



Washington State Auditor's Office

Troy Kelley

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Financial Statements Audit Report

**Public Utility District No. 1 of Cowlitz
County**

For the period January 1, 2014 through December 31, 2014

Published April 13, 2015

Report No. 1013956





Washington State Auditor
Troy Kelley

April 13, 2015

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 KELLEY
STATE AUDITOR
OLYMPIA, WA

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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, 2014 through December 31, 2014**

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, 2014, 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 3, 2015. The prior year comparative information has been derived from the District's 2013 basic financial statements, on which we issued our report dated April 25, 2014.

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 opinion 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.

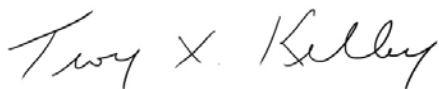
COMPLIANCE AND OTHER MATTERS

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 KELLEY
STATE AUDITOR
OLYMPIA, WA

April 3, 2015

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

Public Utility District No. 1 of Cowlitz County January 1, 2014 through December 31, 2014

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, 2014, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed on page 9.

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, 2014, and the respective changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Report on Summarized Comparative Information

The prior year comparative information has been derived from the District's 2013 financial statements and, in our report dated April 25, 2014, 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, 2013, from which such partial information was derived.

Other Matters

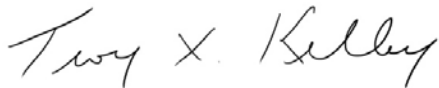
Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 10 through 12 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 3, 2015 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 considering the District's internal control over financial reporting and compliance.



TROY KELLEY
STATE AUDITOR
OLYMPIA, WA

April 3, 2015

FINANCIAL SECTION

Public Utility District No. 1 of Cowlitz County January 1, 2014 through December 31, 2014

REQUIRED SUPPLEMENTARY INFORMATION

Management's Discussion and Analysis – 2014

BASIC FINANCIAL STATEMENTS

Statement of Net Position – 2014

Statement of Revenues, Expenses and Changes in Net Position – 2014

Statement of Cash Flows – 2014

Notes to the Combined Financial Statements – 2014

MANAGEMENT DISCUSSION AND ANALYSIS
For the Year Ended December 31, 2014

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, 2014 with comparable information for 2013 and 2012. 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 its internal control structure, including annual budgets and external audits of its financial statements. These policies set standards for rate sufficiency, rate stability, reserve funds, capital investment and debt management that guide the development of budgets, rates and debt issuance. Taken as a whole, the financial policies are intended to provide financial performance indicators, including debt service coverage and reserve requirements.

The District's 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 develop 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 2014 and 2013 retail power sales of 5,076,899 MWHs and 5,195,417 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.

Since the majority of the District's power supply comes from hydroelectric generation, financial performance of the Electric System is largely influenced by the availability of water for generation and by prices obtainable for excess generation in the wholesale markets. Wholesale sales activity can complement sales to retail customers and provides a stabilizing portfolio effect in years when wholesale sales are at or higher than budget. Conversely, when wholesale sales are below budget, this activity will not provide the expected support for retail rates and may cause upward rate pressures. The District also uses forward physical power contracts and financial instruments that set a "floor" to protect the District from commodity price risk. When the amount of water available for generation is at or greater than budget and prices are sufficient, funds can be added to reserves for future uses or used to supplement revenues required for current year operations.

Overall the Electric System's net position increased approximately \$5.2 million or 3% for 2014 and approximately \$5 million or 3% for 2013. 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.

Selected Financial Data – Electric System

	2014	2013	2012
Current Assets	\$ 108,916,909	\$ 96,007,597	\$ 72,587,164
Net Utility Plant	171,152,727	168,760,942	167,300,173
Other Assets and Deferred Outflows	131,818,279	149,216,565	169,452,120
Total Assets and Deferred Outflows	411,887,915	413,985,104	409,339,457
Current Liabilities	41,000,998	43,180,130	39,302,884
Long-Term Debt	168,858,382	178,331,925	187,452,157
Other Liabilities and Deferred Inflows	33,904,281	29,579,399	24,701,701
Total Liabilities and Deferred Inflows	243,763,661	251,091,454	251,456,742
Net investment in capital assets	29,163,896	27,762,653	31,828,050
Restricted	1,195,345	1,232,803	1,286,857
Unrestricted	137,765,013	133,898,194	124,767,808
Total Net Position	168,124,254	162,893,650	157,882,715
Operating Revenues	252,397,828	255,210,338	248,591,573
Operating Expenses	241,241,413	246,145,937	240,418,315
Net Operating Revenues	11,156,415	9,064,401	8,173,258
Other Income (Expense)	(5,925,811)	(4,053,466)	(6,837,810)
Loan Forgiveness	-	-	12,390,200
Change in Net Position	5,230,604	5,010,935	13,725,648

Results of operations are primarily impacted by changes in rates, retail load, power supply costs, particularly generation levels and wholesale prices, and rate stabilization decisions. Other changes include taxes 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 September 2013 and 2014 residential rates were increased 5% and 4.6% with either no change or decreases ranging from 2% to 15% and 3.5% to 8% among the commercial and industrial classes, respectively.

Capital Asset and Long-Term Debt Activity

As of year-end, the Electric System had \$292 million invested in electric system plant in service, an increase of 1.0%. 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, 2014, 2013, and 2012 consisted of the following:

	2014	2013	2012
Intangible	\$ 239,963	\$ 239,963	\$ 239,963
Land and Land Rights	3,082,142	3,518,364	3,515,814
Transmission & Distribution	236,389,683	237,450,237	228,397,149
General Plant	52,370,855	49,550,207	48,192,160
Total Plant In Service	<u>\$ 292,082,643</u>	<u>\$ 290,758,771</u>	<u>\$ 280,345,086</u>

At December 31, 2014 the Electric System had outstanding revenue bonds totaling \$163 million compared to \$171 million and \$179 million at December 31, 2013 and 2012, 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 both 2014 and 2013.

Selected Financial Data – Production System

	2014	2013	2012
Current Assets	\$ 27,985,758	\$ 26,661,070	\$ 26,068,311
Net Utility Plant	119,568,067	122,792,683	125,611,661
Other Assets and Deferred Outflows	21,654,803	19,308,364	19,974,703
Total Assets and Deferred Outflows	169,208,628	168,762,117	171,654,675
Current Liabilities	2,102,940	2,348,151	2,102,339
Long-Term Debt	64,403,872	62,860,707	63,881,481
Other Liabilities and Deferred Inflows	7,433,402	7,433,402	7,433,402
Total Liabilities and Deferred Inflows	73,940,214	72,642,260	73,417,222
Net investment in capital assets	56,872,798	58,683,041	60,526,245
Restricted	-	-	-
Unrestricted	37,640,391	37,436,816	37,711,208
Total Net Position	94,513,189	96,119,857	98,237,453
Operating Revenues	7,411,680	7,225,776	8,079,384
Operating Expenses	6,101,966	6,759,512	4,975,665
Net Operating Revenues	1,309,714	466,264	3,103,719
Other Income (Expense)	(2,916,382)	(2,583,860)	(2,476,589)
Loan Forgiveness	-	-	(12,889,123)
Change in Net Position	(1,606,668)	(2,117,596)	(12,261,993)

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 in 2014 or 2013 and new debt in 2014. The District did refund the 2004 Production System bonds in 2014 resulting in a net present value savings of approximately \$3.5 million. Total Production System plant in service as of December 31, 2014, 2013 and 2012 consisted of the following:

	2014	2013	2012
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	144,047,698	143,853,231
Transmission Plant	4,624,838	4,624,838	4,624,838
Total Plant In Service	<u>\$ 155,006,235</u>	<u>\$ 155,006,235</u>	<u>\$ 154,811,768</u>

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 2,241 participating employers in PERS. Membership in PERS consisted of the following as of the latest actuarial valuation date for the plans of June 30, 2014:

Retirees and Beneficiaries Receiving Benefits	85,328
Terminated Plan Members Entitled to But Not Yet Receiving Benefits	31,047
Active Plan Members Vested	107,073
Active Plan Members Nonvested	43,633
	<u>267,081</u>

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, 2014 and 2013 were:

2014	Plan 1	Plan 2	Plan 3
Employer *	9.21%	9.21%	9.21%
Employee	6.00%	4.92%	***

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

- * 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
2014	\$ 20,567	\$ 1,166,247	\$ 70,064
2013	\$ 23,872	\$ 1,007,121	\$ 60,969
2012	\$ 23,657	\$ 878,294	\$ 49,567
2011	\$ 44,382	\$ 743,904	\$ 39,991

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 2014 and 2013, the District made matching contributions of \$398,265 and \$397,150, 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.

10. COMMITMENTS AND CONTINGENCIES

Bonneville Power Administration (BPA)

During 2008 the District entered into 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:

2015	\$	111,544
2016		116,668
2017		122,027
2018		127,633
2019		133,497
2020		<u>139,630</u>
Total	\$	<u><u>750,999</u></u>

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 to achieve our vision of government that works for citizens, by helping governments work better, cost less, deliver higher value, and earn greater public trust.

In fulfilling our mission to hold state and local governments accountable for the use of public resources, we also hold ourselves accountable by continually improving our audit quality and operational efficiency and developing highly engaged and committed employees.

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.

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 as well as [fraud](#), state [whistleblower](#) and [citizen hotline](#) investigations.

The results of our work are widely distributed through a variety of reports, which are available on our [website](#) and through our free, electronic [subscription](#) service.

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

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