Annual Financial Report

Public Utility District No.2

of

Pacific County,

Washington

2013

PUBLIC UTILITY DISTRICT NO. 2 Of PACIFIC COUNTY, WASHINGTON

2013 FINANCIAL REPORT

This report contains selected entries from the Washington State Auditor's Office Accountability Audit Report (report #1012360) 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, 2013 through December 31, 2013 (report #1012361). The Auditor's reports were issued August 5, 2014.

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Public Utility District No. 2 of Pacific County

January 1, 2013 through December 31, 2013

Description of the District

Public Utility District No. 2 of Pacific County
August 5, 2014

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 receives the majority of its power from the Bonneville Power Administration as a slice/block customer.

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 2013, the District operated on an annual budget of $36 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, 2013 through December 31, 2013

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 years ended December 31, 2013 and 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 5, 2014.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audits 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.

Independent Auditor's Report on Financial Statements

Public Utility District No. 2 of Pacific County
January 1, 2013 through December 31, 2013

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 years ended December 31, 2013 and 2012, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed on page 5.

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 audits. We conducted our audits 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, 2013 and 2012, and the changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

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 6 through 9 and information on postemployment benefits other than pensions on page 43 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 August 5, 2014 on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control over financial reporting and compliance.

Troy X. Kelley

TROY KELLEY
STATE AUDITOR

August 5, 2014

The following discussion and analysis of the financial results of Public Utility District No. 2 of Pacific County (District) provides an overview of the District's financial activities for the years ended December 31, 2013 and 2012, with additional comparative data for 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 is a municipal corporation with financial activities in the areas of electric and water. The operations of the District include the electric system, three water systems.

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, 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.

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)

	2013	2012	Change	% Change	2011
Current and Other Assets	$16,090	$14,236	$1,854	13.0%	$12,015
Net Capital Assets	48,718	47,847	871	1.8%	45,752
Other Noncurrent Assets	683	643	40	6.2%	844
Deferred Outflows of Resources	42	68	(26)	(38.2%)	28
Total Assets & Deferred Outflows	**65,533**	**62,794**	**2,739**	**4.4%**	**58,639**
Current Liabilities	3,791	5,017	(1,226)	(24.4%)	3,503
Noncurrent Liabilities	4,813	4,759	54	1.1%	3,639
Deferred Inflows of Resources	167	73	94	128.8%	44
Total Liabilities & Deferred Inflows	**8,771**	**9,849**	**(1,078)**	**(11.0%)**	**7,186**
Net Investment in Capital Assets	48,323	47,128	1,195	2.5%	44,767
Restricted for Debt Service	178	177	1	0.6%	431
Restricted for Construction	3,961	3,955	6	0.2%	3,947
Unrestricted	4,300	1,685	2,615	155.2%	2,308
Total Net Position	**$56,762**	**$52,945**	**$3,817**	**7.2%**	**$51,453**

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

	2013	2012*	Change	% Change	2011*
Operating Revenues					
Utility Sales & Service Fees	$22,317	$23,581	($1,264)	(5.4%)	$21,305
Other	568	543	25	4.6%	554
Non-operating Revenues					
Interest Income	20	16	4	25%	36
Other Income	2,525	18	2,507	---%	1,084
Total Revenues	**25,430**	**24,158**	**1,272**	**5.0%**	**22,979**
Operating Expenses					
Power Supply	11,390	10,843	547	5.0%	10,891
Operations & Maintenance	2,432	2,385	47	2.0%	2,144
Administrative	5,633	5,570	63	1.1%	5,199
Taxes & Depreciation	4,161	4,135	26	.6%	3,940
Non-operating Expenses					
Interest & Other	16	33	(17)	(51.5%)	661
Total Expenses	**23,632**	**22,966**	**666**	**2.9%**	**22,835**
Income (Loss) Before Capital Contributions	**1,798**	**1,192**	**606**	**50.8%**	**144**
Capital Contribution	2,019	1,181	838	71.0%	660
Change in Net Position	**3,817**	**2,373**	**1,444**	**60.9%**	**804**
Beginning Net Position	52,945	51,453			50,649
Cumulative Effect of Restatement**		(881)			
Beginning Net Position as Restated	52,945	50,572	2,373	4.7%	50,649
Ending Net Position	**$56,762**	**$52,945**	**$3,817**	**7.2%**	**$51,453**

**Certain amounts reported with the 2012 and 2011 financial statements have been reclassified to conform to the 2013 presentation.*

*** See Note 9 for additional information.*

Financial Analysis

During 2013, the District's overall financial position improved significantly and results of operations improved. The District's net position increased by $3.8 million compared to an increase in net position of $1.5 million in 2012. The following narrative is an analysis of the change in net position by major components of income.

Operating Revenues

During 2013, revenue from Utility Sales and Service Fees dropped $1.3 million when compared to 2012. As mentioned in the 2012 MD&A, 2012 revenue was buoyed by a $1.6 million credit resulting from the resumption of the year end accrual of unbilled revenue. When this accrual is backed out, Utility Sales and Services are nearly flat year to year.

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 9) while the balance reflects the first full year of the rate increase implemented in October 2011.

Non-operating Revenues

Other non-operating revenue increased over $2.5 million in 2013 which is driven by grant reimbursement associated with the District's Broadband Technologies Opportunities Program (BTOP) Grant.

Other Income decreased $1.1 million between 2012 and 2011. The District received no BTOP related grant reimbursement in 2012 while over $1 million was received in 2011.

Operating Expenses
Overall Operating Expenses were up $683,000 when compared to 2013, the largest individual increase coming in Power Supply expense which increased $547,000 over 2012. The main contributing factor here is decreases in net balance market activity, due in large part to additional balance market purchases required to meet load during periods of cold weather / high demand. 2012 Power Supply expense was relatively flat when compared to 2011, decreasing by $48,000.

Other components of 2013 Operating expense (Operation and Maintenance, Administrative, Taxes and Depreciation) all saw modest increases, totaling $136,000 or 3.7% in comparison to 2012.

In 2012, Administrative expense increased $371,000 overall from 2011. The increase was driven by a continued escalation in health care costs which added $181,000. Attorney fees associated with the pole attachment action contributed an additional $128,000. These increases were offset in part, by a decrease in outside engineering firm expense which saw a drop of $103,000 which was led by a favorable rebate from our L & I retro group. District funded conservation measures contributed an additional $188,000 to the increase in this category.

2012 Operational and Maintenance costs increased $241,000 when compared to 2011. 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.

2012 Tax and Depreciation expense was up $195,000, with taxes contributing $150,000 and depreciation $46,000. 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.

Non-Operating Expenses
Interest and Other expense was relatively flat from 2012 to 2013; while this category decreased $628,000 from 2011 to 2012. During 2011, the District refunded the then outstanding portion of its 2001 bonds, leaving only minimal long term debt. Interest expense dropped accordingly.

Capital Contributions
Capital Contributions, primarily reimbursement received from customers for extending District facilities on their behalf, increased $838,000 from 2012 to 2013. This increase was driven by Telecom line extension fees received from Cellular providers expanding their presence in the District's service territory utilizing PUD owned fiber. Capital contributions increased $521,000 from 2011 to 2012

Capital Asset and Long-Term Debt Activity
The District's net capital additions including construction work-in-progress were approximately $871,000 in 2013 and $2.1 million in 2012. Total additions to capital assets were $3.1 million in 2013 and $4.9 million in 2012 and consisted 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 2013 fiscal year, the District had $395,000 in outstanding long term debt, a decrease of $325k from the prior year. At the end of 2012, the District had $719k in outstanding long term debt, a decrease of $266k from 2011.

The District has not undertaken any additional debt obligations in 2013, 2012 or 2011 and is on schedule to make its final debt service payment on its 2007 bond in 2014. See Notes 6 and 14 to the financial statements and for additional information on the long-term debt.

Summary of Financial Position

The assets of the District exceeded its liabilities at the end of 2013 by $56.8 million (net position). $4.3 million of this amount represents unrestricted net position, which may be used to meet ongoing obligations. Net investment in capital assets accounted for $48.3 million or 85 percent of the Districts net position. The District's overall financial position improved in 2013, with an increase in net position of $3.8 million.

At the end of 2012, the assets of the District exceeded its liabilities by $52.9 million (net position). $1.7 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 over 2011.

Other Significant Matters

2013 saw the completion of construction and most reporting and financial reimbursement activities associated with the District's participation in the BTOP Grant financed expansion of its fiber backbone within the County.

The District also completed its second full year as a BPA's Slice/Block customer in 2013. The actual runoff for water year 2013 at The Dalles came in at 97.8 MAF. Overall, water year 2013 was slightly below average (102.4 MAF). Water year 2012 was well above average coming in at 127.4 MAF. Notwithstanding power price volatility, lower than average water years generally increase market purchases and lower potential market sales. During 2013, the District reported net income from balance market activity of $423,816. This was down considerably from 2012 when $1,090,392 was reported.

Effective October 1, 2013, the District implemented a 3% PCA to its retail rates in response to increases by Bonneville in its wholesale power and transmission rates.

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.

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.

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

As of December 31, 2013 and 2012

		2013		2012
ASSETS AND DEFERRED OUTFLOWS OF RESOURCES				*(As restated)*
ASSETS				
CURRENT ASSETS				
Cash & Cash Equivalents				
Unrestricted Cash & Cash Equivalents	$	4,099,369	$	2,460,508
Restricted Construction Account		3,961,219		3,955,006
Investments (Note 1)		-		255,346
Accounts Receivable, net		2,505,941		2,257,531
Accrued Unbilled Revenues (Note 9)		1,877,043		1,582,580
Inventory - Materials & Supplies		3,581,045		3,637,602
Prepaid Expenses & Option Premiums		65,118		87,056
Total Current Assets		**16,089,735**		**14,235,629**
NONCURRENT ASSETS				
Restricted Bond Reserve Fund (Note 1)		177,685		177,406
Other Receivables		338,982		388,982
Other Charges (Note 9)		166,756		77,030
Subtotal Noncurrent Assets		**683,423**		**643,418**
Utility Plant (Note 4)				
Land and Intangible Plant		1,132,808		1,130,092
Electric & Water Plant in Service		92,411,688		87,391,739
Construction Work in Progress		6,114,625		7,999,619
Less: Accumulated Depreciation		(50,941,511)		(48,674,607)
Net Utility Plant		48,717,610		47,846,843
Total Noncurrent Assets		**49,401,033**		**48,490,261**
TOTAL ASSETS		**65,490,768**		**62,725,890**
DEFERRED OUTFLOWS OF RESOURCES				
Accumulated Decrease in Fair Value of Hedging Derivatives (Note 3)		42,158		68,107
Total Deferred Outflows of Resources		**42,158**		**68,107**
TOTAL ASSETS AND DEFERRED OUTFLOWS OF RESOURCES	**$**	**65,532,926**	**$**	**62,793,997**

NET POSITION, LIABILITIES AND DEFERRED INFLOWS OF RESOURCES				*(As restated)*
LIABILITIES				
CURRENT LIABILITIES				
Accounts Payable		2,610,594		3,729,188
Accrued Taxes Payable		501,915		484,810
Other Accrued Liabilities		-		-
Current Portion Of Personal Time Off		525,135		524,762
Accrued Interest Payable		2,012		3,335
Revenue Bonds, Current Portion (Note 6)		151,362		274,283
Total Current Liabilities		**3,791,018**		**5,016,378**
NONCURRENT LIABILITIES				
Revenue Bonds & Other Long Term Debt (Note 6)		243,205		444,920
Personal Time Off		52,329		46,723
Accrued Other Post Employment Benefits		3,921,631		3,038,515
Customer Advances for Construction		-		635,178
Customer Deposits		553,732		525,515
Other Credits & Liabilities		42,158		68,107
Total Noncurrent Liabilities		**4,813,055**		**4,758,958**
Total Liabilities		**8,604,073**		**9,775,336**
DEFERRED INFLOWS OF RESOURCES				
Accumulated Increase in Fair Value of Hedging Derivatives (Note 3)		166,756		73,328
Total Deferred Inflows of Resources		**166,756**		**73,328**
NET POSITION				
Net Investment in Capital Assets		48,323,042		47,127,640
Restricted for Debt Service		177,685		177,407
Restricted for Construction		3,961,219		3,955,006
Unrestricted		4,300,151		1,685,280
Total Net Position		**56,762,097**		**52,945,333**
TOTAL NET POSITION, LIABILITIES AND DEFERRED INFLOWS OF RESOURCES	**$**	**65,532,926**	**$**	**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, 2013 and 2012

	2013	2012 *(As restated)*
OPERATING REVENUES		
Sales of Electric Energy & Water - Retail	$ 22,316,967	$ 23,581,304
Broadband Revenue	261,153	229,418
Other Revenue	307,350	313,558
Total Operating Revenues	**22,885,470**	**24,124,280**
OPERATING EXPENSES		
Power Supply	11,390,276	10,843,444
Transmission Operation & Maintenance	-	33,210
Distribution Operation & Maintenance	2,194,927	2,146,538
Broadband Expense	237,360	205,615
Customer Accounting, Collection and Information	813,202	837,336
Administrative & General Expense	4,819,484	4,733,112
Taxes	1,331,272	1,276,932
Depreciation	2,830,225	2,857,571
Total Operating Expenses	**23,616,746**	**22,933,759**
OPERATING INCOME (LOSS)	**(731,276)**	**1,190,521**
NONOPERATING REVENUES & EXPENSES		
Interest Income	19,682	15,809
Other Income	75,209	2,463
Grant Reimbursement	2,450,021	15,181
Other Expense	(10)	(6,659)
Interest Expense	(12,233)	(22,140)
Debt Discount/Premium Amortization & Bond Issue Costs	(3,702)	(2,953)
Total Nonoperating Revenues & Expenses	**2,528,967**	**1,701**
INCOME BEFORE CONTRIBUTIONS	**1,797,691**	**1,192,222**
CAPITAL CONTRIBUTIONS	2,019,073	1,181,269
CHANGE IN NET POSITION	**3,816,764**	**2,373,491**
TOTAL NET POSITION, BEGINNING OF YEAR	**52,945,333**	**51,453,454**
CUMULATIVE EFFECT OF RESTATEMENT (see note 9)		**(881,612)**
TOTAL NET POSITION, BEGINNING OF YEAR AS RESTATED		**50,571,842**
TOTAL NET POSITION, END OF YEAR	**$ 56,762,097**	**$ 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, 2013 and 2012

	2013	2012 (As restated)
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash Received from Customers and Counterparties	$ 22,302,858	$ 22,611,938
Cash Paid to Suppliers and Counterparties	(16,672,433)	(13,719,876)
Cash Paid to Employees for Services	(3,458,136)	(3,038,571)
Taxes Paid	(1,331,272)	(1,276,957)
Net Cash Provided by Operating Activities	**841,017**	**4,576,534**
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisition of Capital Assets	(3,700,991)	(4,952,464)
Proceeds from Sale of Revenue Bonds	0	0
Cash Defeasance Principal and Interest	0	0
Bond Principal Paid	(274,636)	(266,351)
Bond Interest Paid	(15,935)	(25,093)
Capital Contributions	2,019,073	1,181,269
Grant Reimbursement	2,450,021	15,181
Other	51,776	1,040
Net Cash Used by Capital and Related Financing Activities	**529,308**	**(4,046,418)**
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest Income	19,682	15,809
Change in Investments	255,346	254,280
Purchase of Investments	-	-
Net Cash Provided (Used) by Investing Activities	**275,028**	**270,089**
NET INCREASE (DECREASE) IN CASH	**1,645,353**	**800,205**
CASH BALANCE, BEGINNING OF YEAR	**6,592,920**	**5,792,715**
CASH BALANCE, END OF YEAR	**8,238,273**	**6,592,920**

RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES		
Operating Income (Loss)	(731,276)	1,190,521
Adjustments to reconcile net operating income to net cash provided by operating activities:		
Depreciation & Amortization	2,830,225	2,857,571
(Increase) Decrease in Unbilled Revenues	(294,463)	(1,582,580)
Increase (Decrease) in Net OPEB Obligation	883,116	955,827
Misellaneous Other Revenue & Receipts	23,424	(5,236)
Decrease (Increase) in Accounts Receivable	(248,410)	89,868
Decrease (Increase) in Inventories	56,557	103,837
Decrease (Increase) in Prepaid and Other Purchased Power Expense	(309)	(15,103)
Decrease (Increase) in Deferred Derivative Outflow	25,949	(40,447)
Increase (Decrease) in Deferred Derivative Inflow	93,428	28,892
Increase (Decrease) in Warrants Outstanding	-	(24,815)
Increase (Decrease) in Accounts Payable	(1,112,616)	1,546,704
Increase (Decrease) in Accrued Taxes Payable	17,105	31,396
Increase (Decrease) in Customer Deposits	28,216	3,749
Increase (Decrease) in Other Current Liabilities	(1,323)	(1,000)
Increase (Decrease) in Other Credits	(728,606)	(562,648)
Net Cash Provided by Operating Activities	**$ 841,017**	**$ 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	
	2013	2012	2013	2012
RESIDENTIAL	19,183,832	17,931,804	$ 1,467,793	$ 1,348,978
NUMBER OF CUSTOMERS			*14,996*	*14,998*
GREEN POWER			$ 2,207	$ 2,333
COMMERCIAL	5,150,510	4,948,947	$ 422,618	$ 399,893
NUMBER OF CUSTOMERS			*1,544*	*1,534*
PUBLIC AUTHORITY	2,442,623	2,376,009	$ 195,791	$ 184,285
NUMBER OF CUSTOMERS			*435*	*434*
INDUSTRIAL	2,050,800	2,010,000	$ 105,225	$ 101,699
NUMBER OF CUSTOMERS			*2*	*3*
IRRIGATION	196	196	$ 3,876	$ 3,882
NUMBER OF CUSTOMERS			*64*	*64*
PUBLIC LIGHTING	11,984	12,278	$ 9,042	$ 9,179
STREET & HIGHWAY LIGHTING	46,849	46,849	$ 5,239	$ 5,239
TOTAL SALES	28,886,794	27,326,083	$ 2,211,792	$ 2,055,489
TOTAL NUMBER OF CUSTOMERS			*17,041*	*17,033*
SELF CONSUMED	68,363	63,382	$ -	$ -
TOTAL	28,955,157	27,389,465	$ 2,211,792	$ 2,055,489

ENERGY PURCHASED
MONTH END DECEMBER

	MONTH		YEAR TO DATE	
	2013	2012	2013	2012
COST OF POWER	$ 1,369,516	$ 941,528	$ 10,216,544	$ 9,618,932
TOTAL KWH PURCHASED	38,786,466	33,541,182	305,444,730	303,584,771
COST PER KWH	$ 0.0353	$ 0.0281	$ 0.0334	$ 0.0317
MAXIMUM DEMAND--KW	76,412	57,712		
TOTAL KWH PURCHASED	(38,786,466)	(33,541,182)	(305,444,730)	(303,584,771)
KWH SOLD	28,886,794	27,326,083	285,071,177	285,854,970
KWH SELF-CONSUMED	68,363	63,382	635,203	663,880
KWH VARIANCE: GAIN\(LOSS)	(9,831,309)	(6,151,717)	(19,738,350)	(17,065,921)
KWH Variance %	*-25.3%*	*-18.3%*	*-6.5%*	*-5.6%*

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

	KILOWATT HOURS		REVENUE	
	2013	**2012**	**2013**	**2012**
RESIDENTIAL	176,852,599	179,571,558	$ 13,774,734	$ 13,848,693
NUMBER OF CUSTOMERS				
GREEN POWER	0	0	$ 27,273	$ 28,045
COMMERCIAL	56,333,298	55,964,338	$ 4,586,020	$ 4,570,696
NUMBER OF CUSTOMERS				
PUBLIC AUTHORITY	26,016,803	25,872,656	$ 2,047,877	$ 2,028,919
NUMBER OF CUSTOMERS				
INDUSTRIAL	24,433,200	23,082,600	$ 1,212,529	$ 1,158,780
NUMBER OF CUSTOMERS				
IRRIGATION	728,465	654,393	$ 84,301	$ 80,313
NUMBER OF CUSTOMERS				
PUBLIC LIGHTING	144,624	147,197	$ 109,376	$ 102,875
STREET & HIGHWAY LI	562,188	562,228	$ 62,898	$ 62,907
TOTAL SALES	285,071,177	285,854,970	$ 21,905,008	$ 21,881,228
TOTAL NUMBER OF CUSTOMERS				
SELF CONSUMED	635,203	663,880	$ -	$ -
TOTAL	285,706,380	286,518,850	$ 21,905,008	$ 21,881,228

PUBLIC UTILITY DISTRICT NO. 2 OF PACIFIC COUNTY

Notes to Financial Statements

For Fiscal Years Ended December 31, 2013 and 2012

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of Public Utility District No. 2 of Pacific County (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.

The District's financial statements include the financial position of electric and water systems and results of their operations. In the combined statements certain intersystem transactions, such as intersystem loans, interest on intersystem loans, and intersystem administrative charges are eliminated to combine total balances.

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 (and certain related agreements) separate restricted funds are required to be established. The assets held in these funds are restricted for specific uses including construction, debt service and other special reserve requirements.

The restricted assets are composed of the following:

	2013	2012
Bond Reserve	177,685	177,406
Construction Funds	3,961,219	3,955,006

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. The District's allowance for doubtful accounts was $26,714 and $42,304 as of December 31, 2013 and 2012.

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 12/31/2013	Carrying Amount	Market Value
Certificates of Deposit	0	0

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

I. Compensated Absences

Personal Leave

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. 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.

In accordance with the terms and conditions of the Health Reimbursement Arrangement – Voluntary Employees' Beneficiary Association (HRA-VEBA) Plan, the CBA and/or District Resolution:

- Personal Leave is payable in full upon an employee's resignation or death.
- At retirement, the District will deposit the cash value of any unused PL hours to the retirees HRA-VEBA account.

<u>Supplemental Leave Bank</u>
Employees with sick leave balances remaining under the terms of the former sick leave plan were able to transfer the balance into a Supplemental Leave Bank (SLB). No additional hours may be posted to the SLB.

In accordance with the terms and conditions of the HRA-VEBA Plan, the CBA and/or District Resolution:

- 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 balances receive an annual transfer of the cash value of up to16 SLB hours to their respective HRA-VEBA accounts,
- Employees who leave employment due to resignation or retirement forfeit any remaining hours in their respective SLBs
- In the event of the death of an active employee, the surviving dependents shall receive 50% of the cash value remaining in the deceased employee's SLB

Changes in the Compensated Absences during the current and prior fiscal period are as follows:

Balance as of December 31, 2012	$571,485
Earned during 2013	530,741
Taken during 2013	524,762
Balance as of December 31, 2013	$577,464
Balance as of December 31, 2011	$518,447
Earned during 2012	474,970
Taken during 2012	421,932
Balance as of December 31, 2012	$571,485

The District estimates $525,135 will be used in the next fiscal year. The current and noncurrent liability for unpaid personal time off appears on the statement of net position.

See Note 7 – Pension Plans for additional information on the HRA-VEBA plan.

J. Purchase Commitments

See Note 13 – Power Supply; for contracts with the Bonneville Power Administration and others for future power supply.

K. Reclassification

Certain amounts reported with the 2012 financial statements have been reclassified to conform to the 2013 presentation. Such reclassifications would have no effect on previously reported results of operations and cash flows.

L. Revenue Recognition

Revenues from retail sales of electricity include an estimate for energy delivered to customers between the last billing date and the end of the year. This amount is reflected in the accompanying financial statements in the amount of $294,463 at December 31, 2013 and $1,582,580 at December 31, 2012.

M. Contributed Capital

Capital contributions for the District consist mainly of line extension fees. Line extension fees represent amounts collected to recover the costs of installing new lines. Capital contributions are recorded as revenues when received.

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).

Custodial credit risk – Deposits. For a deposit, this is the risk that in the event of a bank failure, the District's deposits may not be returned to it. The District's deposits and certificates of deposit are entirely covered by the Federal Depository Insurance Commission (FDIC) or by collateral held in a multiple financial institution collateral pool administered by the PDPC. Under state law, public depositories under the PDPC are required to pledge securities as collateral at 100 percent of all deposited uninsured public funds. As a result, deposits covered by collateral held in the multiple financial institution collateral pool are considered to be insured. State law requires that deposits may only be made with institutions that are approved by the PDPC.

For balance sheet purposes, the Washington State Treasurer's Local Government Investment Pool (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.

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 be used or sold by the reporting entity in the normal course of business are generally considered "normal purchases and normal sales." These transactions are excluded 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, 2013 the District had the following hedging derivative instruments outstanding:

Changes in Fair Value			Fair Value at December 31, 2013			
Classification		Amount	Classification		Amount	Notional
Other Credit	$	(42,158)	Deferred Outflow	$	42,158	3,120 MWh
Other Charge	$	166,756	Deferred Inflow	$	(166,756)	27,080 MWh

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

Changes in Fair Value			Fair Value at December 31, 2012			
Classification		Amount	Classification		Amount	Notional
Other Credit	$	(68,107)	Deferred Outflow	$	68,107	4,800 MWh
Other Charge	$	73,328	Deferred Inflow	$	(73,328)	5,760 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, 2013, was as follows:

	Beginning Balance	Increase	Decrease	Ending Balance
Utility Plant Not Being Depreciated:				
Land	$1,130,092	$2,716		$1,132,808
Construction in Progress	7,999,619		(1,884,994)	6,114,625
Total	**9,129,711**	**2,716**	**(1,884,994)**	**7,247,433**
Utility Plant Being Depreciated:				
Transmission Plant	4,757,896			4,757,896
Distribution Plant	62,965,566	1,854,283	(273,740)	64,546,109
Telecom Plant	5,780,016	3,515,300	(6,807)	9,288,509
General Plant	11,505,699	173,447	(437,040)	11,242,106
Water Plant	2,382,562	194,506		2,577,068
Total	**87,391,739**	**5,737,536**	**(717,587)**	**92,411,688**
Less: Accumulated Depreciation	(48,674,607)	(2,830,225)	563,321	(50,941,511)
Total Net Utility Plant	**$47,846,843**	**$2,910,027**	**$(2,039,260)**	**$48,717,610**

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: Accumulated Depreciation	(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 2013.

NOTE 5 –LEASES

The District is committed under annual operating leases for office equipment. Lease expense for the years ended December 31, 2013 and 2012 amounted to $13,503 and $13,541 respectively. For these leases, the minimum annual lease commitments for 2014 and 2015 are approximately $13,600. These leases expire in October 2015. The District had no capital leases during 2013.

NOTE 6 - LONG-TERM DEBT

During the year ended December 31, 2013, 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	$377,356	-	$(250,315)	$127,041	$127,041
DWSRF Loan – Bay Center Water, interest at .5%, maturing in 2024	462,091	291,847	-	(24,321)	267,526	24,321
Totals	**$2,038,241**	**$669,203**	**-**	**($274,636)**	**$394,567**	**$151,362**

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, interest at .5%, maturing in 2024	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. See Note 14 for additional information.

Year	Principal	Interest	Total
2014	$ 151,362	$ 3,858	$ 155,220
2015	$ 24,321	$ 1,216	$ 25,537
2016	$ 24,321	$ 1,094	$ 25,415
2017	$ 24,321	$ 973	$ 25,294
2018	$ 24,321	$ 851	$ 25,172
2019-2023	$ 121,600	$ 2,432	$ 124,032
2024-2028	$ 24,321	$ 122	$ 24,443
Total	$ 394,567	$ 10,546	$ 405,113

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.

<u>Intersystem Loan to Lebam Water System</u>

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 loan is eliminated in the combined financial statements and is not included in the totals presented in the accompanying financial statements.

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, 2012:

Active Plan Members	150,590
Terminated Plan Members Entitled to But Not Yet Receiving Benefits & Retirees and Beneficiaries Receiving Benefits	112,757
Total	**263,347**

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, as of December 31, 2013, are as follows:

	PERS Plan 1	PERS Plan 2	PERS Plan 3
Employer 1/1/2013-6/30/2013	7.21%	7.21%	7.21%
Employee 1/1/2013-6/30/2013	6.00%	4.64%	*
Employer 7/1/2013-8/31/2013	9.19%	9.19%	9.19%
Employee 7/1/2013-8/31/2013	6.00%	4.92%	*
Employer 9/1/2013-12/31/2013	9.21%	9.21%	9.21%
Employee 9/1/2013-12/31/2013	6.00%	4.92%	*

** 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 ended December 31 were as follows:

	PERS Plan 1	PERS Plan 2	PERS Plan 3
2013	$0	$332,263	$18,879
2012	$0	$265,559	$20,820

The District's payroll subject to PERS plans for the years ended December 31, 2013 and 2012 was $4,296,846 and $3,983,723 respectively. The District's total payroll for all employees for the same periods was $4,443,478 and $4,099,307 respectively.

HRA VEBA
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 2013, employee contributions totaled $99,644 and the District contributed an additional $31,402 on behalf of its employees. In 2012, employee contributions were $118,273 and the District contributed $25,815.

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 years ended December 31, 2013 and 2012 follows:

Telecommunication Services	2013	2012
Operating Revenues:		
Wholesale Fiber Services to ISP	$235,833	$203,448
Installation Charges (Capital Contributions)	$775,905	$650
Other	$25,320	$25,320
Total Revenues	$1,037,058	$229,418
Operating Expenses		
Administration and General	$69,930	$54,500
Repairs and Maintenance	$80,022	$77,334
Network Coordinated Services	$42,000	$42,000
Tower Lease	$11,700	$9,900
Interconnection Access	$20,089	$17,247
NOANET Repayments	$4,200	$4,200
Other	$9,419	$434
Total Operating Expenses	$237,360	$205,615
Plant in Service	$9,288,509	$5,780,016
Construction Work in Progress	$1,385,135	$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.

NoaNet recorded an increase in net position (excluding member assessments) of $25,346,160 in 2013, and an increase of $47,709,253 for 2012. In accordance with Accounting Principles Board Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock, as well as a position statement issued by the Washington State Auditor concerning the appropriate accounting treatment for NoaNet, a proportionate share of the changes in net position has not been recorded by the District. NoaNet had positive net position of $99,474,750 as of December 31, 2013, and positive net position of $74,128,591 as of December 31, 2012.

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 10th, 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 16th, 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 the District 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. BTOP reimbursement received in 2013 totaled $2,450,021 which includes $2,245,568 in cash and $204,453 in assets transferred from NOANET to the District. All remaining funds, approximately $545,000, are expected to be received in 2014.

NOTE 9 - 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 2012 beginning net position. In 2011, the District erroneously included Customer Advances for Construction of $1,168,634 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. This change in policy 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 net assets. The District considered the previous annual entries to be immaterial.

In 2012 the District reinstated its policy for recording unbilled revenue booking a total of $1,582,580. In 2013, the District reversed the 2012 accrual and accrued $1,877,043 for 2013. This had a net positive impact on 2013 revenue of $294,463.

NOTE 10 - CONTINGENT LIABILITIES AND LITIGATIONS

<u>Pole Attachment Lawsuit</u>

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 Note 15 - 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.

In January 2014, the District received notification that oral arguments before the Court of Appeals would be heard on March 5, 2014.

<u>Retiree Claim</u>

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. In July 2013, the District paid $117,898, including reimbursement for premiums paid, interest and statutory fees to the attorney for the claimants as directed by the Pacific County Superior Court and agreed upon by the parties.

NOTE 11 – PUBLIC ENTITY RISK POOLS / OTHER COVERAGE

<u>LIABILITY RISK POOL</u>

A. Liability Pool – Primary Self-Insured and Excess Coverages

The Public Utility Risk Management Services (hereinafter, "PURMS") provides liability insurance coverages for its members participating in the Liability Risk Pool, and to a limited extent for the benefit of their employees, under an agreement entitled "PURMS Joint Self-Insurance Agreement" (amended and restated as of November 10, 2011 ("SIA"). Under the SIA, from 1977 through 1995, the Liability Pool had a self-insured retention (or "Liability Coverage Limit") of $500,000 per occurrence. Effective January 1, 1996, PURMS increased the Liability Coverage Limit to $1,000,000 per occurrence, which was the coverage limit in effect for 2013, and in effect as of December 31, 2013.

At all times, PURMS maintains excess liability insurance for its members in the Liability Pool. For 2013, the first layer of excess liability coverage, in which all Liability Pool members must participate, was $35,000,000 in excess of the Liability Pool's $1,000,000 liability coverage limit.

The Liability Pool also offers an additional layer of Excess Liability Insurance coverage for those members that choose to participate. For 2013, this additional Excess Liability Insurance layer was $25,000,000 in excess of $35,000,000. During 2013, the District chose not to carry this layer of coverage.

Finally, the Liability Pool offers public officials liability coverage for a subgroup of members of the Liability Pool who chose to participate in the coverage. For 2013, the Public Officials coverage was $35,000,000 excess of the liability coverage limit. The District is a member of this subgroup.

B. Liability Pool – Funding Level and Assessment Mechanisms

As a general matter, the Liability Pool is funded to the amount of its Designated Liability Pool Balance, which in 2013 was $3,000,000. Of this amount, $500,000 is used to pay claims costs as they are incurred and ongoing liability pool operating expenses, including program administration (collectively, "Operating Funds"). The $500,000 of operating funds is replenished by assessments of liability pool members, as described below. The remaining $2,500,000 of the designated balance is held by the liability pool to meet regulatory reserve requirements, as described in paragraphs C. – E. below. Assessments to fund operation of the liability pool are triggered automatically in accordance with the terms of the liability general assessment formula. An automatic annual assessment is issued at the beginning of each calendar year to replenish the liability pool to its $3,000,000 designated balance. Automatic interim assessments are issued to replenish the $3,000,000 designated balance whenever the Liability Pool's cash and investments are depleted to the amount of the liability pool's automatic assessment "trigger", which in 2013 was $500,000 below the designated balance, or at $2,500,000. In this manner, the Liability Pool: (a) pays for its claims costs and operating expenses on an ongoing basis while generally maintaining cash and investments between $3,000,000 and $2,500,000; and (b) starts every new fiscal year by replenishing the Liability Pool's actual balance to its $3,000,000 designated balance.

C. Liability Pool – WAC Program Funding Requirements
As required by WAC 200-100-03001(1), at the close of each fiscal year, PURMS obtains an actuarial report for the liability pool from an independent qualified actuary ("Actuarial Report") which, among other things, sets the "expected" (i.e. 55%) and 70% confidence levels for the program's unpaid claims as of the end of the fiscal year. WAC 200-100-00301(2) then requires the liability pool to establish and maintain *primary assets* (defined by WAC 200-100-020(20) to mean "cash and investments") at or above the "expected" confidence level and to establish and maintain *total assets* (i.e. cash and investments plus "secondary assets") at or above the 70% confidence level.

D. Liability Pool – Funding Methodology
The Liability Pool funding methodology ensures compliance with the WAC program funding requirements by adopting the 70% confidence level required for "total assets" funding under WAC 200-100-03001(3) as its minimum level of "primary assets" funding (rather than using the lower 55% confidence level designated by WAC 200-100-03001(2) as the minimum permitted primary asset funding) (hereinafter, "70% Funding Level"). As a result, the 70% Funding Level, which coincides with the actuarially established 70% confidence level, is the minimum amount to which Liability Pool cash and investments could be reduced by payment of claims costs and operating expenses before triggering an automatic assessment to return the Liability Pool to its $3,000,000 designated balance (regardless of the amount at which the actual balance trigger is set, *see* discussion in next paragraph below). Furthermore, so long as the 70% funding level is established at an amount *below* the Liability Pool's $2,500,000 actual balance trigger (as it has been in the past and was in 2013, see paragraph E. below), then the Liability Pool's cash and investments are unlikely to be depleted to the 70% funding level before an automatic interim assessment of all Liability Pool members (which under the PURMS interlocal agreement must be paid within 30 days of issuance) replenishes the Liability Pool's actual balance to the amount of its $3,000,000 designated balance (see paragraph E. below).

Finally, the Liability Pool's funding methodology ensures the pool ultimately maintains its cash and investments at an amount greater than the 70% confidence level, even if an actuarial report established that number at an amount in excess of the actual balance trigger. The funding methodology accomplishes this by triggering an automatic interim assessment when the actual balance drops *either* to the $2,500,000 actual balance trigger *or* to the 70% funding level, *whichever amount is greater*. (See paragraph B. above and paragraph E. below) Thus, if trends in claims experience or the assertion of a major claim resulted in the 70% confidence level increasing to an amount that *exceeded* the $2,500,000 actual balance trigger, then the 70% funding level would become the Liability Pool's automatic assessment trigger.

A copy of the actuarial report for the liability pool is provided to the Washington State Risk Manager ("SRM") and made available to the State Auditor.

E. Liability Pool – 2013 Claims Payments and Operating Funding Levels
The total paid for Liability Claims in 2013 was $692,960, including claims adjustment expenses, i.e. costs and attorneys' fees for defending claims (but excluding Liability Pool operating expenses).

For 2013, the Liability Pool's Designated Balance was $3,000,000. The 70% confidence level for the Liability Pool established by the actuarial report in effect for 2013 was $2,008,991, an amount that is $491,009 *less than* the Liability Pool's $2,500,000 actual balance trigger for an automatic assessment. In January 2013, the automatic annual assessment replenished the Liability Pool to its $3,000,000 designated balance. For the remainder of 2013, an automatic interim assessment to replenish the Liability Pool's actual balance to $3,000,000 was triggered whenever the actual balance dropped to $2,500,000, an amount substantially in excess of the $2,008,991 minimum 70% confidence level applicable to the Liability Pool in 2013.

F. Liability Pool – Pending Claims at Year End – Assessments to Replenish Cash Assets to Designated Balance

As of December 31, 2013, there were 57 known incidents or unresolved liability claims pending against one or more members or former members of the Liability Pool. The total dollar amount of the risk posed by these claims to such members and to the Liability Pool itself is unknown and can only be estimated. The case reserves set by the administrator for these Claims, as of December 31, 2013, was $198,668. The Liability Pool's actual balance was replenished to the $3,000,000 designated balance via the automatic annual assessment issued in January 2014.

G. Liability Pool – Members' Contractual Obligations relating to Paying Pending Liability Claims and IBNR Liability

Because the total dollar amount of the risk posed by the pending liability claims is based on case reserves estimated by the administrator, and because the amount of "incurred-but-not-reported" claims is based on the actuarial report, no opinion can be provided and no representation is made as to the risk the total of such pending liability claims and IBNR Liability pose to the solvency of the Liability Pool. However, as a contractual matter, since the PURMS' interlocal agreement requires members participating in the Liability Pool to pay their liability assessments within thirty (30) days of the date they are issued, assuming that these assessment obligations of members are enforceable and that the members are at the time solvent and pay such assessments, the Liability Pool would have the assets to pay the pending liability claims and IBNR liability on behalf of its participating members for any reasonably foreseeable risk such claims pose to the Liability Pool.

<u>PROPERTY RISK POOL</u>

A. Property Pool – Primary Self-Insured and Excess Coverages

PURMS provides property insurance coverage for its members participating in the Property Risk Pool in accordance with the terms of the SIA. Under the SIA, from its inception in 1997 to the present, the Property Pool has had a self-insured retention or "Property Coverage Limit" of $250,000 per property loss.

At all times, PURMS also maintains excess property insurance for its members in the Property Pool. For 2013, the amount of the excess property insurance was $200,000,000, with excess coverage attaching at the $250,000 property coverage limit for all property losses except those subject to increased retention levels for certain property risks.

The Property Pool also provides its members with automatic extended property coverage for property losses that exceed the Property Pool's $250,000 property coverage limit if those losses were also subject to increased retentions under the excess property insurance. Under the excess property insurance retentions in effect for 2013, the maximum exposure to the Property Pool from a property loss that exceeded $250,000, and that was subject to an increased retention, was $250,000, less the applicable deductible, or a maximum of $250,000 more than the Property Coverage Limit.

B. Property Pool – Funding Level and Assessment Mechanisms
As a general matter, the Property Pool is funded to the amount of its designated Property Pool balance, which in 2013 was $750,000. Of this amount, $250,000 is used to pay claims costs as they are incurred and ongoing Property Pool operating expenses, including program administration. The $250,000 of Operating Funds is replenished by assessments of property pool members, as described below. The remaining $500,000 of the Designated Balance is held by the Property Pool to meet regulatory reserve requirements, as described in paragraphs C. – E. below.

Assessments to fund operation of the Property Pool are triggered automatically in accordance with the terms of the Property General Assessment Formula. An Automatic Annual Assessment is issued at the beginning of each calendar year to replenish the Property Pool to its $750,000 designated balance. Automatic interim assessments are also issued to replenish the $750,000 designated balance at any time during the year that the Property Pool's cash and investments is depleted to the amount of the Property Pool's Automatic Assessment Trigger, which in 2013 was $500,000.
In this manner, the Property Pool: (a) pays for its claims costs and operating expenses on an ongoing basis while generally maintaining cash and investments between $750,000 and $500,000; and (b) starts every new fiscal year by replenishing the Property Pool's actual balance to its $750,000 designated balance.

C. Property Pool – WAC Program Funding Requirements and Property Pool Funding Methodology
The Property Pool is governed by the same requirements contained in WAC § 200-100-03001 regarding "actuarially determined liabilities, program funding and liquidity" that apply to the Liability Pool. (See paragraph C. and footnote 3 regarding the Liability Pool above.) Therefore, the same funding methodology as described for the Liability Pool in paragraph D. above was also adopted for the Property Pool. In particular, the Property Pool funding methodology uses the actuarially established 70% funding level as the minimum amount to which Property Pool's "primary assets" (i.e. its cash and investments) can be reduced by payment of claims costs and operating expenses before triggering an automatic assessment to return the Property Pool to its $750,000 designated balance.

Also, like the Liability Pool, the Property Pool funding methodology ensures the Property Pool ultimately maintains its cash and investments at an amount greater than the 70% funding level by triggering an automatic interim assessment whenever the actual balance drops *either* to the $500,000 actual balance trigger *or* to the 70% funding level, *whichever amount is greater*. (See paragraph B. above and paragraph D. below).

A copy of the actuarial report for the Property Pool is provided to the SRM and made available to the State Auditor.

D. Property Pool – 2013 Claims Payments and Operating Funding Levels
The total paid for property claims in 2013 was $129,510, including claims adjustment expenses (but excluding Property Pool Operating Expenses).

For 2013, the Property Pool's designated balance was $750,000. In January 2013, the automatic annual assessment replenished the Property Pool to its $750,000 designated balance. Thereafter, for the remainder of 2013, automatic interim assessments to replenish the Property Pool's actual balance to $750,000 were triggered whenever the actual balance dropped to $516,974. This was the amount PURMS believed represented the 70% confidence level, and therefore the 70% funding level, in effect for 2013.

Since the 70% funding level of $516,974 exceeded the Property Pool's $500,000 actual balance trigger, during 2013, automatic interim assessments were triggered at $516,974 rather than at the lower $500,000 actual balance trigger.

E. Property Pool – Pending Claims at Year End – Assessments to Replenish Cash Assets to Designated Balance
As of December 31, 2013, there were 12 known property claims pending from the members of the Property Pool. The total dollar amount of the risk posed by these claims to the Property Pool is unknown and can only be estimated. The case reserves set by the administrator for these claims, as of December 31, 2013, was $285,074. The Property Pool's actual balance was replenished to its $750,000 designated balance via the automatic annual assessment issued in January 2014.

F. Property Pool – Members' Contractual Obligations relating to Paying Pending Property Claims and IBNR Liability
Because the total dollar amount of the risk posed by the pending property claims is based on case reserves estimated by the administrator, and because the amount of "incurred-but-not-reported" claims (IBNR Liability) is based on the actuarial report, the District has received no opinion as to the risk the total of such pending property claims and IBNR liability pose to the solvency of the Property Pool. However, as a contractual matter, since the Interlocal Agreement requires members participating in the Property Pool to pay their property assessments within thirty (30) days of the date they are issued, assuming that these assessment obligations of members are enforceable and that the members are at the time solvent and pay such assessments, the Property Pool would have the assets to pay the pending property claims and IBNR liability on behalf of its participating members for any reasonably foreseeable risk such claims pose to the Property Pool.

<u>HEALTH & WELFARE (H&W) RISK POOL</u>
A. H&W Pool – Primary Self-Insured and Stop-Loss Coverage
PURMS provides health and welfare insurance coverage for the employees of each of its members participating in the Health & Welfare Risk Pool in accordance with the terms of the Health & Welfare Coverage of the SIA and the terms of each Member's respective Coverage Booklet provided to its Employees. The H&W Pool was established as one of PURMS' Risk Pools effective March 31, 2000.

B. H&W Pool – Funding Level and Assessment Mechanisms
Under the terms of the interlocal agreement and the H&W General Assessment Formula the H&W Pool is funded with cash reserves in an amount approximately equal to the sum of three (3) times the amount of each Member's historical average monthly H&W Claims Experience for its respective employees and their dependents. Unless required otherwise by the H&W pool funding methodology (see paragraph E. below), the Pool Claims Experience Reserves (of three (3) times each member's historical average monthly H&W Claims Experience) shall be deemed its "*Designated* H&W Pool Reserves". The H&W Pool members' H&W claims experience was reevaluated and recalculated in June 2011, establishing the designated H&W Pool Reserves at $2,185,474. Every month, a portion of the H&W Pool Reserves is used for paying H&W Claims and H&W Pool Operating Expenses, and the funds spent are replenished monthly by assessments of the H&W Pool members, as described below. The remaining reserves are held by the H&W Pool to meet regulatory reserve requirements, as described in paragraphs D., E. and G. below.

The H&W Pool's operations are financed through assessments of its participating members in accordance with the H&W General Assessment Formula. Under the H&W Assessment Formula, each month, each Member of the H&W Pool is assessed for: (a) the cost the H&W Pool incurred during the preceding month for the H&W claims for such member's employees; and (b) for such member's share of Shared H&W Costs. Shared H&W Costs consist of administrative expenses incurred by the H&W Pool, premiums for Stop-Loss Insurance, PPO charges and Shared H&W Claims.

Thus, under the H&W assessment formula, each month: (1) the operating expenses of the H&W Pool and all members' H&W claims costs for that month are paid; and (2) the H&W Pool reserves are replenished by these assessments to the amount of the Designated H&W Pool Reserves.

C. H&W Pool – Limits on Members' Self-Insured Exposures to the H&W Claims Costs of their Respective Health Plans

1. Stop-Loss Insurance acquired by H&W Pool
The exposure of each H&W Pool Member to the H&W Claims Costs of its Employees is limited by two different pairs of stop-loss points. The first pair of Stop-Loss Points is established annually by the Excess Stop-Loss Insurance that the H&W Pool acquires and maintains for its Members. These Stop-Loss Points represent the dollar amounts at which the Stop-Loss Insurance attaches and begins paying either the H&W Claim Costs relating to an individual employee's total medical claims for the year or the H&W Claims Costs of all employees of all members for the year.

For 2013, the H&W Pool Individual Stop-Loss Point was $225,000 per employee and the H&W Pool Aggregate Stop-Loss Point was $15,643,814 for the combined H&W Claims Costs of the employees of all members of the H&W Pool.

2. Shared H&W Claims within H&W Pool
Each H&W Pool member's exposure to the H&W claims costs of its employees is further limited by even lower Stop-Loss Points determined by the H&W Pool for its members.

Medical expenses that exceed these Stop-Loss Points become “Shared H&W Claims” and therefore are assessed as “Shared H&W Costs” which are paid by all H&W Pool members except the member whose employee’s H&W Claim exceeded the applicable Stop-Loss Point. The member Stop-Loss Points are calculated annually under the H&W assessment formula based on the amounts of the individual and aggregate Stop-Loss Points established for the year by the Stop-Loss Insurance.

As a result of this process, each member is assigned a dollar amount at which any further payments by the H&W Pool on claims for a particular employee constitute Shared H&W Costs and a dollar amount at which any further payments by the H&W Pool on the H&W Claims of all of a member’s employees constitute Shared H&W Costs.

3. Scope of Members’ Self-Insured Exposures

Except for H&W Claims which are shared claims because they exceed a member’s individual Stop-Loss point, and the portions of claims that are covered by Stop-Loss Insurance because they exceed a member’s Aggregate Stop-Loss Point, each member and its Health Plan is solely responsible for paying the member’s H&W claims costs and the assessments issued to the member to cover those claims costs and the member’s share of H&W pool operating costs. Except for obligations relating to shared claims, no other H&W pool member or health plan, nor the H&W Pool, is required to pay anything towards the member’s H&W claims costs or assessments to cover those costs.

D. H&W Pool – WAC Program Funding Requirements

WAC 200-110-040 requires jointly self-insured health and welfare program reserves to be funded at the amount determined by the formula set forth in WAC 200-110-040(1), or at the amount of the actuarially determined program liability if the program does not establish program and contingency reserves in accordance with the formula. *See* WAC § 200-110-040(2).

WAC 200-110-040(3) also requires a program to establish reserves for prescription drug, dental and vision benefits in the minimum amount of eight (8) weeks of program expenses allocable to those benefits. (See paragraph G. below.)

E. H&W Pool –Funding Methodology

The H&W Pool Funding Methodology allows the H&W Pool to determine the minimum funding requirements for the H&W Pool Reserves by establishing the program liability for medical benefits either by actuarial report or under the formula in WAC 200-110-040(1). Like the funding methodology for the Liability and Property Pools, the H&W Pool funding methodology also requires funding action and specifies the funding mechanisms in the event of an increase in H&W claims experience that results in establishing the program liability in excess of the amount of the designated H&W Pool reserves.

F. H&W Pool – 2013 H&W Claims Payments

The total paid by the H&W Pool for H&W Claims Costs in 2013 was $11,514,071 (including shared H&W claims but excluding H&W pool operating expenses).

G. H&W Pool – H&W Claims IBNR and Designated H&W Pool Reserves
The most recent actuarial report for the H&W Pool, dated February 3, 2014, states that the H&W Pool's incurred-but-not-reported reserve liability for medical coverage is $880,647.

The Report states that this number reflects the actuary's "…best estimates of the amounts for which the PURMS H&W Pool would be liable if the [medical] benefit program had terminated on December 31, 2013…"

In addition, as directed by WAC 200-110-040(3), the administrator has determined that eight weeks of program expenses for prescription drug, dental and vision benefits was $305,998, $165,577 and $31,802, respectively. These numbers are based on the monthly average expenditures for these benefits over a twelve month period of claims experience ending December 31, 2013.

The Medical IBNR of $880,647 established by the Actuarial Report and the eight weeks of program expenses calculated by the Administrator for prescription drug, dental and vision benefits, in the combined amount of $503,377, results in a total H&W Pool reserves requirement under WAC 200-100-040 of $1,384,024, as of December 31, 2013. The amount of the designated H&W Pool Reserves as of December 31, 2013 was $2,185,474. Under the H&W assessment formula, the monthly H&W assessment of each member pays for the H&W claims costs of the previous month and its allocation of shared H&W costs to replenish the H&W Pool to the amount of the designated H&W Pool reserves. (See paragraph B. above).

H. H&W Pool – Members' Contractual Obligations relating to Paying H&W Pool Program Liability
Because the H&W Pool program liability is based on the actuarial report, and on the administrator's calculations for prescription drug, dental and vision benefits, no opinion can be provided and no representation is made as to the risk the known and IBNR Claims that make up that program liability pose to the solvency of the H&W Pool. However, as a contractual matter, since the Interlocal Agreement requires each member participating in the H&W Pool to pay its H&W assessment on a monthly basis within twenty (20) days of the date it is issued to fully replenish its share of the H&W Pool Reserves, assuming that these assessment obligations of members under the SIA are enforceable and that the members are at the time solvent and pay such assessments, the H&W Pool would have the assets to pay the program liability on behalf of each of its participating members.

Further, for reasons discussed in paragraph C.3 above, the District has been provided no representations relating to the solvency of any H&W Pool member or its health plan, or the ability of the member or Health Plan to pay its assessments issued by the H&W Pool.

State and Independent Audits

PURMS and each of PURMS' Risk Pools are audited annually by the State Auditor's Office. As required by WAC 200-100-060(3) and 200-110-130(2), on an annual basis, PURMS submits audited financial statements, in the format prescribed by the State Auditor's office, to the State Risk Manager's Office. 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.

OTHER COVERAGE

District Official Bond / Employee Practices

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.

Unemployment Insurance

The District is self-insured for unemployment compensation, in that it reimburses the state for actual claims made. Unemployment claims are infrequent; during 2013, the District recognized $16,840 and $14,969 in 2012, in unemployment compensation expense.

NOTE 12 - OTHER POSTEMPLOYMENT BENEFITS (OPEB)

Plan Description

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 and for 2013 was $1,461,216.

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, 2013**	**December 31, 2012**	**December 31, 2011**
Normal Cost at year end	$706,484	$706,484	$706,484
Amortization of UAAL	$754,732	$754,732	$754,732
Annual Required Contribution (ARC)	$1,461,216	$1,461,216	$1,461,216
Determination of Net OPEB Obligation			
Annual Required Contribution	$1,461,216	$1,461,216	$1,461,216
Interest on prior year Net OPEB Obligation	$121,541	$83,308	$42,614
Adjustment to ARC	($121,541)	($80,103)	($39,458)
Annual OPEB Cost	$1,461,216	$1,464,421	$1,464,372
Contributions made	$578,100	$508,594	$447,037
Increase in Net OPEB Obligation	$883,116	$955,827	$1,017,335
Net OPEB Obligation – beginning of year	$3,038,515	$2,082,688	$1,065,353
Net OPEB Obligation – end of year	$3,921,631	$3,038,515	$2,088,688

<u>Funded Status and Funding Progress</u>
In 2013, the payment of employee health care benefits for retirees and qualified dependents totaled $578,100. The current year funding resulted in an accrued OPEB Liability of $3,921,631.

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
12/31/2012	$1,464,421	34.73%	$3,038,515
12/31/2013	$1,461,216	39.56%	$3,921,631

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	$3,975,825	N/A

The Schedule of Funding Progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information that shows whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

<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 2011 valuation used a projected payroll increase of 4% per year and a medical inflation rate of 7.9% grading down to 4.7% (see table below).

Year Ending December 31	Retiree Premiums and Claims*
2011	7.9%
2012	7.2%
2013	6.6%
2014	6.0%
2020	5.9%
2030	5.8%
2040	5.5%
2082+	4.7%

** Combined Medical and Dental*

The UAAL is being amortized on a closed basis at the assumed discount rate. The remaining amortization period at January 1, 2011 was 30 years.

NOTE 13– POWER SUPPLY

BPA Power Contract

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 flat, but shaped monthly amounts. The power ranged from 12MW to 23MW. The rate for Block power is the lowest applicable Priority Firm rate made available to BPA's preference customers.

The Slice product provides the District with a 0.28252% share of the output of the augmented Tier 1 System capability Federal Based System (FBS).

The currently applicable base-rate for Slice purchases is $1,961,053 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%.

BPA Transmission Services

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 years ending December 31, 2013 and 2012 was $10,216,543 and $9,618,932, respectively. Power transmission cost for the years ending December 31, 2013 and 2012 was $1,173,732 and $1,224,512, respectively.

NOTE 14 – SUBSEQUENT EVENTS

2014 Bond Issue

In early 2014, the District began work on issuing bonds to finance approximately $15,000,000 in future capital improvement projects. The proceeds will also provide funding for the bond reserve account and cover the cost of issuance.

Pole Attachment Lawsuit

On March 5th, 2014 Division II of the Washington State Court of Appeals, heard oral arguments from the District and the attaching companies after receiving extensive briefing from both sides. As of this writing, no decision has been handed down.

Required Supplementary Information
Other Postemployment Benefits
For the Year Ended December 31, 2013

Actuarial Valuation Date	Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability (AAL)* (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll [(b-a)/c]
1/1/2008	-	$11,747,549	$11,747,549	0%	N/A	N/A
12/31/2008	-	$11,747,549	$11,747,549	0%	$3,602,534	326.1%
12/31/2009	-	$11,747,549	$11,747,549	0%	$3,794,016	309.6%
12/31/2010	-	$11,747,549	$11,747,549	0%	$3,761,334	312.3%
12/31/2011	-	$19,594,003	$19,594,003	0%	$3,975,825	492.8%
12/31/2012	-	$19,594,003	$19,594,003	0%	$3,983,723	491.9%
12/31/2013	-	$19,594,003	$19,594,003	0%	$4,296,846	456.0%

**based on Entry Age actuarial cost method*
N/A Indicates data not available
Source: Milliman, Inc.

Fiscal Year Ending	Total Employer Contributions	Annual Required Contribution (ARC)	Percentage of ARC Contributed
12/31/2008	430,739	774,549	55.6%
12/31/2009	425,347	774,549	54.9%
12/31/2010	415,061	774,549	53.6%
12/31/2011	447,037	1,461,216	30.6%
12/31/2012	508,594	1,461,216	34.8%
12/31/2013	578,100	1,461,216	39.6%