Annual Financial Report

Public Utility District No.2

of

Pacific County,

Washington

2012

PUBLIC UTILITY DISTRICT NO. 2 Of PACIFIC COUNTY, WASHINGTON

2012 FINANCIAL REPORT

This report contains selected entries from the Washington State Auditor's Office Accountability Audit Report (report #1010365) and the Washington State Auditor's Office Financial Statements Audit Report for Public Utility District No. 2 of Pacific County for the Audit Period of January 1, 2012 through December 31, 2012 (report #1010366). The Auditor's reports were issued August 19, 2013.

Table of Contents

Public Utility District No. 2 of Pacific County

January 1, 2012 through December 31, 2012

Description of the District

Public Utility District No. 2 of Pacific County
August 19, 2013

ABOUT THE DISTRICT

Public Utility District No. 2 of Pacific County is a customer-owned utility providing electricity, water and wholesale telecommunication services. The District was formed in 1937 and began business operations in 1940 serving 4,800 customers. The District now serves over 17,000 residential, commercial, industrial and irrigation customers throughout the 937 square miles of Pacific County. The District is a slice/block customer of the Bonneville Power Administration.

An elected, three-member Board of Commissioners governs the District. The Board appoints a General Manager to oversee the District's daily operations as well as its approximately 57 employees. For fiscal year 2012, the District operated on an annual budget of $33.5 million.

ELECTED OFFICIALS

These officials served during the audit period:

Board of Commissioners:	Diana Thompson
	Ron Hatfield
	Michael Swanson

APPOINTED OFFICIALS

General Manager	Douglas Miller
Treasurer	Jeanne Ledford
Auditor	Renae Powell
Attorney	James Finlay

DISTRICT CONTACT INFORMATION

Address:	Public Utility District No. 2 of Pacific County
	P.O. Box 472
	Raymond, WA 98577
Phone:	(360) 942-2411
Website:	www.pacificpud.org

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. 2 of Pacific County
January 1, 2012 through December 31, 2012

Board of Commissioners
Public Utility District No. 2 of Pacific County
Raymond, 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 Public Utility District No. 2 of Pacific County, Washington, as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise the District's basic financial statements, and have issued our report thereon dated August 19, 2013. During the year ended December 31, 2012, the District implemented Governmental Accounting Standards Board Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position* and Statement No. 65, *Items Previously Reported as Assets and Liabilities*. The District has omitted the information on postemployment benefits other than pensions that accounting principles generally accepted in the United States of America has determined is necessary to supplement, although not required to be part of, the basic financial statements. Our opinion on the basic financial statements is not affected by this missing information.

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 X. Kelley

TROY KELLEY
STATE AUDITOR

August 19, 2013

Independent Auditor's Report on Financial Statements

Public Utility District No. 2 of Pacific County
January 1, 2012 through December 31, 2012

Board of Commissioners
Public Utility District No. 2 of Pacific County
Raymond, Washington

REPORT ON THE FINANCIAL STATEMENTS

We have audited the accompanying financial statements of Public Utility District No. 2 of Pacific County, Washington, as of and for the year ended December 31, 2012, 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 an opinion 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 opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Public Utility District No. 2 of Pacific County, as of December 31, 2012, and the 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.

Matters of Emphasis

As discussed in Note 1 to the financial statements, in 2012, the District adopted new accounting guidance, Governmental Accounting Standards Board Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position* and Statement No. 65, *Items Previously Reported as Assets and Liabilities*. Our opinion is not modified with respect to this matter.

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.

Management has omitted the information on postemployment benefits other than pensions that governmental accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing 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. Our opinion on the basic financial statements is not affected by this missing information.

OTHER REPORTING REQUIRED BY GOVERNMENT AUDITING STANDARDS

In accordance with *Government Auditing Standards*, we have also issued our report dated August 19, 2013 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

The following discussion and analysis of the financial results of Public Utility District No. 2 of Pacific County (District) provides an overview of the Utility's financial activities for the years ended December 31, 2012 and 2011. This discussion is designed to be used in conjunction with the financial statements and notes, which follow this section.

Overview of the Financial Statements

The District accounts for its financial activities within a single proprietary fund. The fund is used to account for the purchase, transmission, distribution and sale of electric energy as well as the sale of water and wholesale telecommunication services.

In accordance with requirements set forth by the Governmental Accounting Standards Board, the District's financial statements employ the accrual basis of accounting in recognizing increases and decreases in economic resources. Accrual accounting recognizes all revenues when earned and expenses when incurred during the year, regardless of when cash is received or paid.

The basic financial statements, presented on a comparative format for the years ended December 31, 2012 and 2011, are comprised of:

Comparative Statement of Net Position

The Statement of Net Position presents information on the District's assets and liabilities, with the difference between the two reported as net position. The net position section of the Statement is separated into three categories: net investment in capital assets; restricted net position; and unrestricted net position.

In 2012, the District implemented GASB 63, which prescribes specific presentation for Deferred Inflows and Deferred Outflows of Resources. The District's accumulated gains and losses in fair value from hedging activities are considered deferred inflows and deferred outflows and have been classified as such on the Statement of Net Position.

Comparative Statement of Revenues, Expenses, and Changes in Net Position

This comparative statement reflects the transactions and events that have increased or decreased the District's total economic resources during the period. Revenues are presented net of allowances and are summarized by major source. Revenues and expenses are classified as operating or non-operating based on the nature of the transaction.

Comparative Statement of Cash Flows

The Comparative Statement of Cash Flows reflects the sources and uses of cash separated into three categories of activities: operating, capital and related financing, and investing. The District does not include cash equivalents within its definition of cash.

The notes to the financial statements presented at the end of the basic financial statements are considered an integral part of the District's presentation of financial position, results of operations, and changes in cash flows.

Statement of Net Position (in thousands)

	2012	2011*	Increase (Decrease)	% Change
Current and Other Assets	$14,236	$12,015	$2,221	18.49%
Net Capital Assets	47,847	45,752	2,095	4.58%
Other Noncurrent Assets	643	844	(201)	-23.82%
Deferred Outflows of Resources	68	28	40	142.86%
Total Assets & Deferred Outflows	**62,794**	**58,639**	**4,155**	**7.09%**
Current Liabilities	5,063	3,503	1,560	44.53%
Noncurrent Liabilities	4,712	3,639	1,073	29.49%
Deferred Inflows of Resources	73	44	29	65.91%
Total Liabilities & Deferred Inflows	**9,848**	**7,186**	**2,662**	**22.06%**
Net Investment in Capital Assets	47,128	44,767	2,361	5.27%
Restricted for Debt Service	177	431	(254)	-58.93%
Unrestricted	5,640	6,255	(615)	-9.83%
Total Net Position	**$52,945**	**$51,453**	**$1,492**	**2.90%**

Statement of Revenues, Expenses and Change in Net Position (in thousands)

	2012	2011*	Increase (Decrease)	% Change
Operating Revenues				
Utility Sales & Service Fees	$23,581	$21,305	$2,276	10.68%
Other	543	554	(11)	-1.99%
Non-operating Revenues				
Interest Income	16	36	(20)	-55.55%
Other Income	1,173	992	181	18.25%
Total Revenues	**25,313**	**22,887**	**2,426**	**10.60%**
Operating Expenses				
Power Supply	10,843	10,891	(48)	-.44%
Operations & Maintenance	2,385	2,144	241	11.24%
Administrative	5,570	5,199	371	7.14%
Taxes & Depreciation	4,135	3,940	195	4.95%
Non-operating Expenses				
Interest & Other	33	661	(628)	-95.01%
Total Expenses	**22,966**	**22,835**	**131**	**0.57%**
Income (Loss) Before Capital Contributions	**2,347**	**52**	**2,295**	**4413.46%**
Capital Contribution	26	752	(726)	-96.54%
Change in Net Position	**2,373**	**804**	**1,569**	**195.15%**
Beginning Net Position	51,453	50,649		
Cumulative Effect of Restatement**	(881)			
Beginning Net Position as Restated	50,572	50,649	(77)	-.15%
Ending Net Position	**$52,945**	**$51,453**	**$1,492**	**2.90%**

** Certain amounts reported with the 2011 financial statements have been reclassified to conform to the 2012 presentation*

*** See Note 10*

Financial Analysis

During 2012, the District's overall financial position and results of operations improved. The District's net position increased by $1.5 million compared to a decrease in net position of $77 thousand in 2011. The following narrative is an analysis of the change in net position by major components of income.

Operating Revenues

In 2012, revenues from sales to retail customers (Retail Energy Sales) increased by approximately $2.3 million. The bulk of this, $1.6 million comes from the resumption of the accrual of unbilled revenue (see note 10) while the balance reflects the first full year of the rate increase implemented in October 2011.

Operating Expenses

Administrative Expenses increased $371k overall. The increase was driven by a continued escalation in health care costs which added $181k. Attorney fees associated with the pole attachment action contributed an additional $128k. These increases were offset in part, by a decrease in outside engineering firm expense which saw a drop of $103k which was led by a favorable rebate from our L & I retro group. District funded conservation measures contributed an additional $188k to the increase in this category.

Operating and Maintenance costs increased $241k. 2012 saw a lower amount of line extension and other capital activity. This was taken as an opportunity to focus more on core maintenance versus rebuilds or system expansion. This tends to shift costs away from capital and into O & M.

Tax and Depreciation expense was up $195k, with taxes contributing $150k and depreciation $46k. Taxes are based largely on retail revenues which were up considerably in 2012 based on the rate increase implemented in October 2011. Depreciation is based on increased capital projects being closed and placed in service.

Power Supply expense remained relatively flat when compared to 2011, decreasing by $48k.

Other Income & Expense

Interest and Other expense decreased $628k from 2011 to 2012. As previously mentioned, the District refunded the outstanding portion of its 2001 bonds, leaving only minimal outstanding debt. Interest expense dropped accordingly.

Other Income increased $181k between 2011 and 2012. The two material components in this category are Service Revenue (revenue received from customers for line extensions) and Conservation Reimbursement.

In 2012, Service Revenue was up $596k when compared with 2011. In 2012, the District adjusted Customer Advances for Construction to actual advances subject to refund as of year-end. This adjustment resulted in a reduction of Customer Advances of $534k with an offsetting increase in Service Revenue.

Partially offsetting the favorable variance in Service Revenue, Conservation Reimbursement dropped by $416k in 2012. In 2011 the District had 'special' contracts under which BPA funded various energy efficiency measures. This revenue was offset by the District's expense incurred in putting the measures in place. The District's expense was charged to the Energy Services Department. No such funding existed in 2012.

Capital Contributions
Capital Contributions experienced a decrease of $726k from 2011 to 2012. $26k in grant reimbursement was received during 2012, compared to $752 that was received in 2011. 2011's numbers included $665k received by the electric division, primarily BTOP reimbursement, while an additional $87k was received from the customers of the Wilson Point water system as their contributions towards needed system improvements.

Capital Asset and Long-Term Debt Activity
The District's net capital additions including construction work-in-progress were approximately $2.1 million in 2012. Total additions to capital assets were $4.9 million and consist of the following major projects: expansion to the District's broadband system related to the Districts BTOP Grant, and various other improvements to the District's infrastructure. More detailed information about the District's capital assets is presented in Note 4 to the financial statements.

At the end of the current fiscal year, the District had $719k in outstanding long term debt, a decrease of $266k from the prior year. The District has not undertaken any additional debt obligations in 2011 or 2012 and is on schedule to make its final debt service payment on its 2007 bond in 2014. See Note 6 to the financial statements for additional information on the long-term debt.

Summary of Financial Position
The assets of the District exceeded its liabilities at the end of 2012 by $52.9 million (net position). $5.6 million of this amount represents unrestricted net position, which may be used to meet ongoing obligations. Net investment in capital assets accounted for $47 million or 89 percent of the Districts net position. The District's overall financial position improved in 2012, with an increase in net position of $1.5 million.

Other Significant Matters
During 2012 the District put in place a $2 million revolving line of credit as a hedge against extraordinary power and transmission expense generally driven by low BPA slice generation and high market prices. See Note 6 for additional information.

Requests for Information
The basic financial statements, notes and management discussion and analysis are designed to provide a general overview of the District's finances. Questions concerning any of the information provided in this report should be directed to the District at Post Office Box 472, or 405 Duryea Street, Raymond, WA 98577.

PUD No. 2 of Pacific County

MCAG 1793

STATEMENT OF NET POSITION

For the year ended December 31, 2012

ASSETS AND DEFERRED OUTFLOWS OF RESOURCES		
ASSETS		
CURRENT ASSETS		
Cash & Cash Equivalents		
Unrestricted Cash & Cash Equivalents	$	2,460,508
Restricted Construction Account		3,955,006
Investments (Note 1)		255,346
Accounts Receivable, net		2,257,531
Accrued Unbilled Revenues (Note 10)		1,582,580
Inventory - Materials & Supplies		3,637,602
Prepaid Expenses & Option Premiums		87,056
Total Current Assets		**14,235,629**
NONCURRENT ASSETS		
Restricted Bond Reserve Fund (Note 1)		177,406
Other Receivables (Note 1)		388,982
Other Charges (Note 9)		77,030
Subtotal Noncurrent Assets		**643,418**
Utility Plant (Note 4)		
Land and Intangible Plant		1,130,092
Electric & Water Plant in Service		87,391,739
Construction Work in Progress		7,999,619
Less: Accumulated Depreciation		(48,674,607)
Net Utility Plant		47,846,843
Total Noncurrent Assets		**48,490,261**
TOTAL ASSETS		**62,725,890**
DEFERRED OUTFLOWS OF RESOURCES		
Unamortized Loss on Defeased Debt		-
Accumulated Decrease in Fair Value of Hedging Derivatives (Note 3)		68,107
Total Deferred Outflows of Resources		**68,107**
TOTAL ASSETS AND DEFERRED OUTFLOWS OF RESOURCES	**$**	**62,793,997**

PUD No. 2 of Pacific County

MCAG 1793

STATEMENT OF NET POSITION

For the year ended December 31, 2012

NET POSITION, LIABILITIES AND DEFERRED INFLOWS OF RESOURCES	
LIABILITIES	
CURRENT LIABILITIES	
Warrants Outstanding	$ -
Accounts Payable	3,729,188
Accrued Taxes Payable	484,810
Other Accrued Liabilities	571,485
Accrued Interest Payable	3,335
Revenue Bonds, Current Portion (Note 6)	274,283
Total Current Liabilities	**5,063,101**
NONCURRENT LIABILITIES	
Revenue Bonds & Other Long Term Debt (Note 6)	444,920
Unamortized Premium & Discount	-
Accrued Other Post Employment Benefits	3,038,515
Customer Advances for Construction	635,178
Customer Deposits	525,515
Other Credits & Liabilities (Note 9)	68,107
Total Noncurrent Liabilities	**4,712,235**
Total Liabilities	**9,775,336**
DEFERRED INFLOWS OF RESOURCES	
Accumulated Increase in Fair Value of Hedging Derivatives (Note 3)	73,328
Total Deferred Inflows of Resources	**73,328**
NET POSITION	
Net Investment in Capital Assets	47,127,640
Restricted for Debt Service	177,407
Unrestricted	5,640,286
Total Net Position	**52,945,333**
TOTAL NET POSITION, LIABILITIES AND DEFERRED INFLOWS OF RESOURCES	**$ 62,793,997**

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

PUD No. 2 of Pacific County

MCAG 1793

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION

For the year ended December 31, 2012

OPERATING REVENUES		
Sales of Electric Energy & Water - Retail	$	23,581,304
Broadband Revenue		229,418
Other Revenue		313,558
Total Operating Revenues		**24,124,280**
OPERATING EXPENSES		
Power Supply		10,843,444
Transmission Operation & Maintenance		33,210
Distribution Operation & Maintenance		2,146,538
Broadband Expense		205,615
Customer Accounting, Collection and Information		837,336
Administrative & General Expense		4,733,112
Taxes		1,276,932
Depreciation		2,857,571
Total Operating Expenses		**22,933,759**
OPERATING INCOME (LOSS)		**1,190,521**
NONOPERATING REVENUES & EXPENSES		
Interest Income		15,809
Other Income		1,172,752
Other Expense		(6,659)
Interest Expense		(22,140)
Debt Discount/Premium Amortization & Bond Issue Costs		(2,953)
Total Nonoperating Revenues & Expenses		**1,156,809**
INCOME (LOSS) BEFORE CONTRIBUTIONS		**2,347,330**
CAPITAL CONTRIBUTIONS		26,161
CHANGE IN NET POSITION		**2,373,491**
TOTAL NET POSITION, BEGINNING OF YEAR		**51,453,454**
CUMULATIVE EFFECT OF RESTATEMENT (see note 10)		**(881,612)**
TOTAL NET POSITION, BEGINNING OF YEAR AS RESTATED		**50,571,842**
TOTAL NET POSITION, END OF YEAR	**$**	**52,945,333**

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

PUD No. 2 of Pacific County

MCAG 1793

STATEMENT OF CASH FLOWS

For the year ended December 31, 2012

CASH FLOWS FROM OPERATING ACTIVITIES		
Cash Received from Customers and Counterparties	$	22,611,938
Cash Paid to Suppliers and Counterparties		(13,719,876)
Cash Paid to Employees for Services		(3,038,571)
Taxes Paid		(1,276,957)
Net Cash Provided by Operating Activities		**4,576,534**
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisition of Capital Assets		(4,952,464)
Proceeds from Sale of Revenue Bonds		0
Cash Defeasance Principal and Interest		0
Bond Principal Paid		(266,351)
Bond Interest Paid		(25,093)
Capital Contributions		1,196,450
Other		1,040
Net Cash Used by Capital and Related Financing Activities		**(4,046,418)**
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest Income		15,809
Change in Investments		254,280
Purchase of Investments		-
Net Cash Provided (Used) by Investing Activities		**270,089**
NET INCREASE (DECREASE) IN CASH		**800,205**
CASH BALANCE, BEGINNING OF YEAR		**5,792,715**
CASH BALANCE, END OF YEAR		**6,592,920**

RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES

Operating Income (Loss)		$1,190,521
Adjustments to reconcile net operating income to net cash provided by operating activities:		
Depreciation & Amortization		2,857,571
(Increase) Decrease in Unbilled Revenues		(1,582,580)
Increase (Decrease) in Net OPEB Obligation		955,827
Misellaneous Other Revenue & Receipts		(5,236)
Decrease (Increase) in Accounts Receivable		89,868
Decrease (Increase) in Inventories		103,837
Decrease (Increase) in Prepaid and Other Purchased Power Expense		(15,103)
Decrease (Increase) in Deferred Derivative Outflow		(40,447)
Increase (Decrease) in Deferred Derivative Inflow		28,892
Increase (Decrease) in Warrants Outstanding		(24,815)
Increase (Decrease) in Accounts Payable		1,546,704
Increase (Decrease) in Accrued Taxes Payable		31,396
Increase (Decrease) in Customer Deposits		3,749
Increase (Decrease) in Other Current Liabilities		(1,000)
Increase (Decrease) in Other Credits		(562,648)
Net Cash Provided by Operating Activities	**$**	**4,576,534**

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

PUBLIC UTILITY DISTRICT NO. 2 OF PACIFIC COUNTY
BILLING STATISTICS
MONTH END DECEMBER

	KILOWATT HOURS BILLED		REVENUE	
	2012	**2011**	**2012**	**2011**
RESIDENTIAL	17,931,804	21,660,406	$ 1,348,978	$ 1,588,860
NUMBER OF CUSTOMERS			*14,998*	*14,978*
GREEN POWER			$ 2,333	$ 2,179
COMMERCIAL	4,948,947	5,512,012	$ 399,893	$ 436,060
NUMBER OF CUSTOMERS			*1,534*	*1553*
PUBLIC AUTHORITY	2,376,009	2,827,056	$ 184,285	$ 214,388
NUMBER OF CUSTOMERS			*434*	*431*
INDUSTRIAL	2,010,000	1,710,000	$ 101,699	$ 89,180
NUMBER OF CUSTOMERS			*3*	*2*
IRRIGATION	196	471	$ 3,882	$ 4,000
NUMBER OF CUSTOMERS			*64*	*64*
PUBLIC LIGHTING	12,278	12,425	$ 9,179	$ 9,143
STREET & HIGHWAY LIGHTING	46,849	46,898	$ 5,239	$ 5,247
TOTAL SALES	27,326,083	31,769,268	$ 2,055,489	$ 2,349,058
TOTAL NUMBER OF CUSTOMERS			*17,033*	*17,028*
SELF CONSUMED	63,382	73,931	$ -	$ -
TOTAL	27,389,465	31,843,199	$ 2,055,489	$ 2,349,058

ENERGY PURCHASED
MONTH END DECEMBER

	MONTH		YEAR TO DATE	
	2012	**2011**	**2012**	**2011**
COST OF POWER				
BPA	$ 941,528	$ 1,181,553	$ 9,618,932	$ 8,658,053
Non-Federal	$ -	-	$ -	$ -
TOTAL COST	$ 941,528	$ 1,181,553	$ 9,618,932	$ 8,658,053
KWH'S PURCHASED				
BPA	33,541,182	35,548,634	303,584,771	311,815,750
Non-Federal	-	-	-	-
TOTAL PURCHASED	33,541,182	35,548,634	303,584,771	311,815,750
COST PER KWH	$ 0.0281	$ 0.0332	$ 0.0317	$ 0.0278
MAXIMUM DEMAND--kW	57,712	57,767		
TOTAL kWh PURCHASED	(33,541,182)	(35,548,634)	(303,584,771)	(311,815,750)
kWh SOLD	27,326,083	31,769,268	285,854,970	296,627,858
kWh SELF-CONSUMED	63,382	73,931	663,880	704,100
kWh VARIANCE: GAIN\(LOSS)	(6,151,717)	(3,705,435)	(17,065,921)	(14,483,792)
kWh Variance %	*-18.3%*	*-10.4%*	*-5.6%*	*-4.6%*

PUBLIC UTILITY DISTRICT NO.2 OF PACIFIC COUNTY
BILLING STATISTICS
YEAR-TO-DATE DECEMBER

	KILOWATT HOURS		REVENUE	
	2012	**2011**	**2012**	**2011**
RESIDENTIAL	179,571,558	188,509,880	$ 13,848,693	$ 13,507,713
NUMBER OF CUSTOMERS				
GREEN POWER	0	0	$ 28,045	$ 27,017
COMMERCIAL	55,964,338	58,309,648	$ 4,570,696	$ 4,406,145
NUMBER OF CUSTOMERS				
PUBLIC AUTHORITY	25,872,656	27,158,835	$ 2,028,919	$ 1,993,100
NUMBER OF CUSTOMERS				
INDUSTRIAL	23,082,600	21,283,200	$ 1,158,780	$ 1,017,302
NUMBER OF CUSTOMERS				
IRRIGATION	654,393	655,908	$ 80,313	$ 75,201
NUMBER OF CUSTOMERS				
PUBLIC LIGHTING	147,197	147,622	$ 102,875	$ 103,628
STREET & HIGHWAY LIGHTING	562,228	562,765	$ 62,907	$ 58,053
TOTAL SALES	285,854,970	296,627,858	$ 21,881,228	$ 21,188,161
TOTAL NUMBER OF CUSTOMERS				
SELF CONSUMED	663,880	704,100	$ -	$ -
TOTAL	286,518,850	297,331,958	$ 21,881,228	$ 21,188,161

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the Public Utility District No. 2 of Pacific County (the District) conform to generally accepted accounting principles (GAAP) as applicable to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard setting body for establishing governmental accounting and financial reporting principals. The District has applied all applicable GASB pronouncements. The following is a summary of the more significant policies:

A. Reporting Entity

Public Utility District No. 2 of Pacific County was incorporated on March 1, 1940, and operates under the laws of the State of Washington applicable to a public utility district. The District is organized as a municipal corporation, authorized under Title 54 RCW and is governed by an elected three-member Board. The District provides retail electricity to the majority of Pacific County and provides water to three areas of the County and is authorized under State law to provide wholesale telecommunication service.

B. Basis of Accounting

The accounting and reporting policies of the District are regulated by the Washington State Auditor's Office under chapter 43.09 RCW and are based on the Uniform System of Accounts prescribed for public utilities and licensees by the Federal Energy Regulatory Commission (FERC). The District uses the full accrual basis of accounting where revenues are recognized when earned and expenses are recognized when incurred. Revenues and expenses related to the District's principal operations are considered to be operating revenues and expenses; while revenues and expenses related to capital, financing, and investing activities are considered to be non-operating revenues and expenses.

C. Cash and Cash Equivalents

For the purpose of the Statement of Cash Flows, the District considers all highly liquid investments, with maturity of three months or less when purchased, to be cash equivalents.

D. Utility Plant and Depreciation

See Note 4 – Capital Assets

E. Restricted Funds

In accordance with bond resolutions, related agreements and laws, separate restricted funds have been established. The assets held in these funds are restricted for specific uses including debt service and special purpose funds.

The restricted assets are composed of the following:

Bond Reserve	$177,406

F. Receivables and Allowance for Doubtful Accounts
Management periodically assesses the collectability of accounts receivable. This assessment provides the basis for the allowance for doubtful accounts and the related bad debt expense.

G. Inventories
Inventories are valued at average cost, which approximates the market value.

H. Investments
As required by state law, all investments of the District's funds are obligations of the U.S. Government or government agencies, deposits with Washington state banks and savings and loan institutions, the Washington State Treasurer's Investment Pool, or other investments allowed by Chapter 39.59 RCW.

Investments as of 12/31/2012	**Carrying Amount**	**Market Value**
Certificates of Deposit	$255,346	$255,346

I. Compensated Absences
The District provides its employees with a single Personal Leave (PL) plan, in lieu of separate programs for vacation and illness benefits. Employees accrue PL based upon their length of service.

Employees with sick leave balances remaining under the terms of the former plan were able to transfer the balance into a Supplemental Leave Bank (SLB). No additional hours may be posted to the SLB, though an employee on Short Term Disability may utilize SLB hours to make up the difference between the 70% pay they received while on STD and 100% of their regular earnings. Employees with SLB remaining receive an annual transfer of up to16 hours (converted to cash) to their respective HRA-VEBA accounts in accordance with the terms and conditions of the HRA-VEBA Plan and the Collective Bargaining Agreement (CBA).

Personal Leave is payable in full upon resignation or death, subject to certain provisions in the CBA. Supplemental Leave is forfeited upon resignation or paid at 50% at the time of death of an active employee. At retirement, the District will deposit any remaining PL hours (converted to cash) to the retirees HRA-VEBA account, any remaining SLB is forfeited.
PL is charged as a component of payroll overhead as time is incurred by an employee. A corresponding liability is recognized until such time an employee uses or sells PL to the District in accordance with the terms of the plan.

J. Unamortized Debt Expenses
Amounts stemming from original issue and reacquired bonds, including premiums, discounts and expenses, are amortized over the life of the issue whether defeased or held to term. Resulting differences are amortized using the straight-line basis.

K. Purchase Commitments
See Note 15 – Power Supply; for contracts with the Bonneville Power Administration and others for future power supply.

L. Reclassification
Certain 2011 account balances may have been reclassified to conform to the 2012 presentation. Such reclassifications would have no effect on previously reported results of operations and cash flows.

During 2012 the District adopted recently issued Governmental Accounting Standards Board (GASB) statements No. 63 and 65, which changed the accounting for certain deferred balances and debt-related activity. In accordance with transition provisions of these statements, the changes in accounting related to them were applied retrospectively for all periods presented.

NOTE 2 - DEPOSITS AND INVESTMENTS

Deposits
The District's deposits and certificates of deposits are entirely covered by federal depository insurance (FDIC and FSLIC) or by collateral held in a multiple financial institution collateral pool administered by the Washington Public Deposit Protection Commission (PDPC). Deposit accounts are reconciled to the District's accounting records at year end, and the book balance of these accounts does not materially differ from the bank balance.

For balance sheet purposes, the LGIP is considered a cash equivalent.

NOTE 3 - DERIVATIVE INSTRUMENTS

The District has adopted GASB Statement No. 53, Accounting and Financial Reporting for Derivative Instruments. Subject to certain exceptions, GASB Statement No. 53 requires that every derivative instrument be recorded on the Balance Sheet as an asset or liability measured at its fair value, and that changes in the derivative's fair value be recognized currently in earnings unless such derivatives meet specific hedge accounting criteria to be determined as effective. Effective hedges qualify for hedge accounting and such changes in fair values are deferred. The District uses FASB pronouncements on Accounting for the Effects of Certain Types of Regulation to defer unrecognized gains or losses for derivatives that are not deemed to be effective.

It is the District's policy to document and apply as appropriate the normal purchase and normal sales exceptions under GASB Statement No. 53. The District has reviewed its various contractual arrangements to determine applicability of these standards. Purchases and sales of forward electricity and natural gas that require the physical delivery and which are expected to 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 from GASB Statement No. 53 and therefore are not required to be recorded at fair value in the financial statements. Financial swaps for electricity and natural gas are considered to be derivatives under GASB Statement No. 53, but generally do not meet the "normal purchases and normal sales" criteria.

At December 31, 2012 the District had the following derivative instruments outstanding:

Changes in Fair Value Classification	Amount	Fair Value at December 31, 2012 Classification	Amount	Notional
Deferred Credit	$ (68,107)	Deferred Asset	$ 68,107	14,880 MWh
Deferred Charge	$ 73,328	Deferred Liability	$ (73,328)	16,600 MWh

NOTE 4 - CAPITAL ASSETS
Major expenditures (exceeding $1,500) for capital assets, including capital leases and major repairs that increase useful lives, are capitalized. Maintenance, repairs, and minor renewals are accounted for as expenses when incurred.

All capital assets are valued at historical cost or estimated historical cost, where historical cost is not known. Preliminary costs incurred for proposed projects are deferred until construction of the project is completed. Costs relating to projects ultimately constructed are transferred to the utility's plant assets. Charges that relate to abandoned projects are expensed.

Electric and Water plant activity for the year ended December 31, 2012, was as follows:

	Beginning Balance	Increase	Decrease	Ending Balance
Utility Plant not being depreciated:				
Land	1,130,092	-	-	1,130,092
Construction in Progress	5,829,924	2,169,695	-	7,999,619
Total	**6,960,016**	**2,169,695**	**-**	**9,129,711**
Utility Plant being depreciated:				
Transmission Plant	4,758,254	2,468	(2,826)	4,757,896
Distribution Plant	61,454,303	1,811,575	(300,312)	62,965,566
Telecom Plant	4,816,427	965,892	(2,303)	5,780,016
General Plant	11,272,313	325,671	(92,285)	11,505,699
Water Plant	2,382,562	-	-	2,382,562
Total	**84,683,859**	**3,105,606**	**(397,726)**	**87,391,739**
Less: Accum. Deprec.	(45,891,925)	(2,857,571)	74,889	(48,674,607)
Total Net Utility Plant	**45,751,950**	**2,417,730**	**(322,837)**	**47,846,843**

Property, plant and equipment is depreciated using the straight-line method over the following estimated useful lives:

Buildings & Improvements	25-40 years
Electric Plant – Transmission	17-30 years
Electric Plant – Distribution	17-33 years
Transportation Equipment	7-10 years
General Plant & Equipment	5-20 years
Water Plant	5-40 years
Telecommunications	7-20 years

The estimated original cost of operating property retired or otherwise disposed of and the cost of removal, less salvage, is charged to accumulated depreciation. However, in the case of the sale of a significant operating unit or system, the original cost is removed from the utility plant accounts; accumulated depreciation is charged with accumulated depreciation related to the property sold, and the net gain or loss on disposition is credited or charged to income. There were no sales of significant units or systems in 2012.

NOTE 5 –LEASES

The District is committed under operating leases for office equipment. Lease expense for the years ending December 31, 2012 amounted to $13,541. For these leases, the minimum annual lease commitment for 2012 equals $13,541. The District had no capital leases during 2012.

NOTE 6 - LONG-TERM DEBT

During the year ended December 31, 2012, the following changes occurred in long-term debt:

Issue	Original Issue Amount	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
2007 Electric Refunding Bonds, interest at 3.95%, maturing in 2018	$1,576,150	$619,387	-	($242,031)	$377,356	249,962
DWSRF Loan – Bay Center Water	462,091	316,167	-	(24,320)	291,847	24,321
Totals	**$2,038,241**	**$935,554**	**-**	**($266,351)**	**$669,203**	**$274,283**

The following table shows the debt service payments due on the outstanding 2007 Bonds and the DWSRF Loan. The District has no other outstanding bonds or loans.

Year	Principal	Interest	Total
2013	$ 274,283	$ 13,908	$ 288,191
2014	$ 151,715	$ 3,796	$ 155,511
2015	$ 24,321	$ 1,216	$ 25,537
2016	$ 24,321	$ 1,094	$ 25,415
2017	$ 24,321	$ 973	$ 25,294
2018-2022	$ 121,601	$ 3,040	$ 124,641
2023-2027	$ 48,641	$ 366	$ 49,007
Total	$ 669,203	$ 24,393	$ 693,596

In accordance with Bond Resolutions and the Official Bond Statements, separate restricted fund accounts are required to be established. The assets held in these fund accounts are restricted for specific uses, including debt service and other specific uses.

Loan to Lebam Water System
During 2004, the Electric Department issued a $50,000 Long Term loan to the Lebam Water System to help cover startup costs associated with the new system. Lebam Water pays monthly interest to the Electric Department. The interest rate is based on percentage of interest earned on the District's funds in the LGIP. This amount is included in Long Term Debt as presented in the Statement of Net Position.

Line of Credit
During 2012 the District put in place a $2,000,000 revolving line of credit as a hedge against low BPA slice generation and high market prices.

Per the terms of the not, each draw pursuant to a Request for Draw shall bear interest at the variable rate of 0.150% below the Prime Rate (but not less than 3.10% per annum). Interest on the Note shall accrue from the date money is drawn, pursuant to a Request for Draw, until paid and shall be computed on the principal amount outstanding on the basis of a 360-day year and the actual days elapsed.

No draws were made on the line during 2012.

NOTE 7 - PENSION PLAN
Substantially all District full-time and qualifying part-time employees participate in one of the following statewide retirement systems administered by the Washington State Department of Retirement Systems, under cost-sharing multiple-employer public employee defined benefit and defined contribution retirement plans. The Department of Retirement Systems (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.*

Public Employees' Retirement System (PERS) Plans 1, 2, and 3

Plan Description

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 defined benefit plan with a defined contribution component.

Membership in the system includes: elected officials; state employees; employees of the Supreme, Appeals, and Superior courts (other than judges currently in a judicial retirement system); employees of legislative committees; community and technical colleges, college and university employees not participating in national higher education retirement programs; judges of district and municipal courts; and employees of local governments.

PERS members who joined the system by September 30, 1977 are Plan 1 members. Those members 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 members 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 in Plan 2 until a choice is made. Employees who fail to choose within 90 days default to PERS Plan 3. Notwithstanding, PERS Plan 2 and Plan 3 members may opt out of plan membership if terminally ill, with less than five years to live.

PERS Plan 1 and Plan 2 defined benefit retirement benefits are financed from a combination of investment earnings and employer and employee contributions. PERS retirement benefit provisions are established in chapters 41.34 and 41.40 RCW and may be amended only by the State Legislature.

PERS Plan 1 members are vested after the completion of five years of eligible service. Plan 1 members are eligible for retirement after 30 years of service, or at the age of 60 with five years of service, or at the age of 55 with 25 years of service. The monthly benefit is 2% of the average final compensation (AFC) per year of service. (AFC is the monthly average of the 24 consecutive highest-paid service credit months.) The retirement benefit may not exceed 60% of AFC. The monthly 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 retiring 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 3% 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 3% annually. To offset the cost of this annual adjustment, the benefit is reduced.

PERS Plan 1 provides duty and non-duty disability benefits. Duty disability retirement benefits for disablement prior to the age of 60 consist of a temporary life annuity payable to the age of 60. The allowance amount is $350 a month, or two-thirds of the monthly AFC, whichever is less. The benefit is reduced by any workers' compensation benefit and is payable as long as the member remains disabled or until the member attains the age of 60. A member with five years of covered employment is eligible for non-duty disability retirement. Prior to the age of 55, the allowance amount is 2% of the AFC for each year of service reduced by 2% for each year that the member's age is less than 55. The total benefit is limited to 60% of the AFC and is actuarially reduced to reflect the choice of a survivor option. A cost-of living allowance is granted at age 66 based upon years of service times the COLA amount (based on the consumer Price Index), capped at 3% annually. To offset the cost of this annual adjustment, the benefit is reduced.

PERS Plan 1 members can receive credit for military service while actively serving in the military, if such credit makes them eligible to retire. Members can also purchase up to 24 months of service credit lost because of an on-the-job injury.

PERS Plan 2 members are vested after the completion of five years of eligible service. Plan 2 members are eligible for normal retirement at the age of 65 with five years of service. The monthly benefit is 2% of the AFC per year of service. (AFC is the monthly average of the 60 consecutive highest-paid service months.)

PERS Plan 2 members who have at least 20 years of service credit and are 55 years of age, or older, are eligible for early retirement with a reduced benefit. The benefit is reduced by an early retirement factor (ERF) that varies according to age, for each year before age 65.

PERS Plan 2 members who have 30 or more years of service credit and are at least 55 years old can retire under one of two provisions:

- With a benefit that is reduced by 3% for each year before age 65.
- With a benefit that has a smaller (or no) reduction (depending on age) that imposes stricter return-to-work rules.

PERS Plan 2 retirement benefits are also actuarially reduced to reflect the choice, if made, 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 3% annually.

The surviving spouse or eligible child or children of a PERS Plan 2 member who dies after leaving eligible employment having earned ten years of service credit may request a refund of the member's accumulated contributions. Effective July 22, 2007, said refund (adjusted as needed for specified legal reductions) is increased from 100% to 200% of the accumulated contributions if the member's death occurs in the uniformed service to the United States while participating in *Operation Enduring Freedom or Persian Gulf, Operation Iraqi Freedom*.

PERS 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 monthly benefit that is 1% of the AFC per year of service. (AFC is the monthly average of the 60 consecutive highest-paid service months.)

Effective June 7, 2006, PERS 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 for normal retirement at age 65, or they may retire early with the following conditions and benefits:

- If they have at least ten service credit years and are 55 years old, the benefit is reduced by an ERF that varies with age, for each year before age 65.
- If they have 30 service credit years and are at least 55 years old, they have the choice of a benefit that is reduced by 3% for each year before age 65; or a benefit with a smaller (or no) reduction factor (depending on age) that imposes stricter return-to-work rules.

PERS Plan 3 defined benefit retirement benefits are also actuarially reduced to reflect the choice, if made, 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.

PERS Plan 3 defined contribution retirement benefits are solely dependent upon the results of investment activities.

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 Director of the Department of Retirement Systems.

PERS Plan 2 and Plan 3 provide disability benefits. There is no minimum amount of service credit required for eligibility. The Plan 2 monthly benefit amount is 2% of the AFC per year of service. For Plan 3, the monthly benefit amount is 1% of the AFC per year of service.

These disability benefit amounts are actuarially reduced for each year that the member's age is less than 65, and 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 3% annually.

PERS Plan 2 and Plan 3 members may have up to ten years of interruptive military service credit; five years at no cost and five years that may be purchased by paying the required contributions. Effective July 24, 2005, a member who becomes totally incapacitated for continued employment while serving the uniformed services, or a surviving spouse or eligible children, may apply for interruptive military service credit. Additionally, PERS Plan 2 and Plan 3 members can also purchase up to 24 months of service credit lost because of an on-the-job injury.

PERS members may also purchase up to five years of additional service credit once eligible for retirement. This credit can only be purchased at the time of retirement and can be used only to provide the member with a monthly annuity that is paid in addition to the member's retirement benefit.

Beneficiaries of a PERS Plan 2 or Plan 3 member with ten years of service who is killed in the course of employment receive retirement benefits without actuarial reduction, if the member was not at normal retirement age at death. This provision applies to any member killed in the course of employment, on or after June 10, 2004, if found eligible by the Department of Labor and Industries.

A one-time duty-related death benefit is provided to the estate (or duly designated nominee) of a PERS member who dies in the line of service as a result of injuries sustained in the course of employment, or if the death resulted from an occupational disease or infection that arose naturally and proximately out of said member's covered employment, if found eligible by the Department of Labor and Industries.

Membership in PERS consisted of the following as of the latest actuarial valuation date for the plans of June 30, 2011:

Active Plan Members	152,417
Terminated Plan Members Entitled to But Not Yet Receiving Benefits	29,925
Retirees and Beneficiaries Receiving Benefits	79,363
Total	**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% for state agencies and local government unit employees, and at 7.5 % 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. Under PERS Plan 3, employer contributions finance the defined benefit portion of the plan and member contributions finance the defined contribution portion. The Director of the Department of Retirement Systems sets Plan 3 employee contribution rates. Six rate options are available ranging from 5% to 15%; two of the options are graduated rates dependent on the employee's age. As a result of the implementation of the Judicial Benefit Multiplier Program in January 2007, a second tier of employer and employee rates was developed to fund, along with investment earnings, the increased retirement benefits of those justices and judges that participate in the program. 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 for 2012 follows:

	PERS Plan 1	PERS Plan 2	PERS Plan 3
Employer 1/1/2012-3/31/2012	7.25%	7.25%	7.25%
Employer 4/1/2012-6/30/2012	7.08%	7.08%	7.08
Employer 7/1/2012-12/31/2012	7.21%	7.21%	7.21%
Employee 1/1/2012-12/31/2012	4.64%	4.64%	*

** Variable from 5.0% minimum to 15.0% maximum based on rate selected by the PERS 3 member.*

Public Employees' Retirement System (PERS) Plans 1, 2, and 3
Both District and the employees made the required contributions. The District's required contributions for the years ending December 31 were as follows:

	PERS Plan 1	PERS Plan 2	PERS Plan 3
2012	$0	$265,559	$20,820

The District's payroll subject to PERS plans for the years ended December 31, 2012 was $3,983,723. The District's total payroll for all employees for the same period was $4,099,307.

<u>HRA VEBA</u>
In 2006, the Commissioners approved Resolution No. 1248 authorizing participation in a Health Reimbursement Arrangement / Voluntary Employees' Beneficiary Association Plan., as allowed under IRS Code section 501(C)(9).

Under the plan, the District will participate in the Voluntary Employees' Beneficiary Association (VEBA) for Public Service Employees in the Northwest trust, commonly referred to as the HRA VEBA Plan that was established on October 21, 1992 for public sector employees with updated IRS letter of determination March 14, 2000. Contributions are made for the benefit of District employees under three different VEBA groups - for "A" Group or "B" Group IBEW Local Union No. 77 employees, and for non-union employees.

The plan covers all District employees. All employees within their respective VEBA group contribute an amount as described in the plan's documentation. Contributions may be adjusted from time-to-time by a majority vote of the specific VEBA group.

For 2012, employee contributions totaled $118,273 and the District contributed an additional $25,815 on behalf of its employees.

Deferred Compensation Plans

By resolution, the District offers its employees two deferred compensation plans created in accordance with Internal Revenue Code Section 457. These plans are with The Hartford Financial Services Group, Inc., and with the Washington State Department of Retirement Systems (DRS) Deferred Compensation Program. The plans, available to all active employees, permit them 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.

The IRC of 1986, as amended, required the District to establish a trust exempt from tax under IRC Section 457 (g) and 501 (a). A trust was established with each of the plan administrators and the plan is operated for the exclusive benefit of the participants and their beneficiaries. The assets in the plans are not subject to any claims of the District's general creditors. The District has no liability for losses under the plan but does have the duty of due care that would be required of an ordinary prudent investor.

Participation in the Districts deferred compensation plans is voluntary on the part of the employee. Contributions to these plans are 100% employee funded.

NOTE 8 - TELECOMMUNICATION SERVICES

The District has installed and continues to build out a fiber optic backbone system in its service area for internal use by the Electric Department. In July of 2003, the District connected its fiber optic system to the Northwest Open Access Network's (NoaNet's) fiber optic communications system and began making excess capacity available at wholesale rates to retail service providers. These retail providers are in turn offering end users access to the District's fiber for Internet and point-to-point interconnections on a retail basis.

Wholesale Telecommunications operations and capital activity for the year ended December 31, 2012 follows:

Telecommunication Services	2012
Operating Revenues:	
Wholesale Fiber Services to ISP	$203,448
Installation Charges	$650
Other	$25,320
Total Revenues	$229,418
Operating Expenses	
Administration and General	$54,500
Repairs and Maintenance	$77,334
Network Coordinated Services	$42,000
Tower Lease	$9,900
Interconnection Access	$17,247
NOANET Repayments	$4,200
Other	$434
Total Operating Expenses	$205,615
Plant in Service	$5,780,015
Construction Work in Progress	$3,277,105

Northwest Open Access Network, Inc. (NoaNet)

The District, along with several other Washington State Public Utility Districts and Energy Northwest, is a member of NoaNet, a Washington nonprofit mutual corporation. NoaNet was incorporated in February 2000 to provide a broadband communications backbone, over Public Benefit Fibers leased from Bonneville Power Administration, throughout the Pacific Northwest for assisting its members in the efficient management of load, conservation and acquisition of electric energy as well as other purposes. The network began commercial operation in January 2001.

The management of NoaNet anticipates meeting debt obligations through profitable operations; however, there is no assurance NoaNet's plan will be achieved. During the start-up phase, NoaNet assessed its members to cover operating deficits.

As a member of NoaNet, the District has guaranteed certain portions of NoaNet debt based on its proportionate share and has entered into a Repayment Agreement to guarantee the debt of NoaNet. Under the Repayment Agreement, each Member acknowledges and agrees that it is a guarantor of the payment of principal and interest on the Bonds and is liable by assessment or otherwise to repay NoaNet for amounts due and owing with respect to such principal and interest up to each Member's Percentage Interest. NoaNet may assess its Members for their percentage share of principal and interest on the debt to the extent that NoaNet does not have sufficient funds to pay the debt.

Financial statements for NoaNet may be obtained by writing to: Northwest Open Access Network, Chief Financial Officer, 5802 Overlook Ave NE, Tacoma, WA 98422.

Broadband Technology Opportunities Program Grant

At its March 10, 2010 meeting, the NoaNet Board of Directors adopted a resolution accepting an American Recovery and Reinvestment Act - Broadband Technology Opportunities Program (BTOP) grant from the National Telecommunications and Information Administration. The total amount of the grant is $84,347,997. The District is one of seven sub-recipients and will receive $4,149,031 for two fiber build projects to underserved areas of Pacific County. At its March 16, 2010 meeting the District's Board of Commissioners, by motion, accepted the conditions and regulations of the award as stated in the grant. As a condition of the grant, the District will provide $2,627,194 in cash and in-kind contributions towards the two fiber builds, the cash portion being an amount that our Utility will budget for over the ensuing three years, the term of construction per the requirements of the grant. During 2011, the District received $609,874 in BTOP grant reimbursement. No BTOP reimbursement was received in 2012. All remaining reimbursement is expected to be received in 2013.

NOTE 9 - OTHER CHARGES & OTHER CREDITS

Other Charges and Credits as of December 31, 2012 follows:

Other Charges	2012
Deferred Regulatory Charges	$73,328
Unamortized Bond Discount	3,702
Total Deferred Charges	**$77,030**

Other Credits	2012
Derivative Liability	$68,107
Total Deferred Charges	**$68,107**

NOTE 10 - PRIOR PERIOD ADJUSTMENTS

Cumulative Effect of Restatement

The 2012 Statement of Revenues, Expenses and Change in Net position includes a line titled "Cumulative Effect of Restatement". The amount of the adjustment is $881,612 and is needed to correct the net position reported in 2011. In 2011, the District erroneously included Customer Advances for Construction of $1,168,934 in its reported net position. Further, the District should have (but did not) include Grant Advances of $287,322 in its calculation of Net Position. These two figures net to the amount of the adjustment.

Unbilled Revenue

In December of 2010, the District entered a prior period adjustment to retained earnings in the amount of $486,655. This entry was related to a change in accounting procedure for year-end revenue. In 2001, after the District switched from bi-monthly to monthly billing, it was decided that an entry should be made to capture revenue from energy sold in one year but not recognized until the following year. This required a reversing entry and a new entry to book this revenue in each ensuing year since 2001. One problem this created was it caused the general ledger to be out of balance when compared to the underlying customer accounts database. To correct this situation, the District decided to discontinue this entry and reversed the 2009 entry to retained earnings. The District considered the previous annual entries to be immaterial. In 2012 the District resumed booking unbilled revenue booking a total of $1,582,580.

NOTE 11 - CONTINGENT LIABILITIES AND LITIGATIONS

Pole Attachment Lawsuit

On December 28, 2007, the District filed a lawsuit in Pacific County Superior Court against three telecom companies that maintain their facilities as attachments on District owned poles. The suit alleges breach of contract, unjust enrichment and trespass and seeks a declaratory judgment and injunctive relief. The lawsuit stems from the telecom company's refusal to enter into an agreement governing their attachment to District owned poles as well as their refusal to pay the District's approved fees for attachment to its poles. The outcome of this lawsuit is not expected to have a material impact on the District's financial position. A trial was held on this matter during October 2010. See subsequent events for additional information

On March 15, 2011 the Court ruled in favor of the District, awarding over $600,000 in damages. The Districts counsel is currently dealing with the defendants attempted appeal.

As of December 31, 2012, the District was awaiting notification of date from the Court of Appeals.

Retiree Claim

On February 7, 2011, the District was named the defendant in a claim filed in Pacific County Superior Court. The plaintiffs in the claim are seeking damages from the District for alleged breach or anticipatory breach of express or implied agreements made for the benefit of the employee and the employee's spouse. The outcome of this claim is not expected to have a material impact on the District's financial position.

The superior court judge ruled against the District and subsequently a settlement was reached, the detail of which were still pending as of December 31, 2012.

NOTE 12 – RISK MANAGEMENT

PURMS Risk Pools

The District is a member of the Public Utility Risk Management Services Joint Self-Insurance Fund (PURMS), pursuant to the provisions of RCW 54.16.200, and inter-local governmental agreements. Currently there are 18 members of the Liability Pool, 17 members of the Property Pool and 12 members of the Health & Welfare Pool. The general objective of each Pool is to formulate, develop, and administer, on behalf of the members, a program of insurance to achieve lower costs for insured coverage, and to develop a comprehensive loss control program. Admission of a new member requires a supermajority vote of the current members (85%) of PURMS, or of a particular risk pool.

Members may withdraw from these Pools on December 31st of any year by giving 90 days prior notice. Upon termination, a member is responsible for contributions to the Pool for any unresolved, unreported, and in-process claims for the period which they were a signatory to the Pool agreement.

The business and affairs of the Pools are managed and governed by a Board of Directors. Each entity that is a member of a Risk Pool is entitled and required to appoint one designated director to the Board. The Pools are governed by rules established by the State of Washington Division of Risk Management, authorized under RCW 48.62, and are audited for compliance by the Division of Risk Management.

Liability & Property Pools

These Pools are fully funded by current and former members. Members file claims with the administrator, Pacific Underwriters in Seattle, Washington, which has been engaged to provide claims adjustment and loss prevention services.

The Liability Pool self-insures on a $1,000,000 Self Insured Retention (SIR) with a $250 deductible to the members. Coverage is on an occurrence basis. In addition, the Pool purchases excess liability coverage of $35,000,000, which also covers public official errors and omissions as well as employment practices claims.

PURMS maintains a self-insurance property pool with a $250,000 SIR, and a Pool excess limit of $200,000,000. The District and other members of the Pool have also purchased an additional property and vehicle policy, with coverage to $25,000,000.

During 2012, the District recognized $60,198 and $113,545 respectively, in property and liability insurance expense. During 2011, the District recognized $49,004 and $106,265 respectively, in property and liability insurance expense.

Health & Welfare Pool

The District is a member of the PURMS Health & Welfare Risk Pool (H&W Pool) which provides health and welfare insurance for District employees and dependents in accordance with the terms of the self-insurance agreement (SIA) and the terms of each member's respective coverage booklet, provided to employees.

The H&W Pool was established as one of PURMS risk pools effective March 31, 2000. The H&W Pool maintains reserves approximately equal to the sum of three times the amount of each member's historical average monthly H&W claims measured over the previous three years. The H&W Pool's ongoing operations are financed through monthly assessments of its participating members. Under such assessments, each month, each member of the H&W Pool pays the Pool the cost the Pool incurred during the preceding month for H&W claims for member employee coverage as well as the member's share, determined under the H&W Pool general assessment formula, of shared H&W costs.

Shared H&W costs include administrative expenses incurred by the pool, premiums for stop-loss insurance, PPO charges and shared H&W claims. H&W claims become a "shared" expense when and to the extent the cost of the claim exceeds the stop-loss point applicable to a particular member's employee or when the cost of the claim makes the total amount a particular member has paid towards the claims of its employees exceed the stop-loss point applicable to that member.

All stop-loss points are determined for each member and its' employees pursuant to the H&W Pool general assessment formula. During 2012 and 2011 PURMS maintained stop-loss insurance with a commercial carrier in the aggregate amount of $225,000 per insured.

Total health and welfare insurance expense recognized during 2012 was $1,299,766.

Based on its collective bargaining agreement (CBA) with IBEW Local No. 77, the District's contribution towards employees H&W coverage is set at 95% while the employees, through payroll deduction, contribute 5%. This District/Employee split will be subject to change with the expiration of the current CBA on March 31, 2015.

<u>State and Independent Audits of Pools</u>

Each of PURMS Risk Pools is audited annually by the State Auditor's Office. In addition, as required by state regulations, PURMS provides quarterly financial reports to the State Risk Manager reflecting the claims and administrative expenses of the Risk Pools and bi-annually, the State Risk Manager performs its own audit of PURMS Risk Pools. Finally, on an annual basis, PURMS engages the services of the accounting firm of Moss Adams to perform a claims audit for each of the Risk Pools.

<u>District Official Bond / Employee Practices</u>

The District also maintains with a commercial carrier, additional coverage in the amount of $250,000 per loss. The policy indemnifies any District official, required by law to give bonds for the faithful performance of their service, against loss through the failure of any employees under the official's supervision to faithfully perform his or her duties as prescribed by law, when such failure results in loss of money or property. The policy also covers employment practices claims.

<u>Unemployment Insurance</u>

The District is self-insured for unemployment compensation, in that it reimburses the state for actual claims made. Unemployment claims are infrequent; during 2012 the District recognized $14,969 in unemployment compensation expense.

NOTE 13 - OTHER POSTEMPLOYMENT BENEFITS (OPEB)

<u>Plan Description</u>

In accordance with collective bargaining agreements, the District provides employer paid post-retirement medical, vision, prescription and dental benefits for qualified retired employees and their eligible dependents. For employees retiring before September 1, 2009 the District contributes the percentage of the annual cost that was paid at the time of their retirement, this percentage ranges from 80% to 100%. For employees retiring after September 1, 2009, the District pays the same percentage of annual cost that it contributes for active employees, currently 95%.

Funding Policy
The District funds its post-retirement health care benefits when the actual health care costs are incurred for retirees and their eligible dependents. The District is currently evaluating the option of pre-funding all or a portion of the actuarial calculated ARC, but no decision has been made.

Annual OPEB Cost
The District's annual OPEB cost is calculated based upon the annual required contribution (ARC) of the employer. The ARC is an amount actuarially determined based on the entry age normal method, determined in accordance with the guidance of GASB Statement No. 45. The ARC represents level of funding that, if paid on an ongoing basis, is projected to cover the normal cost each year and amortize any unfunded actuarial liabilities over a period of thirty years. The District implemented GASB 45 prospectively in 2008. The District's annual required OPEB cost (expense) for 2012 was $1,464,421.

The following table shows the components for the District's annual OPEB cost for the year, the amount actually contributed to the plan, and changes in the District's net OPEB.

Determination of Annual Required Contribution	**December 31, 2012**
Normal Cost at year end	$706,484
Amortization of UAAL	$754,732
Annual Required Contribution (ARC)	$1,461,216
Determination of Net OPEB Obligation	
Annual Required Contribution	$1,461,216
Interest on prior year Net OPEB Obligation	$83,308
Adjustment to ARC	($80,103)
Annual OPEB Cost	$1,464,421
Contributions made	$508,594
Increase in Net OPEB Obligation	$955,827
Net OPEB Obligation – beginning of year	$2,082,688
Net OPEB Obligation – end of year	$3,038,515

Funded Status and Funding Progress
In 2012, the payment of employee health care benefits for retirees and qualified dependents totaled $508,594. The current year funding resulted in an accrued OPEB Liability of $3,038,515.

The District's annual OPEB cost, the percentage of OPEB cost contributed to the plan, and the net OPEB obligation follows:

Fiscal Year Ended	Annual OPEB Cost	Percentage of OPEB Cost Contributed	Net OPEB Obligation
12/31/2011	$1,464,372	30.53%	$2,082,688

The Schedule of Funding Progress for the unfunded actuarial accrued liability (UAAL) is as follows:

	Valuation Dated Jan 1, 2011	Valuation Dated Jan 1, 2008
Actuarial Value of Assets	$0	$0
Actuarial Accrued Liability	$19,594,003	$11,747,549
UAAL	$19,594,003	$11,747,549
Funded Ratio	0%	0%
Covered Payroll	N/A	N/A

<u>Actuarial Methods and Assumptions</u>
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. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities, consistent with the long-term perspective of the calculations.

In the January 1, 2011 actuarial valuation, the Entry Age Normal actuarial cost method was used. The actuarial assumptions used included a 4.00% discount rate, which is based upon the long-term investment yield on the investments that are expected to be used to finance the payment of benefits. The UAAL is being amortized on a closed basis at the assumed discount rate. The remaining amortization period at January 1, 2011 was 27 years.

NOTE 14 – POWER SUPPLY
<u>BPA Power Contract</u>
The District is a preference customer of the U.S. Department of Energy, Bonneville Power Administration (BPA) that supplies the primary source of the District's power under a contract, which expired on September 30, 2011.

At its November 18, 2008 meeting the District's Board of Commissioners passed Resolution No. 1274, authorizing the execution of a Slice/Block Power Sales Agreement with the Bonneville Power Administration commencing on October 1, 2011 and expiring on September 30, 2028.

These agreements incorporate provisions of the Pacific Northwest Electric Power Planning and Conservation Act of 1980 (Public Law 96-501) and the Bonneville Project Act of 1937 such as preference and priority in the distribution and marketing of BPA's federal power to publicly owned preference customers, such as the District. The contract provides federal power in amounts based on the District's annual Net Requirements in the form of two products: Block and Slice.

The Block product provides power in pre-agreed upon monthly amounts, ranging from 8,898 MWh to 16,526 MWh. The rate for Block power is the lowest applicable Priority Firm rate made available to BPA's preference customers.

The Slice product, on the other hand, provides the District with access to a more variable product: 0.28252% of the Federal System Output (the District's Slice), which is based on the output of the federal system each hour. The output consists of federal hydroelectric projects and some non-federal projects, including thermal projects such as Nuclear Project No. 2 (Columbia Generating Station).

The 2011 applicable base-rate for Slice purchases is $1,952,169 per month for each percent of Slice, with the adjusted base rate subject to an annual true up by BPA based upon updated actual costs allocated to the Slice System. Technical Operating Procedures have been established to provide Slice purchasers with the ability to calculate, schedule, and account for their share of Slice Output on an hourly basis. This product does not include transmission services. Moreover, by its nature, there is a greater degree of potential for exposure – and benefit – depending upon snow-pack amount and timing of runoff and other conditions that affect water, and therefore hydroelectric system output.

BPA reserves the right to implement a Load Based Cost Recovery Adjustment Charge (LBCRAC). The current LBCRAC is 0%.

<u>BPA Transmission Services</u>
The District traditionally purchased bundled electric power and transmission services from BPA under the District's power purchase contract. However, in response to changes in Federal Energy Regulatory Commission regulations in the late 1990s, BPA unbundled their electric power and transmission services, and required that transmission services be purchased separately.

As a result of BPA unbundling its Power Services from Transmission Services, the District entered into a Service Agreement for Network Integration Transmission Service with BPA on June 8, 2001. This agreement is set to expire on October 1, 2031. The agreement specifies that the transmission is used to serve the District's Net Requirements Load.

As a result of execution of the new Slice/Block Power Sales agreement, the District also executed a Point to Point Transmission (PTP) Service agreement with BPA on September 8, 2011. The PTP agreement allows the District to move power and gives greater flexibility in transporting electricity.

The Energy Authority
The Energy Authority (TEA) provides professional power supply management services including wholesale market purchases and sales of electricity on behalf of the District. TEA also provides power scheduling services to the District.

Power Market Risk Management Policies and Procedures
In early 2010 the District commenced with a comprehensive assessment of its risk profile, and the development of policies and procedures for risk management and trading operations. The results of this effort, completed in September 2011, are detailed guidelines for considering and/or engaging in any power trading agreements. The District's Risk Management Committee, with oversight and review by the Board of Commissioners, actively manages financial risk. The District will periodically update the risk management policy to incorporate improved procedures and practices

Total power cost for the year ending December 31, 2012 was $9,618,932. Power transmission cost for the year ending December 31, 2012 $1,224,512.

PUBLIC UTILITY DISTRICT NO. 2 OF PACIFIC COUNTY		
Directory of Officials		
Elective:		
Board of Commissioners	**Term**	**Expiration**
Diana Thompson – President	6 Years	December 2018
Ron Hatfield – Vice President	6 Years	December 2016
Michael Swanson – Secretary	6 Years	December 2014
Appointive:	**Title**	
Douglas L. Miller	General Manager	
Jeanne Ledford	Treasurer	
Renae Powell	Auditor	
James B. Finlay	Attorney	
Mailing Address:		
District:		**Attorney:**
405 Duryea Street		212 Pacific Avenue
PO Box 472		PO Box 755
Raymond, WA 98577		Long Beach, WA 98