Washington State Auditor's Office

Financial Statements Audit Report

Public Utility District No. 1 of Cowlitz County

Audit Period
January 1, 2011 through December 31, 2011

Report No. 1007911

Issue Date
June 11, 2012

WASHINGTON
BRIAN SONNTAG
STATE AUDITOR

Washington State Auditor
Brian Sonntag

June 11, 2012

Board of Commissioners
Public Utility District No. 1 of Cowlitz County
Longview, Washington

Report on Financial Statements

Please find attached our report on Public Utility District No. 1 of Cowlitz County's financial statements.

We are issuing this report in order to provide information on the District's financial condition.

Sincerely,

BRIAN SONNTAG, CGFM
STATE AUDITOR

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January 1, 2011 through December 31, 2011

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Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters in Accordance with *Government Auditing Standards*

Public Utility District No. 1 of Cowlitz County
January 1, 2011 through December 31, 2011

Board of Commissioners
Public Utility District No. 1 of Cowlitz County
Longview, Washington

We have audited the financial statements of each major fund of Public Utility District No. 1 of Cowlitz County, Washington, as of and for the year ended December 31, 2011, which collectively comprise the District's basic financial statements, and have issued our report thereon dated May 23, 2012.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit, we considered the District's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the District's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the District's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

COMPLIANCE AND OTHER MATTERS

As part of obtaining reasonable assurance about whether the District's financial statements are free of material misstatement, we performed tests of the District's compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended for the information and use of management and the Board of Commissioners. However, this report is a matter of public record and its distribution is not limited. It also serves to disseminate information to the public as a reporting tool to help citizens assess government operations.

BRIAN SONNTAG, CGFM
STATE AUDITOR

May 23, 2012

Independent Auditor's Report on Financial Statements

Public Utility District No. 1 of Cowlitz County
January 1, 2011 through December 31, 2011

Board of Commissioners
Public Utility District No. 1 of Cowlitz County
Longview, Washington

We have audited the accompanying financial statements of each major fund of Public Utility District No. 1 of Cowlitz County, Washington, as of and for the year ended December 31, 2011, which collectively comprise the District's basic financial statements as listed on page 5. These financial statements are the responsibility of the District's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of each major fund of Public Utility District No. 1 of Cowlitz County, as of December 31, 2011, and the respective changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 6 through 8 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during the audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

BRIAN SONNTAG, CGFM
STATE AUDITOR

May 23, 2012

Financial Section

Public Utility District No. 1 of Cowlitz County

January 1, 2011 through December 31, 2011

REQUIRED SUPPLEMENTARY INFORMATION

Management Discussion and Analysis – 2011

BASIC FINANCIAL STATEMENTS

Balance Sheet – 2011
Statement of Revenues, Expenses and Changes in Net Assets – 2011
Statement of Cash Flows – 2011
Notes to the Combined Financial Statements – 2011

This discussion and analysis is designed to provide an overview of the financial activities of Public Utility District No. 1 of Cowlitz County, Washington (the District) for the year ended December 31, 2011. This supplementary information is to be read in conjunction with the District's financial statements.

The District is a municipal corporation incorporated in 1936 to serve the citizens of Cowlitz County, Washington. The District is governed by a three-member board of locally elected commissioners, independent of county government. The District manages and operates two systems: Electric and Production (Swift No. 2 Hydroelectric).

Financial Policies and Controls

The District's financial management system consists of financial policies, financial management strategies and the internal control structure, including annual budgets and external audit of its financial statements. The Board has the exclusive right to determine rates and charges for services provided. Planning is guided by forecasts of balance sheet, operating and capital items. These tools are used to identify the impacts of anticipated initiatives and to devise strategies to meet the Board's financial objectives.

ELECTRIC SYSTEM

The Electric System provides electric service throughout Cowlitz County which encompasses 1,144 square miles and approximately 48,500 customers. The District is among the largest PUDs in the state of Washington with total 2011 power sales of 5,186,719 MWHs. Approximately 60% of the District's power and 50% of revenues are generated from two industrial customers. Extreme weather and economic conditions are the primary influences on electricity sales.

The Electric System power supply is provided through contracts with BPA and Grant County PUD, as well as the purchase of the output from the District's Swift No. 2 Hydroelectric Production System on the Lewis River and the power associated with 2 MW of Energy Northwest's Nine Canyon Wind Project. The District also receives and sells energy from interests in two wind projects; 46% of the 204.7 MW White Creek Project and 30% of the 98.9 MW Harvest Wind Project. Both projects are located in Klickitat County, WA. In 2011 approximately 85% of the District's power supply was purchased from BPA.

Selected Financial Data – Electric System

	2011	2010
Current Assets	$ 39,280,888	$ 39,294,667
Net Utility Plant	164,810,983	157,392,300
Other Assets	198,534,616	212,181,482
Total Assets	402,626,487	408,868,449
Current Liabilities	50,107,633	52,585,921
Long-Term Debt	196,246,210	204,084,838
Other Liabilities	12,115,577	10,469,270
Total Liabilities	258,469,420	267,140,029
Total Net Assets	144,157,067	141,728,420
Operating Revenues	220,374,001	208,377,501
Operating Expenses	210,877,263	202,437,026
Net Operating Revenues	9,496,738	5,940,475
Other Income (Expense)	(7,068,091)	(7,506,076)
Change in Net Assets	2,428,647	(1,565,601)

Results of operations are primarily impacted by increased power supply costs and reductions in wind revenue. Other increases include taxes, depreciation and interest costs. In January 2011 the District increased rates approximately 9% with another approximate 17.5% increase in November 2011.

Capital Asset and Long-Term Debt Activity

As of year-end, the Electric System had $263.3 million invested in electric system plant in service, an increase of 3.9%. Additions are primarily related to an enhanced construction program in an effort to improve the reliability of the Electric System for all customers, Advanced Automated Metering project, new ERP computer system and substation upgrades. Capital construction is funded by a combination of rates, aid-to-construction paid by customers and long-term revenue bonds.

Total electric system utility plant in service as of December 31, 2011 and 2010 consisted of the following:

	2011	2010
Intangible	$ 239,963	$ 239,963
Transmission & Distribution	221,142,479	214,013,027
General Plant	41,954,383	39,118,540
Total Plant In Service	$ 263,336,825	$ 253,371,530

At December 31, 2011 the Electric System had outstanding revenue bonds totaling $185 million compared to $192 million at December 31, 2010. On February 23, 2010 the District issued Electric System Revenue Bonds consisting of $17.8 million in tax-exempt bonds (2010A) and $46.2 million in taxable “Build America Bonds” (2010B) to fund capital improvements, pay for bond issuance costs and fund bond debt service and reserve accounts. Principal payments on these bonds are scheduled to begin in September 2013, maturing annually in varying amounts through September 2032. The 2010A bonds are not subject to redemption prior to maturity and carry a coupon rate of 5.00% with an all-in true interest cost of 3.59%. The 2010B bonds are subject to redemption by the District prior to their stated maturities and carry coupon rates of 2.52% – 6.884% before a thirty-five percent subsidy payment from the United States Treasury, subject to certain conditions. The all-in true interest cost for the 2010A and 2010B bonds is 4.26%.

PRODUCTION SYSTEM

The Production System operates the 66.8 MW Swift No. 2 Hydroelectric Dam on the Lewis River. All of the output is sold to the District's Electric System at cost. The 50-year FERC license expires in June 2058.

Selected Financial Data – Production System

	2011	2010
Current Assets	$ 36,267,260	$ 32,837,004
Net Utility Plant	128,616,174	131,671,273
Other Assets	20,606,511	24,798,496
Total Assets	185,489,945	189,306,773
Current Liabilities	2,677,969	5,993,245
Long-Term Debt	64,879,128	65,845,652
Other Liabilities	7,433,402	7,433,402
Total Liabilities	74,990,499	79,272,299
Total Net Assets	110,499,446	110,034,474
Operating Revenues	8,507,955	8,403,422
Operating Expenses	5,556,231	6,214,381
Net Operating Revenues	2,951,724	2,189,041
Other Income (Expense)	(2,486,752)	(2,035,431)
Change in Net Assets	464,972	153,610

Operating revenues are set to cover operating and capital costs, debt service and to fund reserves. Fluctuations in operations from year to year are largely impacted by non-recurring or infrequent projects.

Capital Asset and Long-Term Debt Activity

No substantial capital activity and no new debt in 2011. Total Production System plant in service as of December 31, 2011 and 2010 consisted of the following:

	2011	2010
Intangible	$ 5,109,470	$ 5,109,470
Production Plant	145,077,460	145,077,460
Transmission Plant	4,624,838	4,624,838
Total Plant In Service	$ 154,811,768	$ 154,811,768

PUBLIC UTILITY DISTRICT NO 1 OF COWLITZ COUNTY, WASHINGTON
BALANCE SHEET
DECEMBER 31, 2011

	Electric	Production	Total
ASSETS			
CURRENT ASSETS			
Cash and cash equivalents	$ 8,712,470	$ 22,292,816	$ 31,005,286
Investment	1,105,097	-	1,105,097
Customer accounts receivable and unbilled revenues	22,433,209	-	22,433,209
Other accounts receivable	3,348,641	-	3,348,641
Allowance for uncollectible accounts	(1,751,795)	-	(1,751,795)
Accounts receivable from assoc. companies	194,620	-	194,620
Interfund note receivable	-	12,000,000	12,000,000
Current portion of advances to other funds	97,482	574,863	672,345
Materials and supplies	3,949,058	-	3,949,058
Prepayments	367,095	539,058	906,153
Interest receivable	365,739	860,523	1,226,262
Other current assets	459,272	-	459,272
Total current assets	39,280,888	36,267,260	75,548,148
RESTRICTED ASSETS			
Cash and cash equivalents	71,530,890	7,184,467	78,715,357
Investments	2,290,295	-	2,290,295
Total restricted assets	73,821,185	7,184,467	81,005,652
UTILITY PLANT			
Plant in service	263,336,825	154,811,768	418,148,593
Construction in progress	12,686,016	50,309	12,736,325
Total utility plant	276,022,841	154,862,077	430,884,918
Less accumulated depreciation and amortization	111,211,858	26,245,903	137,457,761
Net utility plant	164,810,983	128,616,174	293,427,157
OTHER PROPERTY AND INVESTMENTS			
White Creek Wind Project Energy Purchase Agreement	67,941,528	-	67,941,528
Investment in associated organizations	49,066,543	-	49,066,543
BPA transmission credit receivable	3,914,425	-	3,914,425
Note receivable	959,603	-	959,603
Advances to other funds	-	12,585,070	12,585,070
Total other property and investments	121,882,099	12,585,070	134,467,169
DEFERRED CHARGES			
Unamortized bond issue costs	2,005,412	832,841	2,838,253
Option premiums	695,360	-	695,360
Miscellaneous deferred charges	130,560	4,133	134,693
Total deferred charges	2,831,332	836,974	3,668,306
TOTAL ASSETS	$ 402,626,487	$ 185,489,945	$ 588,116,432

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

PUBLIC UTILITY DISTRICT NO 1 OF COWLITZ COUNTY, WASHINGTON
BALANCE SHEET
DECEMBER 31, 2011

	Electric	Production	Total
LIABILITIES			
CURRENT LIABILITIES			
Current portion of long-term debt	$ 7,364,863	$ 920,000	$ 8,284,863
Notes payable	12,000,000	-	12,000,000
Accounts payable	18,388,090	360,244	18,748,334
Accounts payable to assoc. companies	-	194,523	194,523
Accrued wages and benefits	2,100,289	-	2,100,289
Customer deposits	2,159,311	-	2,159,311
Taxes payable	4,409,279	140,497	4,549,776
Interest payable	3,588,138	1,060,452	4,648,590
Other current liabilities	97,663	2,253	99,916
Total current liabilities	50,107,633	2,677,969	52,785,602
LONG-TERM LIABILITIES			
Bonds payable	178,640,000	63,880,000	242,520,000
Premium on bonds payable	4,262,462	999,128	5,261,590
Advances from other funds	12,585,070	-	12,585,070
Loan payable	758,678	-	758,678
Total long-term liabilities	196,246,210	64,879,128	261,125,338
OTHER LIABILITIES AND DEFERRED CREDITS			
Lewis River Cost-Share Agreement	-	7,433,402	7,433,402
Deferred revenue - rate stabilization fund	9,700,000	-	9,700,000
Deferred compensation and retirement reserves	1,042,177	-	1,042,177
Insurance reserves and other deferred credits	944,084	-	944,084
Post-retirement benefit obligation	429,316	-	429,316
Total other liabilities and deferred credits	12,115,577	7,433,402	19,548,979
TOTAL LIABILITIES	258,469,420	74,990,499	333,459,919
COMMITMENTS AND CONTINGENCIES			
NET ASSETS			
Invested in capital assets, net of related debt	124,783,839	62,568,111	187,351,950
Restricted	1,290,295	-	1,290,295
Unrestricted	18,082,933	47,931,335	66,014,268
TOTAL NET ASSETS	144,157,067	110,499,446	254,656,513
TOTAL LIABILITIES AND NET ASSETS	$ 402,626,487	$ 185,489,945	$ 588,116,432

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

PUBLIC UTILITY DISTRICT NO 1 OF COWLITZ COUNTY, WASHINGTON
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
YEAR ENDED DECEMBER 31, 2011

	Electric	Production	Total
OPERATING REVENUES			
Retail sales	$ 204,309,719	$ 8,507,955	$ 212,817,674
Wholesale sales	14,724,965	-	14,724,965
Other operating revenues	1,339,317	-	1,339,317
Total operating revenues	220,374,001	8,507,955	228,881,956
OPERATING EXPENSES			
Power costs	167,877,965	-	167,877,965
Operations expense	17,748,047	1,545,205	19,293,252
Maintenance expense	4,032,318	857,441	4,889,759
Depreciation and amortization	9,844,529	3,105,408	12,949,937
Taxes	11,374,404	48,177	11,422,581
Total operating expenses	210,877,263	5,556,231	216,433,494
OPERATING INCOME	9,496,738	2,951,724	12,448,462
OTHER INCOME (EXPENSE)			
Interest and dividend income	183,996	683,090	867,086
Interest on long-term debt	(10,104,523)	(3,136,455)	(13,240,978)
Amortization of debt expense	(196,602)	(33,312)	(229,914)
Income from Harvest Wind Project	1,204,350	-	1,204,350
Miscellaneous nonoperating income (expense)	(2,865)	(75)	(2,940)
Total other income (expense)	(8,915,644)	(2,486,752)	(11,402,396)
CHANGE IN NET ASSETS BEFORE CONTRIBUTIONS AND SUBSIDY	581,094	464,972	1,046,066
Contributions in aid of construction	829,242	-	829,242
BAB subsidy	1,018,311	-	1,018,311
CHANGE IN NET ASSETS	2,428,647	464,972	2,893,619
TOTAL NET ASSETS, beginning of year	141,728,420	110,034,474	251,762,894
TOTAL NET ASSETS, end of year	$ 144,157,067	$ 110,499,446	$ 254,656,513

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

PUBLIC UTILITY DISTRICT NO 1 OF COWLITZ COUNTY, WASHINGTON
STATEMENT OF CASH FLOWS
YEAR ENDED DECEMBER 31, 2011

	Electric	Production	Total
CASH FLOWS FROM OPERATING ACTIVITIES			
Cash received from customers	$ 220,438,384	$ 8,507,955	$ 228,946,339
Cash payments to suppliers	(175,480,185)	(2,511,448)	(177,991,633)
Cash payments to employees	(11,239,430)	-	(11,239,430)
Cash payments for taxes	(10,619,650)	645	(10,619,005)
Net cash from operating activities	23,099,119	5,997,152	29,096,271
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES			
Inter-System Advances	(549,613)	549,613	-
Net cash from non-capital financing activities	(549,613)	549,613	-
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES			
Construction and acquisition of utility plant	(17,263,212)	(3,429,127)	(20,692,339)
Principal paid on long-term debt	(6,465,000)	(885,000)	(7,350,000)
Principal paid on notes payable	(41,322)	-	(41,322)
Interest paid on long-term debt and notes	(10,651,921)	(3,212,331)	(13,864,252)
Harvest Wind Project, net	2,916,392	-	2,916,392
Contributions in aid of construction	829,242	-	829,242
BAB subsidy	1,018,311	-	1,018,311
Materials and supplies	837,328	-	837,328
Deferred charges, net	(45,071)	(4,133)	(49,204)
Miscellaneous nonoperating	(2,866)	(75)	(2,941)
Net cash from capital and related financing activities	(28,868,119)	(7,530,666)	(36,398,785)
CASH FLOWS FROM INVESTING ACTIVITIES			
Net investment activity	1,107,084	-	1,107,084
Net Beacon Hill	93,615	-	93,615
Interest and dividends on investments	259,579	651,890	911,469
Investment in associated organizations	675,343	-	675,343
Net cash from investing activities	2,135,621	651,890	2,787,511
NET CHANGE IN CASH	(4,182,992)	(332,011)	(4,515,003)
CASH AND CASH EQUVALENTS, beginning	84,426,352	29,809,294	114,235,646
CASH AND CASH EQUVALENTS, end of year	$ 80,243,360	$ 29,477,283	$ 109,720,643

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

PUBLIC UTILITY DISTRICT NO 1 OF COWLITZ COUNTY, WASHINGTON
STATEMENT OF CASH FLOWS
YEAR ENDED DECEMBER 31, 2011

Reconciliation of operating income to net cash from operating activities:	Electric	Production	Total
Operating income	$ 9,496,738	$ 2,951,724	$ 12,448,462
Adjustments to reconcile operating income to net cash from operating activities:			
Depreciation and amortization	9,844,529	3,105,408	12,949,937
Amortization of energy purchase agreement	4,317,724	-	4,317,724
Changes in assets and liabilities:			
Customer accounts receivable and unbilled	(2,154,148)	-	(2,154,148)
Other accounts receivable	3,028,790	-	3,028,790
Accounts receivable from assoc. companies	1,816	-	1,816
Prepayments	167,922	(117,874)	50,048
Other current assets	(271,516)	-	(271,516)
BPA transmission credit receivable	429,900	-	429,900
Option premiums	(695,360)	-	(695,360)
Warrants outstanding	(1,504,649)	(20,419)	(1,525,068)
Accounts payable	674,006	32,750	706,756
Accounts payable to assoc. companies	-	(1,913)	(1,913)
Accrued wages and benefits	227,238	-	227,238
Customer deposits	(2,812,075)	-	(2,812,075)
Taxes payable	754,754	48,822	803,576
Other current liabilities	(52,857)	(1,346)	(54,203)
Deferred revenue - rate stabilization fund	2,000,000	-	2,000,000
Deferred compensation and retirement	1,991	-	1,991
Insurance reserves and other deferred credits	(504,579)	-	(504,579)
Post-retirement benefit obligation	148,895	-	148,895
	$ 23,099,119	$ 5,997,152	$ 29,096,271

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

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

Public Utility District No. 1 of Cowlitz County, Washington (the District) was founded on November 3, 1936 and is a municipal corporation of the State of Washington. The District is governed by an elected three-member board of commissioners that have the responsibility to set rates and charges for services provided.

The District's reporting entity is comprised of the combined Electric System and Production System (66.8 MW Lewis River Swift Plant No. 2 Hydroelectric System). Inter-company balances and transactions have not been eliminated from the combined amounts reported. The District has no component units.

The District's wholesale activity is generated from the sale of the output from interests in two wind projects; 46% of the 204.7 MW White Creek Project and 30% of the 98.9 MW Harvest Wind Project. Both projects are located in Klickitat County, WA.

B. Basis of Accounting and Presentation

The accounting policies of the District conform to generally accepted accounting principles (GAAP) as applicable to proprietary enterprise funds of governments using the full accrual basis of accounting. The Governmental Accounting Standards Board (GASB) is the accepted standard setting body for establishing governmental accounting and financial reporting principles. Accounting records are maintained in accordance with methods prescribed by the State Auditor under the authority of Chapter 43.09 RCW and the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission (FERC).

GASB Statement No. 20 requires that the District apply all GASB pronouncements as well as the pronouncements issued on or before November 30, 1989 by the Financial Accounting Standard Board (FASB) and its predecessor organizations, unless those pronouncements conflict with or contradict GASB pronouncements. As provided for in GASB Statement No. 20, the District has elected not to implement FASB Statements and Interpretations issued after November 30, 1989.

C. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

D. Cash Equivalents

The District considers all highly liquid investments (including restricted assets) with a maturity of three months or less to be cash equivalents. Balances in the Local Government Investment Pool (LGIP) are considered cash equivalents as they can be converted to cash within one day.

E. Investments

The District records investments at fair value based on quoted market rates, with changes in unrealized gains and losses reported as investment income (See Note 2).

F. Accounts Receivable and Allowance for Uncollectible Accounts

Accounts receivable are recorded when invoices are issued and are written-off when they are determined to be uncollectible. The allowance for uncollectible accounts includes amounts estimated through an evaluation of specific accounts, based on the best available information, of customers that may be unable to meet their financial obligations, and a reserve based on historical experience. Actual losses between twelve and fifteen months old are then charged against the provision for uncollectible accounts quarterly.

G. Other Accounts Receivable

Other accounts receivable consists of certain wholesale transactions, conservation reimbursements, aid to construction billings and other miscellaneous customer and non-customer items that may require invoicing that would not normally be entered into the customer service billing system.

H. Interfund Balances and Transactions

The District's Electric System makes payments for goods, services and taxes on behalf of the Production System. This is reflected in the balance sheet as "accounts receivable from associated companies." Alternatively, the amounts due by the Production System to the Electric System are reflected in the balance sheet as "accounts payable to associated companies." These accounts include only short-term obligations which are paid monthly and are not interfund loans. A description of loans and long-term advances between funds is contained in Notes 5 & 6.

I. Materials and Supplies

Materials and supplies consist of items for plant maintenance and construction and are stated at average cost.

J. Restricted Assets

In accordance with bond resolutions and certain related agreements, separate restricted funds are required to be established. Cash and investments held in these funds are restricted for specific uses, including construction, debt service and other special reserve requirements.

K. Utility Plant and Depreciation

Utility plant is stated at original cost or, if donated, fair value (See Note 3). Cost includes labor, materials and related indirect costs. Additions, renewals and betterments with a minimum cost of $1,000 per item are capitalized. Repairs and minor replacements are charged to operating expenses. When an asset is removed from service and retired, unless it's a major retirement or a general plant asset, the cost of property plus removal cost less salvage is charged to accumulated depreciation. No material utility plant impairments were noted for the year ended December 31, 2011.

Contributions by developers and customers are recorded at contract price or cost as contributions in aid-of-construction and recorded in the statement of revenues, expenses and changes in net assets.

Depreciation is computed on the straight-line method over estimated useful lives as follows: Distribution Plant - 20 to 33 years; Transmission Plant - 33 years; General Plant - 4 to 50 years; Production Plant - 10 to 50 years; FERC License - 50 years.

L. White Creek Wind Project Energy Purchase Agreement

In November 2007 the White Creek Wind Project began energy production and the District paid $85,572,237 under the Amended and Restated White Creek Wind Project Energy Purchase Agreement to receive a 46% share of the energy from the Project for 20 years. With certain exceptions, the Agreement stipulates a minimum Annual Energy Quantity (225,917 MWh). The payment was made with unrestricted cash and investments held by the Electric System ($70,354,497) and a loan from the Production System to the Electric System ($15,217,740 – See Note 6). The prepayment is being amortized on a straight-line basis over the life of the contract.

M. BPA Transmission Credit Receivable

In October 2007 the White Creek Wind Project assigned 46% of its Bonneville Power Administration (BPA) transmission credit to the District. For the term of the agreement beginning January 1, 2008 and ending the sooner of the exhaustion of the assigned credit or January 1, 2021, the District will receive amounts for use of the facilities from BPA. During 2011 the District received $429,900 under this agreement.

N. Unamortized Bond Issue Costs and Premium

Bond issue costs are amortized to amortization expense using the straight-line method over the term of the bonds. Bond premium is amortized to interest expense using the weighted average method over the term of the bonds.

O. Fair Value of Financial Instruments

The carrying amounts of current assets, including restricted cash and investments, and current liabilities approximate fair value due to the short-term maturity of those instruments. The fair value of the District's investments and debt are estimated based on the quoted market prices for the same or similar issues.

P. Derivative Instruments

The District enters into derivative energy transactions to hedge its known or expected positions within its approved Risk Management policy. Decisions are made to enter into forward transactions to protect its financial position, specifically to deal with expected long and short positions as determined by projected load and resource balance positions, with the objective of providing stable rates and meeting budget.

The District has adopted GASB Statement No. 53, Accounting and Financial Reporting for Derivative Instruments. Subject to certain exceptions GASB Statement No. 53 requires that every derivative instrument be recorded on the balance sheet as an asset or liability measured at its fair value, and that changes in the derivative's fair value be recognized currently in earnings unless such derivatives meet specific hedge accounting criteria to be determined as effective. Effective hedges qualify for hedge accounting and such changes in fair values are deferred.

It is the District's policy to document and apply as appropriate the normal purchase and normal sales exception under GASB Statement No. 53. The District has reviewed its various contractual arrangements to determine applicability of these standards. Purchases and sales of forward electricity and option contracts that require physical delivery and which are expected to be used or sold by the reporting entity in the normal course of business are generally considered "normal purchases and normal sales." These transactions are excluded under GASB Statement No. 53 and therefore are not required to be recorded at fair value in the financial statements. Certain put and call options and financial swaps for electricity are considered to be derivatives under GASB Statement No. 53, but do not generally meet the "normal purchases and normal sales" criteria.

As of December 31, 2011, the District had the following derivative instruments outstanding through June 2013: The mark-to-market amounts are not included in the accompanying financial statements as the balances are not significant and any interim financial impact would be deferred under regulatory accounting until settlement. Options are amortized to power costs over the exercise period of the option.

Cash Flow Hedges (market values):

Financial Swap Forward	Derivative Asset	$ 386,371	92,360	MWh
Financial Swap Forward	Derivative Liability	(412,675)	92,945	MWh
Put Option	Derivative Asset	64,744	100,800	MWh
Put Option	Derivative Liability	(34,392)	63,200	MWh
		$ 4,048		

The fair values used for the mark-to-market amounts are based on the futures price curve for the Mid-Columbia Intercontinental Exchange.

The District has developed a credit policy that establishes guidelines for setting credit limits and monitoring credit exposure on a continuous basis. The policy addresses frequency of counterparty credit evaluations, credit limits per specific counterparty and counterparty credit concentration limits. Commodity transactions, both physical and financial, are entered into only with counterparties approved by the District's Risk Management Committee for creditworthiness. The District has entered into master enabling agreements with various counterparties, such as International Swaps and Derivatives Association Agreements (ISDA) for financial transactions. All of the enabling agreements have provisions addressing credit exposure and provide for various remedies to assure financial performance, including the ability to call on additional collateral as conditions warrant, generally as determined by the exposed party. The District also uses netting provisions in the agreements to diffuse a portion of the risk.

The District proactively works to eliminate or minimize basis risk on energy transactions by entering into derivative transactions that settle pursuant to an index derived from market transactions at the point physical delivery is expected to take place. There are no derivative transactions outstanding that carry basis risk as of December 31, 2011. As of December 31, 2011, no termination events have occurred, and there are no outstanding transactions with material termination risk. There is no rollover, interest rate or market access risk for these derivative products at December 31, 2011.

Q. Compensated Absences

The District accrues personal leave benefits as the obligation is incurred. Personal leave is limited to sixty days at the end of any calendar year.

R. Deferred Revenue – Rate Stabilization Fund

The District's Board of Commissioners deferred revenue as allowed for under regulatory accounting and bond covenants. Such amount will be amortized to revenue or a reduction in power costs consistent with ratemaking decisions. For the year ended December 31, 2011 the District deferred $2 million of revenue.

S. Deferred Compensation and Retirement Reserves

Personal leave accruals may be transferred, according to the District's Banked Personal Leave Plan, into the Banked Personal Leave Fund. Employee amounts in the Banked Personal Leave Fund are no longer tied to the employee's wage rate, but accrue interest according to the earnings of the Banked Personal Leave Fund investments. At December 31, 2011 the value of the accrued liabilities, which reflect a calculation for Social Security and Medicare taxes, are $705,074.

Effective August 1, 1984, the District established a Retirement Reserve Fund in response to the Washington State Legislature's SHB 843 which was signed into law on March 15, 1984. SHB 843 reduced the maximum days of accrued vacation applied to retirement payable by the State to 30 days, with the balance of the maximum accrued vacation and floating holidays applied to retirement payable by the employer under the average compensation formula for Plan 1 employees. The District has elected to fund the financial liability for Plan 1 employees for those days in excess of the 30 days funded by the State. When the District pays the lump sum due for days in excess of 30, the District has no future liability for that retiree's payments. As of December 31, 2011 the amount in the Retirement Reserve Fund was $337,103.

T. Net Assets

Net assets consist of:

- Invested in capital assets, net of related debt – This component of net assets consists of capital assets, net of accumulated depreciation, less outstanding balances of any bonds and other borrowings that are attributable to the acquisition, construction, or improvement of those assets.

- Restricted – This component consists of net assets on which constraints are placed as to their use. Constraints include those imposed by creditors (such as through debt covenants), contributors, or laws or regulation of other governments or constraints imposed by law through constitutional provisions or through enabling legislation.

- Unrestricted – This component of net assets consists of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt."

U. Operating Revenues and Expenses

Operating revenues and expenses result from providing services in connection with the District's principal ongoing operations. Operating revenues are recognized when billed and expenses are recognized when incurred. In addition, the District recognizes unbilled revenue, revenues from services provided, but not yet billed. The principal operating revenues of the District are charges to customers for electric service. Operating expenses for the District include the cost of power, operations, maintenance, administrative expenses, depreciation on capital assets and taxes. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses. Approximately 50% of Electric System retail sales were from two industrial customers.

The credit practices of the District require an evaluation of each new customer's credit worthiness on a case-by-case basis. Based on policy, a deposit may be obtained from the customer. Except for the two large industrial customers, concentrations of credit risk with respect to receivables for retail customers are limited due to the number of customers comprising the District's customer base. Credit losses have been within management's expectations. Similar to its evaluation of residential, commercial and industrial customers' credit reviews, the District continually evaluates its wholesale power customers by reviewing credit ratings and financial credit worthiness of existing and new customers.

V. Significant Risks and Uncertainties

The District is subject to certain business risks that could have a material impact on future operations and financial performance. These risks include, but are not limited to, weather and natural disaster related disruptions; collective bargaining labor disputes (current contract expires March 31, 2015); fish and other Endangered Species Act issues; Environmental Protection Agency regulations; federal and state government regulations or orders; deregulation of the electric industry; and market risks inherent in buying and selling of power, a commodity with inelastic demand characteristics and minimal storage capability.

The District maintains insurance coverage for property, casualty and liability claims and is self-insured for employee health benefits up to certain stop-loss limits. Health benefit claims paid for the year ended December 31, 2011 totaled $2.6 million. The District participates in a State of Washington plan for workers compensation and unemployment benefits.

2. DEPOSITS AND INVESTMENTS

The District's deposits and investments are entirely secured by the Federal Depository Insurance Corporation (FDIC) or by collateral held in a multiple financial institution collateral pool administered by the Washington Public Deposit Protection Commission (PDPC).

Deposits and investments as of December 31, 2011 consist of the following:

	Electric System	Production System	Total
Cash in banks	$ 23,552,727	$ 7,820,448	$ 31,373,175
Investment in Local Government Investment Pool	56,690,633	21,656,835	78,347,468
Certificates of deposit with banks	105,097	-	105,097
Securities	3,290,295	-	3,290,295
Total deposits and investments	$ 83,638,752	$ 29,477,283	$ 113,116,035
Unrestricted:			
Cash and cash equivalents	$ 8,712,470	$ 22,292,816	$ 31,005,286
Investments	1,105,097	-	1,105,097
	9,817,567	22,292,816	32,110,383
Restricted:			
Cash and cash equivalents:			
Construction funds	$ 40,629,073	$ 4,225,493	$ 44,854,566
Debt service and reserve accounts	20,211,107	2,958,974	23,170,081
Rate stabilization fund	9,700,000	-	9,700,000
Customer deposits	2,094	-	2,094
Vacation and retirement reserve	988,616	-	988,616
Total cash and cash equivalents	71,530,890	7,184,467	78,715,357
Investments:			
Construction funds	1,000,000	-	1,000,000
Escrow funds	1,290,295	-	1,290,295
Total investments	2,290,295	-	2,290,295
Total restricted	$ 73,821,185	$ 7,184,467	$ 81,005,652
Total deposits and investments	$ 83,638,752	$ 29,477,283	$ 113,116,035

Investments as of December 31, 2011 consist of the following:

Investment Type	Fair Value	Investment Maturities Less Than 1 Year	Investment Maturities 1 to 2 Years
U.S Treasury	$ 1,290,295	$ 1,290,295	
Federal National Mortgage Association	500,000	500,000	-
Federal Farm Credit Bank	500,000	500,000	-
Federal Home Loan Mortgage Corp.	1,000,000	1,000,000	
Certificate of Deposit	105,097	105,097	-
Totals	$ 3,395,392	$ 3,395,392	$ -

Custodial credit risk is the risk that, in the event of the failure of the counterparty, the District will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. All the aforementioned investments are held in the District's name by a third-party custodian. As required by state law and District policy, all investments of the District's funds are obligations of the U.S. Government or deposits with Washington State banks and savings and loan institutions. The District does not have a formal investment policy that requires diversification of investments by security type and institution or that limits its exposure to fair value losses resulting from rising interest rates.

3. UTILITY PLANT AND DEPRECIATION

A schedule of changes in utility plant and depreciation follows:

	Balance Jan. 1, 2011	Increases	Decreases	Balance Dec. 31, 2011
Electric System Utility Plant				
Intangible (1)	$ 239,963	$ -	$ -	$ 239,963
Land and Land Rights (1)	3,515,771	-	5,550	3,510,221
Transmission	22,812,740	1,363,396	122,808	24,053,328
Distribution	187,684,516	7,604,651	1,710,237	193,578,930
General Plant	39,118,540	2,843,311	7,468	41,954,383
Plant in Service	253,371,530	11,811,358	1,846,063	263,336,825
Construction in Progress	7,391,009	17,106,365	11,811,358	12,686,016
Total Utility Plant	260,762,539	28,917,723	13,657,421	276,022,841
Less Accumulated Depreciation	103,370,239	9,844,529	2,002,910	111,211,858
Net Electric System Utility Plant	$ 157,392,300	$ 19,073,194	$ 11,654,511	$ 164,810,983

Production System Utility Plant	Balance Jan. 1, 2011	Increases	Decreases	Balance Dec. 31, 2011
Intangible	$ 5,109,470	$ -	$ -	$ 5,109,470
Land and Land Rights (1)	1,224,229	-	-	1,224,229
Production	143,853,231	-	-	143,853,231
Transmission	4,624,838	-	-	4,624,838
Plant in Service	154,811,768	-	-	154,811,768
Construction in Progress	-	50,309	-	50,309
Total Utility Plant	154,811,768	50,309	-	154,862,077
Less Accumulated Depreciation and Amortization	23,140,495	3,105,408	-	26,245,903
Net Production System Utility Plant	$ 131,671,273	$ (3,055,099)	$ -	$ 128,616,174

(1) Plant not being depreciated.

4. INVESTMENTS IN ASSOCIATED ORGANIZATIONS

Investments in associated organizations at December 31, 2011 consist of the following:

	Electric System
Harvest Wind Project	$ 45,802,221
White Creek Project, LLC	94,349
The Energy Authority	3,169,973
Totals	$ 49,066,543

Harvest Wind Project

The District is party to a Joint Ownership Agreement whereby the District made an equity investment in the Harvest Wind Project, a 98.9 MW wind generating facility located in Klickitat County, WA. The District's share of the Project is 30%. During 2009, the joint owners of Harvest Wind elected to classify the Project as a taxable corporation. At the time of the election all project assets were treated as contributed to the corporation and the joint owners received shares in proportion to their ownership. Owners share in power output, income and expenses according to their ownership shares. Commercial operations began on December 15, 2009.

The District is committed, through an energy purchase agreement, to purchase its share of the output from the Project and pay its share of Project expenses through the year 2029. Additionally, the District is committed, through a transmission service agreement and a transmission payment agreement, to subsidize the initial construction of transmission lines, deposit funds to ensure contract performance and purchase transmission from the owner of the transmission lines through the year 2029.

The investment in Harvest Wind consists of the District's share of the costs to develop the Project, 30% of the Project's net income and losses and any distributions. During 2011, the District received \$2,730,000 in distributions. Also included is \$3,489,396 in prepaid transmission system and related costs which are being amortized on a straight-line basis over 20 years.

White Creek Project, LLC

The District has a 46% interest in the 204.7 MW White Creek Wind Project located in Klickitat County, WA. The investment in White Creek Project, LLC (WCP, LLC) is being carried as an equity investment. Assets of WCP, LLC consist of cash and other assets related to the White Creek Wind Project Phases I and II. Commercial operations began in November 2007 (See Note 1).

The Energy Authority

On March 30, 2010 the District became a member of The Energy Authority (TEA), a nonprofit corporation that provides power energy trading, RTO market services, natural gas procurement and management services, risk management and hedging services and power management services to 45 public utilities across the nation.

The Membership Agreement required: (a) payment of a $1 million Membership Fee; (b) payment of a $2.8 million Capital Contribution, representing the District's ownership interest in TEA; and (c) the Advance Agreement of $9,642,857, consisting of a $1 million Bank Guarantee and a Trade Guarantee of $8,642,857. The Bank Guarantee makes certain credit representations and guarantees to Bank of America, which will then be able to issue a letter of credit to any counterparty requiring a letter of credit as a condition of any particular transaction. Like the Bank Guarantee, the Trade Guarantee makes certain credit assurances allowing TEA this amount of unsecured credit to trade on behalf of its members.

Should the District separate from TEA within two years, it will receive the $1 million membership fee, less TEA's transactional costs attendant with the District becoming a member. The membership fee is being amortized to expense over twenty-four months. Under TEA Bylaws, at any time upon separation the District will receive all of its then existing interest in the corporation, which would include its Capital Contribution.

5. SHORT-TERM NOTES PAYABLE

Interfund Loan – Production and Electric Systems

On March 24, 2009 the District's Board of Commissioners authorized and approved a loan of not more than $25 million from the Production System to the Electric System for the purpose of developing the Harvest Wind Project. The interest rate on the loan is set at 4.5% and shall be repaid from proceeds received at the closing of the sale of the Project or from proceeds of a bond sale should the District retain ownership in the project. As of December 31, 2011 $12 million has been drawn on this loan.

6. LONG-TERM DEBT

Electric System

Revenue Bonds

During 2001 the District issued $48.675 million in Electric Distribution System Revenue Bonds. These bonds were used to settle existing lines of credit and to provide for capital requirements. The bonds matured serially in varying amounts through September 2011 and had annual interest rates ranging from 5.00% to 5.25%. Pursuant to the bond resolution, the District elected to purchase municipal bond insurance in lieu of the maintenance of bond reserve funds to guarantee the principal and interest payments to the bondholders.

In August 2006 the District issued $61.465 million in Revenue and Refunding Bonds to fund capital improvements, repay $8 million on a line of credit, pay for bond issuance costs, including bond insurance, fund the bond reserve account ($2,373,256) and to refund $11.635 million of outstanding 2001 Electric Distribution System Revenue Bonds (Series 2001 Bonds). Of the net proceeds, $12.08

million was used to purchase U.S. government securities. Those securities were deposited in an irrevocable trust with an escrow agent to provide future debt service payments on a portion of the Series 2001 Bonds maturing on September 1, 2007 through 2011. The primary purpose for the refunding was to restructure debt maturities. The District recorded an accounting loss of $445,286 which was amortized over the remaining life of the Series 2001 Bonds. Principal payments on the 2006 Revenue and Refunding Bonds are scheduled to begin in September 2012, maturing annually in varying amounts through September 2026. The bonds have annual interest rates ranging from 4.50% to 5.00%. With the maturity of the 2001 bonds, the reserve requirement increased by $4,867,500.

In November 2007 the District issued $64.755 million in Electric System Revenue Bonds to fund capital improvements, pay for bond issuance costs (including bond insurance) and fund bond debt service and reserve accounts ($5,421,325). Principal payments on these bonds began in September 2010, maturing annually in varying amounts through September 2027. The bonds have annual interest rates ranging from 4.375 % to 5.00%.

On February 23, 2010 the District issued Electric System Revenue Bonds consisting of $17.805 million in tax-exempt bonds (2010A) and $46.18 million in taxable "Build America Bonds" (2010B) to fund capital improvements, pay for bond issuance costs and fund bond debt service and reserve accounts ($6,398,500). Principal payments on these bonds are scheduled to begin in September 2013, maturing annually in varying amounts through September 2032. The 2010A bonds are not subject to redemption prior to maturity and carry a coupon rate of 5.00% with an all-in true interest cost of 3.59%. The 2010B bonds are subject to redemption by the District prior to their stated maturities and carry coupon rates of 2.52% – 6.884% before a thirty-five percent subsidy payment from the United States Treasury, subject to certain conditions. The all-in true interest cost for the 2010A and 2010B bonds is 4.26%.

Scheduled principal maturities and interest requirements on the Revenue Bonds are as follows:

	Principal	Interest	Total
2012	$ 6,790,000	$ 9,671,792	$ 16,461,792
2013	7,735,000	9,332,292	17,067,292
2014	8,050,000	8,997,870	17,047,870
2015	8,390,000	8,637,841	17,027,841
2016	8,805,000	8,218,341	17,023,341
2017 - 2021	51,000,000	34,125,619	85,125,619
2022 - 2026	64,240,000	20,204,757	84,444,757
2027 - 2031	25,740,000	6,227,664	31,967,664
2032	4,680,000	322,171	5,002,171
Total	$ 185,430,000	$ 105,738,347	$ 291,168,347

Loan Payable

In 2007 the District entered into a contract for a general obligation loan in the amount of $800,000 and a $200,000 grant from the State of Washington Community Economic Revitalization Board. The loan is to be repaid at the rate of 1.60% per annum over a twenty-year term. The terms of the contract provide a deferral of principal and interest repayments. The District is using these funds to provide power to a new business at the Port of Kalama. Scheduled principal maturities and interest requirements on the loan are as follows:

	Principal	Interest	Total
2012	$ -	$ 12,800	$ 12,800
2013	41,983	12,139	54,122
2014	42,655	11,467	54,122
2015	43,337	10,785	54,122
2016	44,031	10,091	54,122
2017 - 2021	230,948	39,661	270,609
2022 - 2026	250,025	20,584	270,609
2027 - 2028	105,699	2,544	108,243
Total	$ 758,678	$ 120,071	$ 878,749

Production System

In September 2004 the District issued Production System (Lewis River Swift No. 2) Bonds for $42.2 million to cover the costs of the embankment rehabilitation. The bonds mature serially over a 30-year period and have interest rates varying from 3.00% to 5.00%. Principal payments on these bonds began in 2006. In August 2006 the District issued Production System Bonds for $27.5 million. The bonds mature serially over a 30-year period and have interest rates varying from 3.00% to 5.00%. These bonds are to finance continuing expenditures for project reconstruction and to provide for capital expenditures associated with FERC licensing. Scheduled principal maturities and interest requirements on the 2004 and 2006 Production System Revenue Bonds are as follows:

	Principal	Interest	Total
2012	$ 920,000	$ 3,181,356	$ 4,101,356
2013	955,000	3,146,856	4,101,856
2014	1,000,000	3,099,106	4,099,106
2015	1,040,000	3,059,107	4,099,107
2016	1,095,000	3,007,106	4,102,106
2017 - 2021	6,340,000	14,159,031	20,499,031
2022 - 2026	8,990,000	12,407,281	21,397,281
2027 - 2031	22,050,000	8,832,030	30,882,030
2032 - 2036	22,410,000	2,952,852	25,362,852
Total	$ 64,800,000	$ 53,844,725	$ 118,644,725

Interfund Advances

In 2007 the District's Board of Commissioners approved a loan from the Production System to the Electric System for up to $16 million. Proceeds from this loan were used to partially fund the White Creek Wind Project Energy Purchase Agreement (See Note 1). The interest rate is 4.50% and the obligation is to be repaid over a period not to exceed twenty years. Scheduled principal maturities and interest requirements on this loan follow:

	Principal	Interest	Total
2012	$ 574,863	$ 580,437	$ 1,155,300
2013	601,272	554,027	1,155,299
2014	628,894	526,405	1,155,299
2015	657,785	497,514	1,155,299
2016	688,004	467,295	1,155,299
2017 - 2021	3,944,181	1,832,316	5,776,497
2022 - 2026	4,937,309	839,187	5,776,496
2027	1,127,625	27,674	1,155,299
Total	$ 13,159,933	$ 5,324,855	$ 18,484,788

Long-term debt activity for the year ended December 31, 2011 follows:

	Date of Original Issue	Date of Maturity	Outstanding Debt as of Jan. 1, 2011	Amount Issued	Amount Redeemed	Outstanding Debt as of Dec. 31, 2011
Electric System						
Electric Revenue Bonds, 4.375% to 5.00%	Nov-07	Sep-27	$ 62,425,000	$ -	$ 2,445,000	$ 59,980,000
Electric Revenue & Refunding Bonds, 4.50% to 5.00%	Aug-06	Sep-26	61,465,000	-	-	61,465,000
Electric Revenue Bonds, 5.00% to 5.25%	May-01	Sep-11	4,020,000	-	4,020,000	-
Electric Revenue Bonds, 2.52% to 6.884%	Feb-10	Sep-32	63,985,000	-	-	63,985,000
Loan Payable - State of Washington, 1.60%	Jun-07	Jun-28	800,000	-	41,322	758,678
Loan Payable - Production System, 4.50%	Dec-07	Dec-27	13,709,546	-	549,613	13,159,933
Total Electric System Long-Term Debt			$ 206,404,546	$ -	$ 7,055,935	$ 199,348,611

	Date of Original Issue	Date of Maturity	Outstanding Debt as of Jan. 1, 2011	Amount Issued	Amount Redeemed	Outstanding Debt as of Dec. 31, 2011
Production System						
Production System Revenue Bonds, 3.00% to 5.00%	Aug-06	Aug-36	$ 27,540,000	$ -	$ -	$ 27,540,000
Production System Revenue Bonds, 3.00% to 5.00%	Sep-04	Sep-34	38,145,000	-	885,000	37,260,000
Total Production System Long-Term Debt			$ 65,685,000	$ -	$ 885,000	$ 64,800,000

7. **LEWIS RIVER COST-SHARE AGREEMENT**

The District reached a cost-sharing agreement with PacifiCorp, assigning the operational and capital expenditure payments to be made by the District for fish passage and other aquatic measures which are required under the Lewis River Settlement Agreement and under the FERC License for Swift No. 2. Operational payments are made annually for each year of the 50-year license and range from $197,000 to $291,000 (2003 dollars) indexed for inflation. During 2011 the District paid $269,096 on this obligation. Also during 2011 the District paid $3,587,944 on the capital portion of this obligation. The Agreement requires these capital payments be made according to the following schedule which has been indexed for inflation using 2003 dollars:

2015	$ 225,255
2020	2,252,546
2021	2,252,546
2022	2,252,546
2035	450,509
Total	$ 7,433,402

8. **POST-RETIREMENT BENEFIT OBLIGATION**

Plan Description

In addition to pension benefits, the District provides post-retirement health care benefits, in accordance with the District's Collective Bargaining Agreement, to its retirees from the age of 55 until the age of 65. Currently, thirty-two retirees meet those eligibility requirements. The District covers the medical insurance premium for those eligible retirees. The District does not pay for a Medicare supplement for any retiree eligible for Medicare.

Funding Policy

The District pays, on a pay-as-you-go basis, medical insurance premiums for employees that voluntarily retire under the Washington State Retirement System after the employee reaches age 55, limited to premiums for coverage not in excess of coverage made available for active employees and limited to payments for a number of months not to exceed the number of months the employee has actually worked for the District; provided, however, such employee may pay their own premiums for the balance of time up to age 65 or when they become eligible for Medicare, whichever occurs first.

Annual PRBO Cost and Net PRBO Obligation

The District's annual post-retirement benefit obligation (PRBO) cost is calculated based on the annual required contribution (ARC) of the employer, an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an on-going basis, is projected to cover normal costs each year and amortize any unfunded liabilities (or funding excess) over a 15-year period. The following table shows the components of the District's annual PRBO cost for the year ended December 31, 2011, the amount actually contributed to the plan and the changes in the District's net PRBO:

Annual Required Contribution (ARC)	$ 541,199
Interest on PRBO	12,619
Adjustments to ARC	(26,676)
Annual PRBO cost	527,142
Benefit payments	378,247
Net increase in PRBO	148,895
Post-Retirement Benefit Obligation - January 1, 2011	280,421
Post-Retirement Benefit Obligation - December 31, 2011	$ 429,316

Funding Status and Funding Progress

As of December 31, 2011, the unfunded actuarial accrued liability (UAAL) was $3,784,166. The annual payroll of active employees covered by the plan was $13,636,908 resulting in a ratio of UAAL to covered payroll of 28%.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual contributions of the employer are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future.

Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations. In the actuarial valuation conducted, the projected unit credit actuarial cost method was used. Actuarial assumptions include a discount rate of 4.5% and the medical trend rate is estimated to gradually decrease from 11.0% in 2009 to 5.0% in 2021 and remain level thereafter.

9. RETIREMENT PLANS

Public Employees Retirement System – Plans 1, 2 and 3

Substantially all District full-time and qualifying part-time employees participate in one of three statewide retirement plans administered by the Washington State Department of Retirement Systems (DRS). The DRS, a department within the primary government of the State of Washington, issues a publicly available comprehensive annual financial report (CAFR) that includes financial statements and required supplementary information for each plan. The DRS CAFR may be obtained by writing to: Department of Retirement Systems, Communications Unit, P.O. Box 48380, Olympia, WA 98504-8380 or it may be downloaded from the DRS website at www.drs.wa.gov. The following disclosures are made pursuant to GASB Statements No. 27, *Accounting for Pensions by State and Local Government Employers* and No. 50, *Pension Disclosures, an Amendment of GASB Statements No. 25 and No. 27*.

Plan Descriptions

PERS is a cost-sharing multiple employer retirement system comprised of three separate plans for membership purposes: Plans 1 and 2 are defined benefit plans and Plan 3 is a combination defined benefit/defined contribution plan. Membership in the system includes: elected officials; state employees; employees of the Supreme, Appeals and Superior Courts (other than judges in a judicial retirement system); employees of legislative committees; college and university employees (not in national higher education retirement programs); judges of district and municipal courts; and employees of local government. Participants who joined the system by September 30, 1977 are Plan 1 members. Those who joined on or after October 1, 1977 and by either February 28, 2002 for state and higher education employees or August 31, 2002 for local government employees, are Plan 2 members unless they exercise an option to transfer their membership to Plan 3. PERS participants joining the system on or after March 1, 2002 for state and higher education employees or September 1, 2002 for local government employees have the irrevocable option of choosing membership in either PERS Plan 2 or PERS Plan 3. The option must be exercised within 90 days of employment. An employee is reported to Plan 2 until a choice is made. Employees who fail to choose within 90 days default to Plan 3. PERS defined benefit retirement benefits are financed from a combination of investment earnings and employer and employee contributions. PERS retirement benefit provisions are established in state statute and may be amended only by the State Legislature.

Plan 1 retirement benefits are vested after an employee completes five years of eligible service. Plan 1 members are eligible for retirement at any age after 30 years of service, or at age 60 with five years of service, or at age 55 with 25 years of service. The annual pension is two percent of the average final compensation per year of service, capped at 60 percent. The average final compensation is based on the greatest compensation during any eligible consecutive 24-month period. This annual benefit is subject to a minimum for PERS Plan 1 retirees who have 25 years of service and have been retired 20 years, or who have 20 years of service and have been retired 25 years. Plan 1 members who retire from inactive status prior to the age of 65 may receive actuarially reduced benefits. If a survivor option is chosen, the benefit is further reduced. A cost-of living allowance (COLA) is granted at age 66 based upon years of service times the COLA amount, which is increased three percent annually. Plan 1 members may also elect to receive an optional COLA that provides an automatic annual adjustment based on the Consumer Price Index. The adjustment is capped at three percent annually. To offset the cost of this annual adjustment, the benefit is reduced.

Plan 2 retirement benefits are vested after an employee completes five years of eligible service. Plan 2 members may retire at the age of 65 with 5 years of service. The annual pension is two percent per year of service of the average final compensation. The average final compensation is based on the greatest compensation during any eligible consecutive 60-month period. Plan 2 members who retire prior to the age of 65 receive reduced benefits. If retirement is at age 55 or older with at least 30 years of service, a three percent per year reduction applies; otherwise an actuarial reduction will apply. The benefit is also actuarially reduced to reflect the choice of a survivor option. There is no cap on years of service credit; and a cost-of-living allowance is granted (based on the Consumer Price Index), capped at three percent annually.

Plan 3 has a dual benefit structure. Employer contributions finance a defined benefit component and member contributions finance a defined contribution component. The defined benefit portion provides a benefit calculated at one percent of the average final compensation per year of service. The average final compensation is based on the greatest compensation during any eligible consecutive 60-month period. Effective June 7, 2006, Plan 3 members are vested in the defined benefit portion of their plan after ten years of service; or after five years of service if twelve months of that service are earned after age 44; or after five service credit years earned in PERS Plan 2 prior to June 1, 2003. Plan 3 members are immediately vested in the defined contribution portion of their plan. Vested Plan 3 members are eligible to retire with full benefits at age 65 or at age 55 with 10 years of service. Retirements prior to the age of 65 receive reduced benefits. If retirement is at age 55 or older with at least 30 years of service, a three percent per year reduction applies; otherwise an actuarial reduction will apply. The benefit is also actuarially reduced to reflect the choice of a survivor option. There is no cap on years of service credit and Plan 3 provides the same cost-of-living allowance as Plan 2.

The defined contribution portion can be distributed in accordance with an option selected by the member, either as a lump sum or pursuant to other options authorized by the Employee Retirement Benefits Board.

There are 1,189 participating employers in PERS. Membership in PERS consisted of the following as of the latest actuarial valuation date for the plans of June 30, 2009:

Retirees and Beneficiaries Receiving Benefits	74,857
Terminated Plan Members Entitled to But Not Yet Receiving Benefits	28,074
Active Plan Members Vested	105,339
Active Plan Members Nonvested	53,896
	262,166

Funding Policy

Each biennium the state Pension Funding Council adopts Plan 1 employer contribution rates, Plan 2 employer and employee contribution rates and Plan 3 employer contribution rates. Employee contribution rates for Plan 1 are established by statute at 6 percent for state agencies and local government unit employees and at 7.5 percent for state government elected officials. The employer and employee contribution rates for Plan 2 and the employer contribution rate for Plan 3 are developed by the Office of the State Actuary to fully fund Plan 2 and the defined benefit portion of Plan 3. All employers are required to contribute at the level established by the Legislature. The Employee Retirement Benefits Board sets Plan 3 employee contribution rates. Six rate options are available ranging from 5 to 15 percent; two of the options are graduated rates dependent on the employee's age. The methods used to determine the contribution requirements are established under state statute in accordance with Chapters 41.40 and 41.45 RCW.

The required contribution rates expressed as a percentage of current year covered payroll as of December 31, 2011 were:

	Plan 1	Plan 2	Plan 3
Employer *	7.07%	7.07%	4.59%
Employee	6.00%	4.59%	***

* The employer rates include the employer administrative expense fee currently set at 0.16%.
** Plan 3 defined benefit portion only.
*** Variable from 5.0% minimum to 15.0% maximum based on rate selected by the PERS 3 member.

Both the District and the employees made the required contributions. The District's required contributions for the years ended December 31, were as follows:

		Plan 1		Plan 2		Plan 3
2011	$	44,382	$	743,904	$	39,991
2010	$	36,075	$	614,863	$	37,756
2009	$	61,137	$	757,455	$	43,742

Deferred Compensation – 401(k) and 457 Plans

The District offers its employees a 401(k) Deferred Compensation Plan created in accordance with Internal Revenue Code Section 401(k) which permits employees to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency. Assets of the plan are deposited, as specified by each participating employee, with Fidelity Investments as trustee. The District matches employee contributions to the plan up to 3 percent of eligible employee compensation. During 2011, the District made matching contributions of $360,819.

The District also offers its employees the State of Washington Department of Retirement System's Deferred Compensation Program. This Deferred Compensation Plan is in accordance with Internal Revenue Code Section 457, which permits employees to defer a portion of their salary until future years. Distributions from the plan can be made after separation from service or upon the death of the participant. Participants can elect to receive an in-service distribution once every two years for an amount not to exceed $5,000.

10. COMMITMENTS AND CONTINGENCIES

Bonneville Power Administration (BPA)

On October 1, 2001 the District began to take deliveries from BPA under a long-term Power Sales Contract (2001 Contract). This 2001 Contract was for a ten-year term and was take-or-pay in nature. That is, BPA was obligated to serve and the District was obligated to purchase the quantity of power required for service to the District's load over and above what was provided by the District's own Swift resource and firm power contracts. BPA rates were variable.

During 2008 the District entered into new purchase power agreements with BPA for Block and Slice running from October 1, 2011 through September 30, 2028. The Block Product provides a set amount of energy delivered in a flat block over all hours of the month, with the blocks of energy varying from month-to-month to correspond to seasonal variations in the District's loads. The Slice Product represents a specified percentage (or "slice") of the output of the Federal System, so that the District receives increased or decreased energy supply depending on the output of the Federal System. The District is required to pay a corresponding percentage of the costs of the portion of the Federal System allocated to the Slice Product. The amounts payable by the District under the 2011 Power Sales Agreement are subject to adjustment from time to time by BPA to recover the costs of the Federal System.

Swift Plant No. 2 Power Contract

The Swift No. 2 Hydroelectric Production System is located on the Lewis River and consists of a 3.2 mile long power canal with an adjacent power house and transmission switchyard. It operates in conjunction with the Swift No. 1 Project, which is owned by PacifiCorp. Swift No. 1 consists of an earthen dam and power house, which discharges into the Swift No. 2 power canal.

Swift No. 2 is operated under contract by PacifiCorp. The operating agreement provides that the District is entitled to 26% of the combined output of Swift No. 1 and Swift No. 2. The District's share of the output is purchased by the Electric System at the cost of production of the energy, whether or not it is producing energy.

Grant County PUD

The District's original 1956 contract with Grant County PUD for output from Priest Rapids Development expired on October 31, 2005. In addition, the District's original 1959 contract with Grant County PUD for output from Wanapum Development expired on October 31, 2009. For a time, the District received its share of power output from the Priest Rapids (beginning in 2005) and Wanapum (beginning in 2009) Developments pursuant to an "exchange" agreement with Grant County PUD that expired on September 30, 2011. Following the expiration of the "exchange" agreement, the District now acquires its power from Grant County PUD pursuant to the "New Power Sales Contracts", which became effective on November 1, 2005. The New Power Sales Contracts, which apply to both the Priest Rapids Development (as of November 1, 2005) and the Wanapum Development (as of November 1, 2009), consist of three separate contracts with terms that extend until expiration of the new long-term license for the Priest Rapids Project (April 1, 2052).

The New Power Sales Contracts consist of the "Additional Products" Contract, the "Product Sales" Contract and the "Reasonable Portion Product" Contract. Grant County PUD sells 30% of the output of the Priest Rapids Project for sales within the region based on market principles (Public Law 83-544), retains approximately 62% of the Project for its own needs and sells approximately 8% to the Purchasers, such as the District. Given these new demands on the output of the Priest Rapids Project, the power available to the District is about 1 aMW on a firm basis, as compared to approximately 21 aMW historically.

Energy Northwest's Nine Canyon Wind Project

The District entered into a contract with Energy Northwest in December 2003 for the purchase of the output associated with 2 megawatts of the Nine Canyon Wind Project. The District utilizes the power to serve its customers by use of a BPA wind integration product. The "green tags" or "renewable energy credits" associated with the District's share of output are committed for sale to the Bonneville Environmental Foundation and are not used for District load at this time.

White Creek Wind Project Related Agreements

White Creek Wind Project Transmission Service Agreement

In 2006 the District entered into a Transmission Service Agreement with Klickitat PUD (KPUD) for power transmission from the White Creek Project Substation to the Rock Creek Substation where the transmission line and the facilities of BPA are connected. The District is billed and pays for services under this Agreement monthly. In accordance with the Agreement, the District was to provide KPUD an irrevocable standby Letter of Credit and for the contract year commencing August 1, 2010 and for the contract years thereafter, the District petitioned and KPUD has waived the requirement for a Letter of Credit or an alternate Letter of Credit.

White Creek Wind Project Energy Storage and Shaping Capacity Agreement

In 2007 the District entered into a White Creek Wind Project Energy Storage and Shaping Capacity Agreement with BPA for its share of White Creek Project generation. The Agreement is through September 30, 2016. The District is billed and pays for services under this agreement monthly.

White Creek Wind Project Scheduling and Marketing Services Agreement

In 2007 the District entered into an agreement with The Energy Authority, Inc. for the scheduling and marketing of the District's share of energy generated from the White Creek Wind Project. Fees for these services are billed and paid monthly.

Beacon Hill Sewer District (BHSD)

Effective January 1, 2008, the District entered into an Inter-Local Agreement with BHSD, a Washington municipal corporation, pursuant to The Cooperation Act of the Revised Code of Washington Chapter 39.34. Under the Agreement BHSD operated and maintained the Water System under joint oversight by the Boards of Commissioners of both the District and BHSD until full ownership was transferred to BHSD. On December 28, 2010 the District transferred ownership of all of the Water System's assets, including related loans. As part of the transfer, existing loans from the Electric System to the Water System along with a vehicle loan were consolidated at 4.5% for ten years. Future maturities are as follows:

2012	$	97,482
2013		101,960
2014		106,644
2015		111,544
2016		116,668
2017 - 2020		522,787
Total	$	1,057,085

Under the terms of the Transfer Agreement, the District may be obligated to assist BHSD with obtaining financing for certain capital needs subject to various conditions, restrictions and limitations through December 28, 2020.

Claims and Litigation

The District is involved in various claims arising in the normal course of business. The District does not believe that the ultimate outcome of these matters will have a material impact on its financial position, results of operations or cash flows.

ABOUT THE STATE AUDITOR'S OFFICE

The State Auditor's Office is established in the state's Constitution and is part of the executive branch of state government. The State Auditor is elected by the citizens of Washington and serves four-year terms.

Our mission is to work with our audit clients and citizens as an advocate for government accountability. As an elected agency, the State Auditor's Office has the independence necessary to objectively perform audits and investigations. Our audits are designed to comply with professional standards as well as to satisfy the requirements of federal, state, and local laws.

The State Auditor's Office employees are located around the state to deliver services effectively and efficiently.

Our audits look at financial information and compliance with state, federal and local laws on the part of all local governments, including schools, and all state agencies, including institutions of higher education. In addition, we conduct performance audits of state agencies and local governments and fraud, whistleblower and citizen hotline investigations.

The results of our work are widely distributed through a variety of reports, which are available on our Web site and through our free, electronic subscription service.

We take our role as partners in accountability seriously. We provide training and technical assistance to governments and have an extensive quality assurance program.

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