Washington State Auditor's Office

Financial Statements Audit Report

Public Utility District No. 1 of Cowlitz County

Audit Period
January 1, 2013 through December 31, 2013

Report No. 1011741

Issue Date
May 1, 2014

Washington State Auditor
Troy Kelley
Independence • Respect • Integrity

Washington State Auditor
Troy Kelley

May 1, 2014

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,

Troy X. Kelley

TROY KELLEY
STATE AUDITOR

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January 1, 2013 through December 31, 2013

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Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

Public Utility District No. 1 of Cowlitz County
January 1, 2013 through December 31, 2013

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

We have audited, 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, 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, 2013, and the related notes to the financial statements, which collectively comprise the District's basic financial statements, and have issued our report thereon dated April 25, 2014. The prior year comparative information has been derived from the District's 2012 basic financial statements, on which we issued our report dated May 24, 2013.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit of the financial statements, we considered the District's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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. Accordingly, we do not express an opinion on the effectiveness of the District's internal control.

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

COMPLIANCE AND OTHER MATTERS

As part of obtaining reasonable assurance about whether the District's financial statements are free from 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*.

PURPOSE OF THIS REPORT

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

Troy X. Kelley

TROY KELLEY
STATE AUDITOR

April 25, 2014

Independent Auditor's Report on Financial Statements

Public Utility District No. 1 of Cowlitz County
January 1, 2013 through December 31, 2013

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

REPORT ON THE FINANCIAL STATEMENTS

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, 2013, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed on page 6.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express 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 from material misstatement.

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

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

Opinion

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, 2013, and the respective changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Report on Summarized Comparative Information

The prior year comparative information has been derived from the District's 2012 financial statements and, in our report dated May 24, 2013, we expressed unmodified opinions on the respective financial statements of each major fund. Such information does not include all of the information required for a presentation in conformity with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with the District's financial statements for the year ended December 31, 2012, from which such partial information was derived.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 7 through 10 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 our 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.

OTHER REPORTING REQUIRED BY GOVERNMENT AUDITING STANDARDS

In accordance with *Government Auditing Standards*, we have also issued our report dated April 25, 2014 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control over financial reporting and compliance.

Troy X. Kelley

TROY KELLEY
STATE AUDITOR

April 25, 2014

Financial Section

Public Utility District No. 1 of Cowlitz County
January 1, 2013 through December 31, 2013

REQUIRED SUPPLEMENTARY INFORMATION

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BASIC FINANCIAL STATEMENTS

Statement of Net Position – 2013
Statement of Revenues, Expenses and Changes in Net Position – 2013
Statement of Cash Flows – 2013
Notes to the Combined Financial Statements – 2013

MANAGEMENT DISCUSSION AND ANALYSIS
For the Year Ended December 31, 2013

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, 2013 with comparable information for 2012 and 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.

<u>ELECTRIC SYSTEM</u>

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 2013 and 2012 retail power sales of 5,195,417 MWHs and 5,136,223 MWHs, respectively. Approximately 70% of the District's power and 50% of revenues are sold to 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 a 2 MW share 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 (contractual interest) and 30% of the 98.9 MW Harvest Wind Project (tenant in common). Both projects are located in Klickitat County, WA. Approximately 90% of the District's power supply is purchased from BPA.

Overall the Electric System's net position increased approximately $5 million or 3% for 2013 and approximately $14 million or 10% for 2012. The Electric System continued investing in plant infrastructure with no new debt since 2010. Cash reserves continue to improve, with a portion funding a rate stabilization fund, primarily due to conservative power cost budgeting.

A summary of net position and results of operations follows.

Selected Financial Data – Electric System

	2013	2012	2011
Current Assets	$ 96,007,597	$ 72,587,164	$ 49,971,598
Net Utility Plant	168,760,942	167,300,173	164,810,983
Other Assets and Deferred Outflows	149,216,565	169,452,120	187,843,906
Total Assets and Deferred Outflows	413,985,104	409,339,457	402,626,487
Current Liabilities	43,180,130	39,302,884	50,107,633
Long-Term Debt	178,331,925	187,452,157	196,246,210
Other Liabilities and Deferred Inflows	29,579,399	24,701,701	12,115,577
Total Liabilities and Deferred Infows	251,091,454	251,456,742	258,469,420
Net investment in capital assets	27,762,653	31,828,050	36,200,023
Restricted	1,232,803	1,286,857	1,290,295
Unrestricted	133,898,194	124,767,808	106,666,749
Total Net Position	162,893,650	157,882,715	144,157,067
Operating Revenues	255,210,338	248,591,573	220,374,001
Operating Expenses	246,145,937	240,418,315	210,877,263
Net Operating Revenues	9,064,401	8,173,258	9,496,738
Other Income (Expense)	(4,053,466)	(6,837,810)	(7,068,091)
Loan Forgiveness	-	12,390,200	-
Change in Net Position	5,010,935	13,725,648	2,428,647

Results of operations are primarily impacted by increased rates, major industrial load and power supply costs, reductions in wind revenue and rate stabilization decisions. Other changes include taxes, depreciation and conservation costs. For 2012, the main driver of the increase in change in net position was due to a $12,000,000 loan forgiveness from the Production System to the Electric System. In January 2011 the District increased rates approximately 9% with another approximate 17.5% increase in November 2011. In September 2013 residential rates were increased 5% with either no change or decreases ranging from 2% to 15% among the commercial and industrial classes.

Capital Asset and Long-Term Debt Activity

As of year-end, the Electric System had $290.8 million invested in electric system plant in service, an increase of 3.7%. 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, 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, 2013, 2012 and 2011 consisted of the following:

	2013	2012	2011
Intangible	$ 239,963	$ 239,963	$ 239,963
Land and Land Rights	3,518,364	3,515,814	3,510,221
Transmission & Distribution	237,450,237	228,397,149	217,632,258
General Plant	49,550,207	48,192,160	41,954,383
Total Plant In Service	$ 290,758,771	$ 280,345,086	$ 263,336,825

At December 31, 2013 the Electric System had outstanding revenue bonds totaling $171 million compared to $179 million and $185 million at December 31, 2012 and 2011, respectively.

PRODUCTION SYSTEM

The Production System operates the 66.8 MW Swift No. 2 Hydroelectric Project 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.

Overall the Production System's net position decreased approximately $2 million or 2% for 2013 and approximately $12 million or 11% for 2012.

Selected Financial Data – Production System

	2013	2012	2011
Current Assets	$ 26,661,070	$ 26,068,311	$ 36,267,260
Net Utility Plant	122,792,683	125,611,661	128,616,174
Other Assets and Deferred Outflows	19,308,364	19,974,703	20,606,511
Total Assets and Deferred Outflows	168,762,117	171,654,675	185,489,945
Current Liabilities	2,348,151	2,102,339	2,677,969
Long-Term Debt	62,860,707	63,881,481	64,879,128
Other Liabilities and Deferred Inflows	7,433,402	7,433,402	7,433,402
Total Liabilities and Deferred Infows	72,642,260	73,417,222	74,990,499
Net investment in capital assets	58,683,041	60,526,245	62,568,111
Restricted	-	-	-
Unrestricted	37,436,816	37,711,208	47,931,335
Total Net Position	96,119,857	98,237,453	110,499,446
Operating Revenues	7,225,776	8,079,384	8,507,955
Operating Expenses	6,759,512	4,975,665	5,556,231
Net Operating Revenues	466,264	3,103,719	2,951,724
Other Income (Expense)	(2,583,860)	(2,476,589)	(2,486,752)
Loan Forgiveness	-	(12,889,123)	-
Change in Net Position	(2,117,596)	(12,261,993)	464,972

Operating revenues are set to cover operating and capital costs, debt service and to fund reserves over time. Fluctuations in operations from year to year are largely impacted by non-recurring or infrequent projects. For 2013, operations were impacted by embankment and turbine repairs. As indicated above, for 2012, the main impact on the change in net position is the $12,000,000 loan forgiveness.

Capital Asset and Long-Term Debt Activity

No substantial capital activity and no new debt in 2013 or 2012. Total Production System plant in service as of December 31, 2013, 2012 and 2011 consisted of the following:

	2013	2012	2011
Intangible	$ 5,109,470	$ 5,109,470	$ 5,109,470
Land and Land Rights	1,224,229	1,224,229	1,224,229
Production Plant	144,047,698	143,853,231	143,853,231
Transmission Plant	4,624,838	4,624,838	4,624,838
Total Plant In Service	$ 155,006,235	$ 154,811,768	$ 154,811,768

PUBLIC UTILITY DISTRICT NO. 1 OF COWLITZ COUNTY, WASHINGTON
STATEMENT OF NET POSITION
DECEMBER 31, 2013 AND 2012

	Electric	Production	2013 Total	2012 Total
ASSETS				
CURRENT ASSETS				
Cash and cash equivalents	$ 66,870,571	$ 25,667,227	$ 92,537,798	$ 68,634,982
Customer accounts receivable and unbilled revenues	20,038,088	-	20,038,088	19,831,161
Other accounts receivable	3,955,713	-	3,955,713	4,176,287
Allowance for uncollectible accounts	(580,421)	-	(580,421)	(484,721)
Accounts receivable from assoc. companies	3,467	-	3,467	14,852
Current portion of advances to other funds	106,644	628,894	735,538	703,232
Materials and supplies	4,705,707	-	4,705,707	4,578,499
Prepayments	392,527	364,949	757,476	624,518
Interest receivable	378,738	-	378,738	400,865
Other current assets	136,563	-	136,563	175,800
Total current assets	96,007,597	26,661,070	122,668,667	98,655,475
RESTRICTED ASSETS				
Cash and cash equivalents	28,068,732	7,184,467	35,253,199	48,955,703
Investments	7,192,803	-	7,192,803	7,246,857
Total restricted assets	35,261,535	7,184,467	42,446,002	56,202,560
UTILITY PLANT				
Plant in service	290,758,771	155,006,235	445,765,006	435,156,854
Construction in progress	4,542,486	251,329	4,793,815	7,465,873
Total utility plant	295,301,257	155,257,564	450,558,821	442,622,727
Less accumulated depreciation and amortization	126,540,315	32,464,881	159,005,196	149,710,893
Net utility plant	168,760,942	122,792,683	291,553,625	292,911,834
OTHER PROPERTY AND INVESTMENTS				
White Creek Wind Project Energy Purchase Agreement	59,306,078	-	59,306,078	63,623,803
Investment in associated organizations	46,721,575	-	46,721,575	46,774,858
BPA transmission credit receivable	2,148,209	-	2,148,209	3,197,929
Note receivable	750,999	-	750,999	857,643
Advances to other funds	-	11,354,904	11,354,904	11,983,798
Other charges	2,977,134	768,993	3,746,127	5,535,814
Total other property and investments	111,903,995	12,123,897	124,027,892	131,973,845
DEFERRED OUTFLOWS OF RESOURCES				
Accum. decrease in fair value of hedging derivatives	2,051,035	-	2,051,035	1,250,418
TOTAL ASSETS AND DEFERRED OUTFLOWS OF RESOURCES	$ 413,985,104	$ 168,762,117	$ 582,747,221	$ 580,994,132

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

PUBLIC UTILITY DISTRICT NO. 1 OF COWLITZ COUNTY, WASHINGTON
STATEMENT OF NET POSITION
DECEMBER 31, 2013 AND 2012

	Electric	Production	2013 Total	2012 Total
LIABILITIES				
CURRENT LIABILITIES				
Current portion of long-term debt	$ 8,678,894	$ 1,000,000	$ 9,678,894	$ 9,291,272
Accounts payable	21,794,369	303,843	22,098,212	18,040,104
Accounts payable to assoc. companies	-	3,467	3,467	14,852
Accrued wages and benefits	2,170,845	-	2,170,845	2,311,149
Customer deposits	2,475,405	-	2,475,405	2,540,411
Taxes payable	4,963,616	7,806	4,971,422	4,979,235
Interest payable	2,999,306	1,033,035	4,032,341	4,132,429
Other current liabilities	97,695	-	97,695	95,771
Total current liabilities	43,180,130	2,348,151	45,528,281	41,405,223
LONG-TERM LIABILITIES				
Bonds payable	162,855,000	61,925,000	224,780,000	233,830,000
Premium on bonds payable	3,447,981	935,707	4,383,688	4,803,145
Advances from other funds	11,354,904	-	11,354,904	11,983,798
Loan payable	674,040	-	674,040	716,695
Total long-term liabilities	178,331,925	62,860,707	241,192,632	251,333,638
OTHER LIABILITIES AND CREDITS				
Lewis River Cost-Share Agreement	-	7,433,402	7,433,402	7,433,402
Compensation and retirement reserves	436,075	-	436,075	653,854
Other credits	2,979,807	-	2,979,807	2,655,155
Post-retirement benefit obligation	577,010	-	577,010	475,144
Total other liabilities and credits	3,992,892	7,433,402	11,426,294	11,217,555
TOTAL LIABILITIES	225,504,947	72,642,260	298,147,207	303,956,416
COMMITMENTS AND CONTINGENCIES				
DEFERRED INFLOWS OF RESOURCES				
Rate stabilization fund	24,700,000	-	24,700,000	18,700,000
Accum. increase in fair value of hedging derivatives	886,507	-	886,507	2,217,548
Total deferred inflows of resources	25,586,507	-	25,586,507	20,917,548
NET POSITION				
Net investment in capital assets	27,762,653	58,683,041	86,445,694	92,354,295
Restricted	1,232,803	-	1,232,803	1,286,857
Unrestricted	133,898,194	37,436,816	171,335,010	162,479,016
TOTAL NET POSITION	162,893,650	96,119,857	259,013,507	256,120,168
TOTAL LIABILITIES, DEFERRED INFLOWS OF RESOURCES AND NET POSITION	$ 413,985,104	$ 168,762,117	$ 582,747,221	$ 580,994,132

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 POSITION
FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

	Electric	Production	2013 Total	2012 Total
OPERATING REVENUES				
Retail sales	$ 243,682,963	$ 7,225,776	$ 250,908,739	$ 250,479,339
Wholesale sales	9,610,784	-	9,610,784	4,854,890
Other operating revenues	1,916,591	-	1,916,591	1,336,728
Total operating revenues	255,210,338	7,225,776	262,436,114	256,670,957
OPERATING EXPENSES				
Power costs	197,652,743	-	197,652,743	191,116,225
Operations expense	22,888,791	1,860,039	24,748,830	22,573,116
Maintenance expense	4,625,890	1,730,774	6,356,664	4,747,058
Depreciation and amortization	10,905,288	3,113,570	14,018,858	14,149,284
Taxes	10,073,225	55,129	10,128,354	12,808,297
Total operating expenses	246,145,937	6,759,512	252,905,449	245,393,980
OPERATING INCOME	9,064,401	466,264	9,530,665	11,276,977
OTHER INCOME (EXPENSE)				
Interest and dividend income	163,015	588,870	751,885	821,065
Interest on long-term debt	(9,385,583)	(3,139,518)	(12,525,101)	(12,861,317)
Amortization of debt expense	(116,429)	(33,312)	(149,741)	(146,965)
Income from Harvest Wind Project	3,096,679	-	3,096,679	972,100
Miscellaneous nonoperating income (expense)	140,382	100	140,482	174,614
Total other income (expense)	(6,101,936)	(2,583,860)	(8,685,796)	(11,040,503)
CHANGE IN NET POSITION BEFORE CONTRIBUTIONS, SUBSIDY AND LOAN FORGIVENESS	2,962,465	(2,117,596)	844,869	236,474
Contributions in aid of construction	1,080,702	-	1,080,702	707,793
BAB subsidy	967,768	-	967,768	1,018,311
Loan forgiveness	-	-	-	(498,923)
CHANGE IN NET POSITION	5,010,935	(2,117,596)	2,893,339	1,463,655
TOTAL NET POSITION, beginning of year	157,882,715	98,237,453	256,120,168	254,656,513
TOTAL NET POSITION, end of year	$ 162,893,650	$ 96,119,857	$ 259,013,507	$ 256,120,168

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

PUBLIC UTILITY DISTRICT NO. 1 OF COWLITZ COUNTY, WASHINGTON
STATEMENT OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

	Electric	Production	2013 Total	2012 Total
CASH FLOWS FROM OPERATING ACTIVITIES				
Cash received from customers	$ 255,266,064	$ 7,225,776	$ 262,491,840	$ 257,739,153
Cash payments to suppliers	(199,056,601)	(3,406,537)	(202,463,138)	(192,251,948)
Cash payments to employees	(11,467,430)	-	(11,467,430)	(11,690,270)
Cash payments for taxes	(10,071,390)	(64,777)	(10,136,167)	(12,378,838)
Net cash from operating activities	34,670,643	3,754,462	38,425,105	41,418,096
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES				
Inter-System Advances	(601,272)	601,272	-	-
Net cash from non-capital financing activities	(601,272)	601,272	-	-
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES				
Construction and acquisition of utility plant	(12,366,057)	(294,592)	(12,660,649)	(13,633,961)
Principal paid on long-term debt	(7,735,000)	(955,000)	(8,690,000)	(7,710,000)
Principal paid on notes payable	(42,655)	-	(42,655)	(41,983)
Interest paid on long-term debt and notes	(9,897,789)	(3,146,857)	(13,044,646)	(13,445,723)
Harvest Wind Project, net	2,877,077	-	2,877,077	2,733,277
Contributions in aid of construction	1,080,702	-	1,080,702	707,793
BAB subsidy	967,768	-	967,768	1,018,311
Materials and supplies	(127,208)	-	(127,208)	(629,441)
Other charges, net	67,292	4,133	71,425	(254,806)
Miscellaneous nonoperating	140,382	100	140,482	174,610
Net cash from capital and related financing activities	(25,035,488)	(4,392,216)	(29,427,704)	(31,081,923)
CASH FLOWS FROM INVESTING ACTIVITIES				
Net investment activity	54,054	-	54,054	(3,851,465)
Net Beacon Hill	101,960	-	101,960	97,482
Interest and dividends on investments	185,142	588,870	774,012	757,344
Investment in associated organizations	272,885	-	272,885	530,508
Net cash from investing activities	614,041	588,870	1,202,911	(2,466,131)
NET CHANGE IN CASH	9,647,924	552,388	10,200,312	7,870,042
CASH AND CASH EQUVALENTS, beginning	85,291,379	32,299,306	117,590,685	109,720,643
CASH AND CASH EQUVALENTS, end of year	$ 94,939,303	$ 32,851,694	$ 127,790,997	$ 117,590,685

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

PUBLIC UTILITY DISTRICT NO. 1 OF COWLITZ COUNTY, WASHINGTON
STATEMENT OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012

Reconciliation of operating income to net cash from operating activities:	Electric	Production	2013 Total	2012 Total
Operating income	$ 9,064,401	$ 466,264	$ 9,530,665	$ 11,276,977
Adjustments to reconcile operating income to net cash from operating activities:				
Depreciation and amortization	10,905,288	3,113,570	14,018,858	14,149,284
Amortization of energy purchase agreement	4,317,725	-	4,317,725	4,317,725
Changes in assets and liabilities:				
Customer accounts receivable and unbilled	(111,227)	-	(111,227)	1,194,046
Other accounts receivable	220,574	-	220,574	(827,646)
Accounts receivable from assoc. companies	11,385	-	11,385	179,768
Prepayments	(120,209)	(12,749)	(132,958)	281,635
Other current assets	39,237	-	39,237	283,472
BPA transmission credit receivable	1,049,720	-	1,049,720	716,496
Option premiums	237,480	-	237,480	457,880
Accounts payable	3,849,698	208,410	4,058,108	(708,230)
Accounts payable to assoc. companies	-	(11,385)	(11,385)	(179,671)
Accrued wages and benefits	(140,304)	-	(140,304)	210,860
Customer deposits	(65,006)	-	(65,006)	522,028
Taxes payable	1,835	(9,648)	(7,813)	429,459
Other current liabilities	1,924	-	1,924	(4,145)
Rate stabilization fund	6,000,000	-	6,000,000	9,000,000
Deferred compensation and retirement	(217,779)	-	(217,779)	(388,323)
Other credits	(475,965)	-	(475,965)	460,653
Post-retirement benefit obligation	101,866	-	101,866	45,828
	$ 34,670,643	$ 3,754,462	$ 38,425,105	$ 41,418,096

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 (contractual interest) and 30% of the 98.9 MW Harvest Wind Project (tenant in common). Both projects are located in Klickitat County, WA.

B. Basis of Accounting and Presentation

The District's accounting policies are in accordance with accounting principles generally accepted in the United States of America. The District applies accounting and reporting standards of the Governmental Accounting Standards Board (GASB), exclusively. The financial statements use a flow of economic resources measurement focus to determine financial position and the change in financial position. The accounting principles used are similar to those applicable to businesses in the private sector and, thus, are maintained on the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when incurred.

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).

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 statement of net position as "accounts receivable from associated companies." Alternatively, the amounts due by the Production System to the Electric System are reflected in the statement of net position 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 years ended December 31, 2013 or 2012.

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 position.

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 for 20 years. With certain exceptions, the Agreement stipulates a minimum Annual Energy Quantity (225,917 MWh). The payment was made with unrestricted funds ($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. In addition, the District is responsible for its share of annual operating costs.

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 2013 and 2012 the District received $1,049,720 and $716,496, respectively under this agreement.

N. Unamortized Bond Premium

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.

Subject to certain exceptions GASB requires that every derivative instrument be recorded on the statement of net position 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. These are recorded on the statement of net position as deferred inflows/outflows of resources as accumulated increase/decrease in fair value of hedging derivatives.

It is the District's policy to document and apply as appropriate the normal purchase and normal sales exception under GASB. 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 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, but do not generally meet the "normal purchases and normal sales" criteria.

As of December 31, 2013 and 2012, the District had the following derivative instruments outstanding. Options are amortized to power costs over the exercise period of the option. Fair value of derivative assets are recorded under deferred charges and fair value of derivative liabilities are recorded under deferred credits on the statement of net position.

Options and Swaps Hedging Derivatives

	2013		2012	
Notional value	$	15,671,760	$	18,338,532
Volumes (MWH)		511,880		710,165
Fair value - asset	$	886,507	$	2,217,548
Fair value - liability	$	2,051,035	$	1,250,418
Reference rates	Mid-C index		Mid-C index	
Dates entered into	6/5/12 - 12/11/13		1/3/12 - 12/15/12	
Dates of maturity	2/14 - 12/16		3/13 - 12/14	
Cash paid	$	-	$	237,480

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, 2013. As of December 31, 2013, 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, 2013.

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. Rate Stabilization Fund

The District's Board of Commissioners deferred amounts as allowed for under regulatory accounting and bond covenants. Such amounts will be amortized to revenue or a reduction in power costs consistent with ratemaking decisions. For the years ended December 31, 2013 and 2012 the District deferred $6,000,000 and $9,000,000, respectively, related to power costs.

S. 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, 2013 and 2012 the value of the accrued liabilities, which reflect a calculation for Social Security and Medicare taxes, are $316,246 and $472,483, respectively.

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, 2013 and 2012 the amount in the Retirement Reserve Fund was $119,829 and $181,371, respectively.

T. Net Position

Net position consists of:

- Net investment in capital assets – This component of net position 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 position consists of net assets that do not meet the definition of "restricted" or "net investment in capital assets," including the White Creek Wind Project Energy Purchase Agreement and joint venture in the Harvest Wind Project (net of inter-system advances).

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 years ended December 31, 2013 and 2012 totaled approximately $3 million each year. The District participates in a State of Washington plan for workers compensation and unemployment benefits.

W. New Accounting Standard

The District has adopted GASB Statement No. 65, Items Previously Reported as Assets and Liabilities. This Statement provides guidance for reclassifying certain items as deferred outflows of resources or deferred inflows of resources. The items specifically related to the District include bond issuance costs and the rate stabilization fund. Bond issue costs have been reclassified as a regulatory asset and amortized consistent with rate recovery. Rate stabilization has been reclassified to deferred inflow of resources.

2. DEPOSITS AND INVESTMENTS

The District's deposits 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, 2013 and 2012 consist of the following:

	Electric System	Production System	2013 Total	2012 Total
Cash in banks	$ 39,175,754	$ 11,118,377	$ 50,294,131	$ 40,271,320
Investment in Local Government Investment Pool	56,890,860	21,733,317	78,624,177	78,500,849
Certificates of deposit with banks	105,492	-	105,492	105,373
Securities	5,960,000	-	5,960,000	5,960,000
Total deposits and investments	$ 102,132,106	$ 32,851,694	$ 134,983,800	$124,837,542
Unrestricted:				
Cash and cash equivalents, includes ES rate stabilization fund of $24.7 million and $18.7 million, respectively	$ 66,870,571	$ 25,667,227	$ 92,537,798	$ 68,634,982
Total unrestricted	$ 66,870,571	$ 25,667,227	$ 92,537,798	$ 68,634,982
Restricted:				
Cash and cash equivalents:				
Construction funds	$ 14,968,151	$ 4,225,493	$ 19,193,644	$ 32,735,801
Debt service and reserve accounts	13,100,581	2,958,974	16,059,555	16,219,902
Total cash and cash equivalents	28,068,732	7,184,467	35,253,199	48,955,703
Investments:				
Debt service and reserve accounts	5,960,000	-	5,960,000	5,960,000
Escrow funds	1,232,803	-	1,232,803	1,286,857
Total investments	7,192,803	-	7,192,803	7,246,857
Total restricted	$ 35,261,535	$ 7,184,467	$ 42,446,002	$ 56,202,560
Total deposits and investments	$ 102,132,106	$ 32,851,694	$ 134,983,800	$124,837,542

Investments as of December 31, 2013 consist of the following:

Investment Type	Fair Value	Investment Maturities: Less Than 1 Year	Investment Maturities: 1 to 4 Years
US Treasury	$ 1,232,803	$ 1,232,803	$ -
Federal National Mortgage Association	2,000,000	-	2,000,000
Federal Farm Credit Bank	1,600,000	600,000	1,000,000
Federal Home Loan Bank	860,000	500,000	360,000
Federal Home Loan Mortgage Corp.	1,500,000	500,000	1,000,000
Totals	$ 7,192,803	$ 2,832,803	$ 4,360,000

Investments as of December 31, 2012 consist of the following:

Investment Type	Fair Value	Investment Maturities: Less Than 1 Year	Investment Maturities: 1 to 4 Years
Federal Agricultural Mortgage Corp.	$ 1,286,857	$ 1,286,857	$ -
Federal National Mortgage Association	1,630,000	-	1,630,000
Federal Farm Credit Bank	1,600,000	-	1,600,000
Federal Home Loan Bank	860,000	-	860,000
Federal Home Loan Mortgage Corp.	1,870,000	-	1,870,000
Totals	$ 7,246,857	$ 1,286,857	$ 5,960,000

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 for the year ended December 31, 2013:

Electric System Utility Plant	Balance Jan. 1, 2013	Increases	Decreases	Balance Dec. 31, 2013
Intangible (1)	$ 239,963	$ -	$ -	$ 239,963
Land and Land Rights (1)	3,515,814	2,550	-	3,518,364
Transmission	24,568,167	1,636,818	717,585	25,487,400
Distribution	203,828,982	11,955,793	3,821,938	211,962,837
General Plant	48,192,160	1,996,054	638,007	49,550,207
Plant in Service	280,345,086	15,591,215	5,177,530	290,758,771
Construction in Progress	7,314,669	12,819,032	15,591,215	4,542,486
Total Utility Plant	287,659,755	28,410,247	20,768,745	295,301,257
Less Accumulated Depreciation	120,359,582	10,905,288	4,724,555	126,540,315
Net Electric System Utility Plant	$ 167,300,173	$ 17,504,959	$ 16,044,190	$ 168,760,942

Production System Utility Plant	Balance Jan. 1, 2013	Increases	Decreases	Balance Dec. 31, 2013
Intangible	$ 5,109,470	$ -	$ -	$ 5,109,470
Land and Land Rights (1)	1,224,229	-	-	1,224,229
Production	143,853,231	194,467	-	144,047,698
Transmission	4,624,838	-	-	4,624,838
Plant in Service	154,811,768	194,467	-	155,006,235
Construction in Progress	151,204	294,592	194,467	251,329
Total Utility Plant	154,962,972	489,059	194,467	155,257,564
Less Accumulated Depreciation and Amortization	29,351,311	3,113,570	-	32,464,881
Net Production System Utility Plant	$ 125,611,661	$ (2,624,511)	$ 194,467	$ 122,792,683

(1) Plant not being depreciated.

A schedule of changes in utility plant and depreciation for the year ended December 31, 2012:

Electric System Utility Plant	Balance Jan. 1, 2012	Increases	Decreases	Balance Dec. 31, 2012
Intangible [(1)]	$ 239,963	$ -	$ -	$ 239,963
Land and Land Rights [(1)]	3,510,221	5,593	-	3,515,814
Transmission	24,053,328	1,268,478	753,639	24,568,167
Distribution	193,578,930	10,949,315	699,263	203,828,982
General Plant	41,954,383	6,457,028	219,251	48,192,160
Plant in Service	263,336,825	18,680,414	1,672,153	280,345,086
Construction in Progress	12,686,016	13,309,067	18,680,414	7,314,669
Total Utility Plant	276,022,841	31,989,481	20,352,567	287,659,755
Less Accumulated Depreciation	111,211,858	11,043,876	1,896,152	120,359,582
Net Electric System Utility Plant	$ 164,810,983	$ 20,945,605	$ 18,456,415	$ 167,300,173

Production System Utility Plant	Balance Jan. 1, 2012	Increases	Decreases	Balance Dec. 31, 2012
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	100,895	-	151,204
Total Utility Plant	154,862,077	100,895	-	154,962,972
Less Accumulated Depreciation and Amortization	26,245,903	3,105,408	-	29,351,311
Net Production System Utility Plant	$ 128,616,174	$ (3,004,513)	$ -	$ 125,611,661

(1) Plant not being depreciated.

4. INVESTMENTS IN ASSOCIATED ORGANIZATIONS

Investments in associated organizations at December 31, 2013 and 2012 consist of the following:

	Electric System	
	2013	2012
Harvest Wind Project	$ 44,260,646	$ 44,041,044
White Creek Project, LLC	179,464	133,456
The Energy Authority	2,281,465	2,600,358
Totals	$ 46,721,575	$ 46,774,858

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 2013 and 2012, the District received $2,685,000 and $1,230,000, respectively in distributions. Also included is $3,105,242 and $3,297,319, respectively, 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% contractual 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 over 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.

The membership fee has been 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 was set at 4.5%. During 2012, the $12 million outstanding and associated accrued interest was forgiven, as reflected on the statement of revenues, expenses and changes in net position.

6. LONG-TERM DEBT

Electric System

Revenue Bonds

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). Principal payments on the 2006 Revenue and Refunding Bonds began 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%.

In February 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 began 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
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	9,245,000	7,778,091	17,023,091
2018	9,710,000	7,315,841	17,025,841
2019 - 2023	56,025,000	29,043,449	85,068,449
2024 - 2028	53,125,000	13,655,701	66,780,701
2029 - 2032	17,555,000	3,087,129	20,642,129
Total	$ 170,905,000	$ 86,734,263	$ 257,639,263

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 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
2014	$ -	$ 11,467	$ 11,467
2015	43,337	10,785	54,122
2016	44,031	10,091	54,122
2017	44,735	9,387	54,122
2018	45,451	8,671	54,122
2019 - 2023	238,398	32,211	270,609
2024 - 2028	258,088	12,519	270,607
Total	$ 674,040	$ 95,131	$ 769,171

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
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	1,145,000	2,952,356	4,097,356
2018	1,205,000	2,895,106	4,100,106
2019 - 2023	6,990,000	13,509,032	20,499,032
2024 - 2028	14,165,000	11,382,030	25,547,030
2029 - 2033	24,305,000	6,578,782	30,883,782
2034 - 2036	11,980,000	1,033,888	13,013,888
Total	$ 62,925,000	$ 47,516,513	$ 110,441,513

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
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	719,611	435,689	1,155,300
2018	752,670	402,630	1,155,300
2019 - 2023	4,314,895	1,461,602	5,776,497
2024 - 2027	4,221,939	399,258	4,621,197
Total	$ 11,983,798	$ 4,190,393	$ 16,174,191

Electric System long-term debt activity for the year ended December 31, 2013 follows:

Electric System	Date of Original Issue	Date of Maturity	Outstanding Debt as of Jan. 1, 2013	Amount Issued	Amount Redeemed	Outstanding Debt as of Dec. 31, 2013
Electric Revenue Bonds, 4.375% to 5.00%	Nov-07	Sep-27	$ 57,410,000	$ -	$ 2,695,000	$ 54,715,000
Electric Revenue & Refunding Bonds, 4.50% to 5.00%	Aug-06	Sep-26	57,245,000	-	2,930,000	54,315,000
Electric Revenue Bonds, 2.52% to 6.884%	Feb-10	Sep-32	63,985,000	-	2,110,000	61,875,000
Loan Payable - State of Washington, 1.60%	Jun-07	Jun-28	716,695	-	42,655	674,040
Loan Payable - Production System, 4.50%	Dec-07	Dec-27	12,585,070	-	601,272	11,983,798
Total Electric System Long-Term Debt			$ 191,941,765	$ -	$ 8,378,927	$ 183,562,838

Production System long-term debt activity for the year ended December 31, 2013 follows:

Production System	Date of Original Issue	Date of Maturity	Outstanding Debt as of Jan. 1, 2013	Amount Issued	Amount Redeemed	Outstanding Debt as of Dec. 31, 2013
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	36,340,000	-	955,000	35,385,000
Total Production System Long-Term Debt			$ 63,880,000	$ -	$ 955,000	$ 62,925,000

Electric System long-term debt activity for the year ended December 31, 2012 follows:

Electric System	Date of Original Issue	Date of Maturity	Outstanding Debt as of Jan. 1, 2012	Amount Issued	Amount Redeemed	Outstanding Debt as of Dec. 31, 2012
Electric Revenue Bonds, 4.375% to 5.00%	Nov-07	Sep-27	$ 59,980,000	$ -	$ 2,570,000	$ 57,410,000
Electric Revenue & Refunding Bonds, 4.50% to 5.00%	Aug-06	Sep-26	61,465,000	-	4,220,000	57,245,000
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	758,678	-	41,983	716,695
Loan Payable - Production System, 4.50%	Dec-07	Dec-27	13,159,933	-	574,863	12,585,070
Total Electric System Long-Term Debt			$ 199,348,611	$ -	$ 7,406,846	$ 191,941,765

Production System long-term debt activity for the year ended December 31, 2012 follows:

Production System	Date of Original Issue	Date of Maturity	Outstanding Debt as of Jan. 1, 2012	Amount Issued	Amount Redeemed	Outstanding Debt as of Dec. 31, 2012
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	37,260,000	-	920,000	36,340,000
Total Production System Long-Term Debt			$ 64,800,000	$ -	$ 920,000	$ 63,880,000

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 2013 and 2012 the District paid $281,076 and $276,204, respectively on this obligation. The Agreement requires capital payments to be made according to the following schedule which has been indexed for inflation using 2003 dollars. Actual payments using a 3% escalator are estimated to be $11.4 million:

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

8. OTHER CHARGES AND CREDITS

Other charges consist of the following:

Electric System	2013	2012
Regulatory asset	$ 1,772,553	$ 1,888,982
Option premiums	-	237,480
Derivatives at fair value	886,507	2,217,548
Miscellaneous charges	318,074	385,366
Total Other Charges	$ 2,977,134	$ 4,729,376

Production System	2013	2012
Regulatory asset	$ 768,993	$ 802,305
Miscellaneous charges	-	4,133
Total Other Charges	$ 768,993	$ 806,438

Other credits consist of the following:

Electric System	2013	2012
Property insurance reserve	$ 274,565	$ 270,965
Derivatives at fair value	2,051,035	1,250,418
Other credits	654,207	1,133,772
Total Other Credits	$ 2,979,807	$ 2,655,155

9. **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, twenty-four 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. 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 years ended December 31, 2013 and 2012, the amount actually contributed to the plan and the changes in the District's net PRBO:

	2013	2012
Annual Required Contribution (ARC)	$ 425,167	$ 425,167
Interest on PRBO	14,254	12,879
Adjustments to ARC	(38,642)	(34,915)
Annual PRBO cost	400,779	403,131
Benefit payments	298,913	357,303
Net increase in PRBO	101,866	45,828
Post-Retirement Benefit Obligation - January 1	475,144	429,316
Post-Retirement Benefit Obligation - December 31	$ 577,010	$ 475,144

The District's annual PRBO cost, contributions, the percentage of annual PRBO cost contributed and the net PRBO for 2013 and the two preceding years are as follows:

Fiscal Year Ended December 31,	Annual PRBO Cost	Contribution	Percentage of Annual PRBO Cost Contributed	Net PRBO
2013	$ 400,779	$ 298,913	75%	$ 577,010
2012	$ 403,131	$ 357,303	89%	$ 475,144
2011	$ 527,142	$ 378,247	72%	$ 429,316

Funding Status and Funding Progress

As of December 31, 2012, the unfunded actuarial accrued liability (UAAL) was $3,248,250. The 2013 and 2012 annual payroll of active employees covered by the plan was $14,161,039 and $14,062,787 respectively. The ratio of UAAL to covered payroll remains 23%.

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 December 31, 2012, the Entry Age Normal (Level Dollar) Method was used. Actuarial assumptions include a discount rate of 3% and the medical trend rate is estimated to increase by 8% in 2014 then decrease by .5% each subsequent year until increasing at 5% per year.

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (b)	Unfunded Actuarial Accrued Liability (UAAL) (b) - (a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
12/31/2012	$ -	$ 3,248,250	$ 3,248,250	0%	$ 14,062,787	23%
12/31/2009	$ -	$ 3,870,091	$ 3,870,091	0%	$ 12,846,150	30%

In the actuarial valuation conducted December 31, 2009, the projected unit credit actuarial cost method was used. Actuarial assumptions included a discount rate of 4.5%. The medical trend rate was estimated to gradually decrease from 11% in 2009 to 5% in 2021 and remain level thereafter.

10. 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 1,184 participating employers in PERS. Membership in PERS consisted of the following as of the latest actuarial valuation date for the plans of June 30, 2011:

Retirees and Beneficiaries Receiving Benefits	79,363
Terminated Plan Members Entitled to But Not Yet Receiving Benefits	29,925
Active Plan Members Vested	105,578
Active Plan Members Nonvested	46,839
	261,705

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, 2013 and 2012 were:

2013	Plan 1	Plan 2	Plan 3
Employer *	9.21%	9.21%	9.21%
Employee	6.00%	4.92%	***

2012	Plan 1	Plan 2	Plan 3
Employer *	7.21%	7.21%	7.21%
Employee	6.00%	4.64%	***

* 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
2013	$ 23,872	$ 1,007,121	$ 60,969
2012	$ 23,657	$ 878,294	$ 49,567
2011	$ 44,382	$ 743,904	$ 39,991
2010	$ 36,075	$ 614,863	$ 37,756

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 4 percent of eligible employee compensation. During 2013 and 2012, the District made matching contributions of $397,150 and $381,808, respectively.

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.

11. COMMITMENTS AND CONTINGENCIES

Bonneville Power Administration (BPA)

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 used for District load.

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.

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:

2014	$	106,644
2015		111,544
2016		116,668
2017		122,027
2018		127,633
2019-2020		273,127
Total	$	857,643

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.

We 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.

State Auditor	**Troy Kelley**
Chief of Staff	**Doug Cochran**
Director of Performance and State Audit	**Chuck Pfeil, CPA**
Director of Local Audit	**Kelly Collins, CPA**
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Deputy Director of Communications	**Thomas Shapley**
Local Government Liaison	**Mike Murphy**
Public Records Officer	**Mary Leider**
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