATION

The required supplementary information includes financial information and disclosures that are required by the GASB but are not consider part of the basic financial statements.

- Budgetary Comparison Schedules
 - General Fund
 - Environmental Management Fund

	2012-2013 Biennial Budget		Actual			Variance Over/ (Under)
	Original	Final	FY 2012	FY 2013	Biennial	
Revenues:						
Taxes	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Licenses and fees	-	-	-	-	-	-
Federal Grants	-	-	-	-	-	-
Interest on Investments	-	-	-	-	-	-
Charges for Services	-	-	-	-	-	-
Intergovernmental	-	-	-	-	-	-
Civil Penalties	1,000,000	1,000,000	491,131	514,787	1,005,918	5,918
Other Revenue	-	-	572	-	572	572
Donations	-	-	-	-	-	-
Miscellaneous	-	-	-	-	-	-
Total Revenues	\$ 1,000,000	\$ 1,000,000	\$ 491,703	\$ 514,787	\$ 1,006,490	\$ 6,490
Expenditures:						
Personal Services	\$ 11,701,689	\$ 11,497,994	\$ 5,191,607	5,786,263	\$ 10,977,869	\$ (520,125)
Services & Supplies	7,646,460	7,594,537	3,978,569	3,889,306	7,867,876	273,339
Special Payments	244,012	244,012	125,433	130,577	256,010	11,998
Capital Outlay	101,813	101,813	257,264	79,337	336,601	234,788
Debt Service						
Principal-Bonds	4,210,888	4,210,888	2,066,774	2,144,113	4,210,887	(1)
Interest - Bonds	1,168,680	1,362,292	718,345	643,945	1,362,289	(3)
Total Expenditures	\$ 25,073,542	\$ 25,011,536	\$ 12,337,992	\$ 12,673,540	\$ 25,011,532	\$ (4)
Excess (Deficiency) of Revenues Over (Under) Expenditures	\$ (24,073,542)	\$ (24,011,536)	\$ (11,846,289)	\$ (12,158,754)	\$ (24,005,043)	\$ 6,493
Other Financing Sources (Uses):						
Transfers Out (Operating)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Transfers Out (State General Fund)	(1,000,000)	(1,000,000)	(491,703)	(514,791)	(1,006,494)	(6,494)
State Appropriations	25,073,542	25,011,536	12,337,992	12,673,544	25,011,536	0
Total Other Financing Sources (Uses)	\$ 24,073,542	\$ 24,011,536	\$ 11,846,289	\$ 12,158,754	\$ 24,005,043	\$ (6,493)
Net Change in Fund Balance	\$ -	\$ -	\$ -	\$ -	\$ -	\$ (0)
Fund Balance, June 30, 2012	\$ -	\$ -		\$ 502,782		
Fund Balance, June 30, 2013	\$ -	\$ -		\$ 502,782		
ADJUSTMENT TO ACCOUNTING PRINCIPLES GENERALLY ACCEPTED IN THE UNITED STATES OF AMERICA (US GAAP) BASIS						
Encumbrances for equipment and supplies ordered but not received are reported in the same year the orders are placed for budgetary purposes, but are reported in the year the equipment and supplies are received for GAAP purposes.			\$	-		
Change in the inventory balance.				6,055		
Change in the prepaid balance.				9,910		
Fund Balance Ending, GAAP Basis				518,747		

	2012-2013 Biennial Budget		Actual		Biennial	Variance Over/ (Under)
	Original	Final	FY 2012	FY 2013		
Revenues:						
Licenses and Fees	\$ 102,986,877	\$ 102,986,877	\$ 39,745,228	\$ 39,827,045	\$ 79,572,273	\$ (23,414,604)
Federal Grants	64,174,161	65,074,161	33,232,385	20,113,433	53,345,818	(11,728,343)
Interest on Investments	32,333,244	32,333,244	11,671,711	10,612,522	22,284,233	(10,049,011)
Charges for Services	6,895,865	6,857,387	5,712,222	16,571,223	22,283,445	15,426,058
Intergovernmental	-	-	-	-	-	-
Other Revenues	914,684	914,684	17,042,341	977,721	18,020,062	17,105,378
Civil Penalties	105,900	105,900	40,268	63,886	104,154	(1,746)
Donations	-	-	-	-	-	-
Miscellaneous	-	-	-	-	-	-
Total Revenues	\$ 207,410,731	\$ 208,272,253	\$ 107,444,155	\$ 88,165,830	\$ 195,609,985	\$ (12,662,268)
Expenditures:						
Personal Services	\$ 115,777,974	\$ 116,374,831	\$ 53,914,468	\$ 51,776,693	\$ 105,691,161	\$ (10,683,670)
Services & Supplies	51,960,306	51,836,449	17,121,002	16,996,952	34,117,954	(17,718,495)
Special Payments	115,168,413	115,526,413	47,794,938	59,080,671	106,875,609	(8,650,804)
Capital Outlay	1,827,522	1,896,522	252,460	327,904	580,364	(1,316,158)
Total Expenditures	\$ 284,734,215	\$ 285,634,215	\$ 119,082,868	\$ 128,182,219	\$ 247,265,087	\$ (38,369,128)
Excess (Deficiency) of Revenues Over (Under) Expenditures	<u>\$ (77,323,484)</u>	<u>\$ (77,361,962)</u>	<u>\$ (11,638,713)</u>	<u>\$ (40,016,389)</u>	<u>\$ (51,655,102)</u>	<u>\$ 25,706,860</u>
Other Financing Sources (Uses):						
Transfers In (Operating)	39,412,213	39,412,214	11,744,010	19,447,639	31,191,649	(8,220,565)
Transfers Out (Operating)	(39,412,213)	(39,412,214)	(13,654,251)	(19,447,639)	(33,101,890)	6,310,324
Transfers In (Other Agencies)	12,946,416	12,946,416	6,707,010	6,099,652	12,806,662	(139,754)
Transfers Out (Other Agencies)	(259,000)	(259,000)	(3,419,541)	(265,624)	(3,685,165)	(3,426,165)
Transfers Out (State General Fund)	-	(3,000,000)	-	-	-	3,000,000
Long-term Debt Issued	16,740,000	16,740,000	-	16,950,000	16,950,000	210,000
Debt Issuance Discount	-	-	-	-	-	-
Debt Issuance Premium	-	-	-	2,763,518	2,763,518	2,763,518
Loan Repayments	62,000,000	62,000,000	52,732,082	86,411,846	139,143,928	77,143,928
Gain/Loss on Disposition of Assets	-	-	-	-	-	-
Insurance Proceeds	-	-	-	-	-	-
Total Other Financing Sources (Uses)	\$ 91,427,416	\$ 88,427,416	\$ 54,109,310	\$ 111,959,392	\$ 166,068,702	\$ 77,641,286
Net Change in Fund Balance	<u>\$ 14,103,932</u>	<u>\$ 11,065,454</u>	<u>\$ 42,470,597</u>	<u>\$ 71,943,003</u>	<u>\$ 114,413,600</u>	<u>\$ 103,348,146</u>
Fund Balance, June 30, 2012	<u>\$ -</u>	<u>\$ -</u>		<u>\$ 610,901,341</u>		
Fund Balance, June 30, 2013				<u>\$ 682,844,344</u>		
ADJUSTMENT TO ACCOUNTING PRINCIPLES GENERALLY ACCEPTED IN THE UNITED STATES OF AMERICA (US GAAP) BASIS						
Encumbrances for equipment and supplies ordered but not received are reported in the same year the orders are placed for budgetary purposes, but are reported in the year the equipment and supplies are received for GAAP purposes.			\$ (1,418,442)			
Loan disbursements are considered expenditures for budgetary purposes, but not for GAAP purposes.			54,820,088			
Loan repayments are considered other financing sources for budgetary purposes but are not considered other financing sources for GAAP purposes.			(86,411,846)			
Loan forgiveness considered expenditures for GAAP purposes but not for budgetary purposes.			(1,879,159)			
Change in the deferred revenue balance.			(468,648)			
Change in the inventory balance.			(31,310)			
Change in the prepaid balance.			95,102			
Fund Balance Ending, GAAP Basis			<u>\$ 647,550,130</u>			

1. Stewardship, Compliance, and Accountability

The State's budget is approved on a biennial basis, where the biennium begins July 1 and ends June 30 of each odd-numbered year. The Governor is required to submit budget recommendations to the Legislature no later than December 1 preceding the biennium. The Governor establishes priorities for the State based on function and the budget is summarized by these functions. Expenditures are budgeted based on the following revenue sources: General, Federal, Lottery, and Other.

The Oregon Legislature approves budgets for a biennial period, with the biennium beginning July 1 and ending June 30 of each odd-numbered year. The Oregon Constitution requires the budget to be in balance at the end of each biennium. Provision is made for interim funding through the Legislature's Emergency Board. The Emergency Board authorizes and allocates all increases in funding and takes other actions to meet emergency needs when the Legislature is not in session.

Appropriated budgets include expenditure authority created by appropriation bills and related estimated revenues. All funds are subject to legislative approval. Also included in the Agency's budget are legally authorized, non-appropriated budget items that are not legislatively limited by an appropriation bill. Non-appropriated budgets and some non-limited financial activities are also subject to allotment control by the Department of Administrative Services.

During the biennium, the Department of Administrative Services approves spending limits for each quarter, and the agency's actual expenditures are monitored against approved budgets, quarterly allotments, and cash balances.

The budgetary basis of accounting is materially consistent with the GAAP basis of accounting, except for transactions related to long-term receivables and payables, debt service and the acquisition and depreciation of capital assets. For budgetary purposes, these transactions may or may not be treated as revenues and expenditures.

The budget is prepared on the cash basis utilizing encumbrance accounting. Encumbrances are commitments related to unperformed contracts for goods or services and are not considered expenditures under GAAP. Services or supplies must be received prior to June 30 of the biennium end to be charged to the current budget.

The major differences between Budgetary (Non-GAAP) basis and GAAP basis are:

1. Encumbrances are recorded as expenditures for budgetary purposes when purchase orders are issued.
2. Revenues are recognized when received in cash (budgetary) as opposed to when they are susceptible to accrual (GAAP)
3. Expenditures are recognized when paid in cash (budgetary) as opposed to when the liability is incurred (GAAP).
4. Timing differences occur because of a six-month lapse period between June 30 and December 31 of each odd-number year.

Reconciliation is included on the Budgetary Comparison Schedules for both the General Fund and Environmental Management Fund. These schedules present both the original and final budgets for the reporting period as well as actual inflows, outflows, and balances, stated on the budgetary

basis. The budgetary comparison schedules are presented as part of the required supplementary information.