Report of Independent Auditors and
Combined Financial Statements for

Public Utility District No. 1 of Klickitat County

December 31, 2013 and 2012

MOSS ADAMS LLP

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REPORT OF INDEPENDENT AUDITORS

The Board of Commissioners
Public Utility District No. 1 of Klickitat County

Report on Financial Statements

We have audited the accompanying combined financial statements of Public Utility District No. 1 of Klickitat County (the District), which comprise the combined statements of net position as of December 31, 2013 and 2012 and the related combined statements of revenues, expenses, and changes in net position and cash flows for the years then ended, and the related notes to the combined financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these combined 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 combined 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 combined financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the combined financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the combined financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the combined 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 entity'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 combined financial statements.

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

REPORT OF INDEPENDENT AUDITORS (continued)

Opinion

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of the District as of December 31, 2013 and 2012 and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 15 to the financial statements, the District adopted the accounting requirements of Governmental Accounting Standards Board Statement No. 65, Items Previously Reported as Assets and Liabilities and changed their application of an accounting policy, Regulatory Assets and Liabilities, which resulted in the restatement of previously reported amounts for the year ended December 31, 2012. Our opinion is not modified with respect to this matter.

Other Matter

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 4 through 12 be presented to supplement the basic combined financial statements. Such information, although not a part of the basic combined financial statements, is required by the Government Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic combined 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 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 combined 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.

Moss Adams LLP

Portland, OR
June 30, 2014

DIRECTORY OF OFFICIALS

Office	Official	Term	Term Expiration
Board of Commissioners			
President	Randy L. Knowles	6 years	December 2018
Vice President	Dan G. Gunkel	6 years	December 2014
Secretary	Ray A. Mosbrucker	6 years	December 2016
Appointed Officials			
General Manager	James R. Smith	1313 S. Columbus	
Attorney	Pacifica Law Group LLP	1191 2nd Avenue, Suite 2100 Seattle, WA 98101	

This section provides an overview and analysis of key data presented in the basic combined financial statements for the years ended December 31, 2013 and 2012. Information within this section should be read in conjunction with the basic combined financial statements and accompanying notes.

About Public Utility District No. 1 of Klickitat County

Public Utility District No. 1 of Klickitat County (the District) consists of the electric system, eight water systems and five wastewater systems. The District also operates two additional water and wastewater systems that are owned by other public entities. The District's service area covers approximately 1,680 square miles in Klickitat County. The District also serves small areas in the surrounding counties of Yakima, Skamania, and Benton. As of December 31, 2013, the District had 12,324 electric, 1,124 water and 1,187 wastewater customers. The District's transmission business line and electric wholesale activities are significant parts of the District's electric system business. Wholesale revenues are generated from the sale of the output from the 26 MW H.W. Hill Methane Facility (Landfill Gas II Project), and from the White Creek Wind I power purchase contract, which the District owns 13% of the generated output from this 205 MW project. The transmission business line is comprised of 230 kV transmission lines and substations that carry renewable generation by others to the BPA transmission system.

Overview of the Combined Financial Statements

The financial statements of the District report the self-supporting, proprietary activities of the District funded primarily by the sale of power, water and wastewater services. The District reports these business-type activities using the accrual basis of accounting in accordance with Generally Accepted Accounting Principles (GAAP). The accrual accounting method recognizes all revenues and expenses incurred during the year, regardless of when cash is received or paid.

The basic financial statements, presented in a comparative format for the years ended December 31, 2013 and 2012, are comprised of:

> **Statement of Net Position:** This statement presents information on the District's assets and liabilities, with the difference between the two reported as net position, and provides information regarding the nature and amount of resource investment (assets) and obligations incurred in the pursuit of such resources. The statement also provides a vehicle for evaluating the capital structure as well as assessing the liquidity and financial flexibility of the District.
>
> **Statement of Revenues, Expenses, and Changes in Net Position:** This statement reflects the transactions and activities that have increased or decreased the District's total economic resources during the period. Revenues and expenses are classified as operating or non-operating based on the type of transaction. The statement may also be used as a partial determinant of creditworthiness.

Statement of Cash Flows: The Statement of Cash Flows provides information concerning the sources and uses of cash during the reporting period resulting from operating, financing, and investing activities. This information provides insight into the District's ability to generate net cash flows to meet obligations as they become due, and is an important indicator of the District's liquidity and financial strength.

The Notes to Financial Statements, presented at the end of the basic financial statements, provide additional information that is essential to a full understanding of the financial statements, as described above, including significant accounting policies, commitments, obligations, risks, contingencies and other financial matters of the District.

The District's 2012 financial statements were restated due to the following:

The Government Accounting Standards Board (GASB) issued Statement No. 65, Items Previously Reported as Assets and Liabilities. This standard requires reclassification of certain items as deferred outflows of resources or deferred inflows of resources, and recognition of outflows of resources or inflows of resources that were previously reported as assets and liabilities. Debt issuance costs fell into this category, and the District recognized all remaining unamortized debt issuance costs as expense in the 2012 period. As part of the District's implementation of GASB No. 65, Power Cost Stabilization and Deferred Revenue were also retroactively restated.

In 2013, the District retroactively adopted Regulatory Accounting policies and procedures, which were applied to certain capital assets that had been donated to the District and recognized as Non-Cash Contributions in Aid of Construction (CIAC) in the period of donation. The District has reclassified the donations as Deferred Inflows of Resources and will recognize the CIAC over the lives of the assets

Condensed Comparative Financial Information

Combined statement of net position

	2013	2012 *As restated*	2011 *As restated*
Capital assets	$ 220,650,478	$ 222,303,198	$ 227,511,508
Current, restricted, and other assets and deferred outflow of resources	56,991,140	58,316,844	61,909,345
Total assets and deferred outflows of resources	$ 277,641,618	$ 280,620,042	$ 289,420,853
Long-term liabilities and deferred inflow of resources	$ 166,573,614	$ 168,856,202	$ 170,691,305
Current liabilities	10,519,075	9,978,351	12,390,980
Total liabilities and deferred inflow of resources	177,092,689	178,834,553	183,082,285
Net investment in capital assets	$ 83,917,588	$ 83,437,537	$ 90,825,703
Restricted - bond funds	12,164,533	12,155,694	11,761,136
Restricted - rate stabilization fund	-	800,000	1,966,887
Unrestricted	4,466,808	5,392,258	1,784,842
Total net position	100,548,929	101,785,489	106,338,568
Total liabilities, deferred inflow of resources and net position	$ 277,641,618	$ 280,620,042	$ 289,420,853

Financial Highlights – 2013

- For the year ended December 31, 2013, the District met its compliance and financial policy obligations with a debt service coverage ratio of 1.40.
- The second phase of the electric rate increase of 5% was implemented April 1, 2013. The two-phase electric rate increase was adopted on August 28, 2012 by the District's Commissioners. This action consisted of a 7% electric rate increase effective October 1, 2012 and a 5% electric rate increase effective April 1, 2013.
- District Management met with each local community where it provides water and/or wastewater services to review operations, financial performance, and projected future projects. Following a public rate hearing, water and wastewater rates were revised for nine systems – eight systems had rate increases ranging from 1% to 5%, while one system had a rate decrease of 5%.

- The District receives transmission revenues for providing transmission services for the White Creek Wind I, Harvest Wind, Tuolumne, Windy Flats, Linden Farms and Windy Point wind projects, and from the Goldendale Energy Center, a 248 MW natural gas-fired combined cycle combustion turbine electric generating facility owned and operated by Puget Sound Energy. The revenue received from this line was $5,131,582 in 2013.

- Since 2012, the District has utilized The Energy Authority (TEA) to manage its day-to-day marketing and purchasing functions and to evaluate the District's Risk Management hedging strategies and power sale contracts. The District continues to focus on maximizing the value of our day-ahead and month-ahead surplus and deficits, and on incorporating prior year experience and best practices.

- The District Commissioners adopted Resolution No. 1672 allowing the use of Regulatory Accounting for any individual capital contributions exceeding $1 million, retroactive to 2009, to better align the revenues and depreciation for these facilities.

- The Bickleton Water System was officially created when the District Commissioners adopted Resolution No. 1649. USDA Rural Development approved a grant/loan in the amount of $650,000/$200,000, respectively. Additionally, the Klickitat County Commissioners committed grant funding assistance from the Klickitat County Landfill Gas Improvement Fund of $250,000. This funding will be used by the District to construct a new water system in the town of Bickleton to address nitrate issues of private wells.

- During 2013, work was completed on the Roosevelt Water New Source and Pipeline Project. With funding assistance from the Klickitat County Landfill Gas Improvement Fund, this project was constructed without the Roosevelt Water System having to incur any debt.

- The District entered into a $2.5 million Credit Facility Agreement with Bank of the West.

- Final payment was made on the 1973 Lyle Water and Sewer System Revenue Bond debt of $163,200.

- Federal government sequestration reduced the scheduled refunds from our participation in the 2009 Build America Bonds (BABS) Program by $41,414 in 2013.

- The District revised the useful lives of certain Landfill Gas II Project in-service assets, which was considered a change in accounting estimates for the year ended December 31, 2013.

- Health insurance premiums charged to employees and to COBRA and retiree participants were increased 10% effective January 1, 2013 to address increases in plan expenses.

Financial Highlights – 2012

- For the year ended December 31, 2012, the District exceeded its debt service coverage compliance obligation of 1.12.

- In January 2012, the District experienced a severe ice storm that required the reconstruction of several miles of line across the entire county and totaled $1.66 million. The District was eligible for reimbursement from FEMA comprised of both Federal and State funds totaling $1.452 million.

- On August 28, 2012, the District's Commissioners adopted a 12.0% Electric Rate Increase to be implemented in two phases – 7.0% effective October 1, 2012 and 5.0% effective April 1, 2013.

- On July 10, 2012, the District's Commissioners adopted a resolution to integrate the Cliffs Water System into the Electric System to provide benefit to the entire county.

- In 2012, the District capitalized an additional $22.0 million of the Landfill Gas II Project. The project is a 26 MW gas-fired combustion turbine and steam recovery generating facility located at the Roosevelt, Washington landfill.

- The District receives transmission revenues for providing transmission services for the White Creek Wind I, Harvest Wind, Tuolumne, Windy Flats, Linden Farms and Windy Point wind projects, and from the Goldendale Energy Center, a 248 MW natural gas-fired combined cycle combustion turbine electric generating facility owned and operated by Puget Sound Energy. The revenue received from this business-line was approximately $5,387,000 in 2012.

- In 2012, the District took its final draw of $158,605 on the Drinking Water State Revolving Fund Loan for the Glenwood Water System. The District expended a total of $792,443 of the approved $1,175,566 budget, resulting in a 32.6% savings. The project replaced distribution lines and developed an additional water source for the Glenwood Water System, lifting moratoriums on new connections due to undersized distribution lines.

- District Management met with each local community where it provides water and/or wastewater services to review operations, financial performance, and projected future projects. System rate increases were adopted to address cash flow needs and cash reserves for future projects.

Financial Analysis

Capital Activity

2012 to 2013:
Net utility plant for the District increased $2.6 million during 2013. The District completed several large projects including a new electric feeder out of Spearfish Substation for the Dallesport area, many new transmission pole changes, a new well and piping in Roosevelt, new 6-inch water lines in Lyle, and transfer of its radio system to narrow band.

Implementation of the Futura Mapping System was also completed during 2013, which improves outage management, inventory control, and customer service engineering design. Additionally, the District capitalized the remaining construction costs of the Landfill Gas II Project.

2011 to 2012:
Net utility plant for the District increased $5.2 million during 2012. In early 2012, the District experienced a severe ice storm, and as a result, multiple capital improvements for affected distribution lines were executed. In addition, the District completed several other large projects, which included the Glenwood Water System, Timber Road Radio Site, and Fisher Hill Bridge. The District also capitalized an additional portion of the Landfill Gas II Project generation facility equating to $22.0 million during 2012.

Debt Activity

2012 to 2013:
During 2013, the District made principal payments of $3,325,000 and $192,949 toward its electric bond debt and water/wastewater loans, respectively. A first draw in the amount of $96,749 was taken from the District's Public Works Trust Fund $500,000 Loan for the Lyle Water System Project. The loan has an interest rate of 0.50% and 20 year term.

2011 to 2012:
The District took a final draw of $158,605 on the Drinking Water State Revolving Fund Loan and completed the Glenwood Water project.

Current, Restricted, and Other Activity

2012 to 2013:
The District expended the remaining balance of the 2011 capital construction bond proceeds in 2013. Also, the District increased its Power Cost Stabilization Fund balance by $400,000 to $2,800,000.

2011 to 2012:
The District expended $5.6 million of the construction funds in 2012 on electric capital projects. The remaining $1.5 million balance of the 2011 capital construction bond proceeds will be fully utilized in 2013.

Overall Results of Operations

2012 to 2013:
The District saw improvement in its results of operations primarily due to rate increases, improvements in wholesale electric power prices, cost management practices, and adoption of Regulatory Accounting policies and procedures.

2011 to 2012:
The District's 2012 results are a reflection of economic conditions in a diversified utility. The District's wholesale segment is subject to external pricing impacts, whereas the retail segment is less cyclical. The District met 2012 forecast targets by implementing rate increases and managing operational expenses.

Electric system operating results

	2013	2012 *As restated*	2011 *As restated*
Operating revenues	$ 40,064,800	$ 36,286,740	$ 31,439,253
Operating expenses	37,528,015	39,565,360	30,128,991
Operating income (loss)	2,536,785	(3,278,620)	1,310,262
Net non-operating revenue (expense)	(5,597,246)	(5,163,050)	(1,464,230)
Capital contributions	1,608,378	2,720,574	947,114
Change in net position	$ (1,452,083)	$ (5,721,096)	$ 793,146

Operating Revenues

2012 to 2013:
Total operating revenues increased by 10.4% in 2013. Major contributors to the 2013 positive results were the April, 2013 implementation of the second phase of the 2012 approved retail rate increase of 5.0% and a 22.5% increase in Generation revenue due to higher than planned output from the H.W. Hill generation facility as well as improved wholesale electric power prices.

2011 to 2012:
The Electric System produced a 12.5% increase in operating revenues between 2011 and 2012. The majority of this increase is attributed to additional wholesale sales through the Landfill Gas II Project and the first full year of the Slice contract with BPA. Retail electric rates were increased 7.0%, effective October 1, 2012 with a scheduled 5.0% increase effective April 1, 2013.

Operating Expenses

2012 to 2013:
The District's operating expenses decreased approximately 7.0% in 2013. This was a continuing result of cost-cutting measures taken the prior year and continued efforts to identify and implement cost saving opportunities in all areas of our operations.

2011 to 2012:
Operating expenses increased 30.5% in 2012. This is mainly attributed to a $5.2 million increase in depreciation expense for the $73.2 million Landfill Gas Phase II project. Operating Expense also reflected a full year of BPA rate increase that went into effect October, 2011 and an increase of 17.0% due to the operation of the LFG II Project for a full year. However, the District did experience some offset to these increases through Maintenance and Administrative and General expenses, which decreased 14.9% as a result of continued efforts to control spending through constant evaluation of expenditures, elimination of cost-of-living increases, and a work force reduction.

Non-Operating Revenue/(Expense)

2012 to 2013:
Major variations from 2012 included a 75.5% increase in interest income and a 24.8% decrease in depreciation expense. The District actively manages the investment of its cash funds to optimize interest earnings while ensuring safety and liquidity. Interest income is also earned from repayment of LUDs. The decrease in depreciation is related to the District's recalculation of Landfill Gas II Project asset lives, which lengthened the depreciation period. Also, $400,000 of revenue was deferred in 2013 to a future period.

2011 to 2012:
Non-operating expenses increased by $3.7 million mainly due to the capitalization of plant which reduced capitalizing interest associated with construction.

Capital Contributions

2012 to 2013:
Customer-paid capital contributions to the District for electric line extensions were down 31.9% from 2012. Poor economic conditions continue to affect growth and new projects.

2011 to 2012:
Capital contributions for the District in 2012 increased $1.8 million. This is largely due to an early 2012 ice storm, which was deemed a FEMA disaster. As a result, multiple capital improvements for affected distribution lines were completed and reimbursed by FEMA equating to $1.5 million.

Water and wastewater systems operating results

	2013	2012 *As restated*	2011 *As restated*
Operating revenues	$ 1,448,854	$ 1,501,866	$ 1,396,608
Operating expenses	1,523,784	640,297	1,460,569
Operating income (loss)	(74,930)	861,569	(63,961)
Net non-operating revenue/(expense)	(9,718)	(17,999)	18,574
Capital contributions and grants	300,171	325,341	29,986
Change in net position	$ 215,523	$ 1,168,911	$ (15,401)

Operating Revenues

2012 to 2013:
Water and Wastewater operating revenues decreased 3.5% in 2013. Despite the implementation of rate increases to many of the systems in June of 2013, water consumption was down 5.8% from 2012. The District continues its ongoing efforts to maximize efficiency of the systems.

2011 to 2012:
The District Water and Wastewater operating revenues recorded an increase of 7.5% in 2012.

Operating Expenses

2012 to 2013:
Water and Wastewater operating expenses reflected an increase of 4.3% from 2011, which was a more representative year than 2012 (see below). Cost management efforts have been successful.

2011 to 2012:
The District Water and Wastewater operating expenses decreased by 56.2% in 2012 due to allocations and capital projects.

Non-Operating Revenue/(Expense)

2012 to 2013:
Water and Wastewater non-operating revenue/(expense) decreased by approximately $8,000 in 2013.

2012 to 2011:
The District Water and Wastewater non-operating expenses increased by $36,500 in 2012.

Capital Contributions and Grants

2012 to 2013:
Water and Wastewater capital contributions were down approximately 7.7% in 2013. Economic conditions in the area are slow-recovering, resulting in fewer housing starts and related new water and wastewater connections.

The District received a total of $280,014 from Klickitat County Landfill Gas Improvement Fund in 2013 to provide funding assistance to complete the Roosevelt Water New Source and Pipeline Project ($155,014) and to apply towards construction of the Bickleton Water System ($125,000).

2011 to 2012:
The District Water/Wastewater Systems received capital contributions in 2012 for the Roosevelt well in the amount of $300,000. This project is on schedule for completion in 2013.

The District Looking Forward

All contractor issues with respect to expansions at the H.W. Hill generation facility that were outstanding during the last year have been resolved. Facility improvements required due to contractor performance issues were completed, and the facility is operating as planned.

The District will continue to focus on our financial stability and on improving operational efficiencies in 2014. We will also be looking to enhance our revenues and improve our processes to ensure that we continue to provide cost effective electric, water and wastewater services to our customers.

ASSETS AND DEFERRED OUTFLOW OF RESOURCES

	December 31, 2013	December 31, 2012 As Restated
CURRENT ASSETS		
Cash and cash equivalents	$ 9,986,883	$ 10,290,717
Notes receivable	163,809	175,918
Accounts receivable, net	1,063,642	779,750
Unbilled revenue	1,678,961	1,613,067
Other receivables	4,831,169	4,497,925
Materials and supplies	1,685,829	1,761,438
Prepayments	702,768	696,654
Current portion of prepaid power contract	1,180,359	1,180,359
Total current assets	21,293,420	20,995,828
RESTRICTED CASH EQUIVALENTS		
Construction funds	-	1,486,603
Special funds	15,567,025	15,167,025
Total restricted cash equivalents	15,567,025	16,653,628
CAPITAL ASSETS		
Total plant in service	297,195,055	290,128,259
Construction work in progress	3,254,603	3,797,441
Total utility plant	300,449,658	293,925,700
Accumulated provision for depreciation	(79,799,180)	(71,622,502)
Net capital assets	220,650,478	222,303,198
OTHER ASSETS		
Other investments and transmission deposits	1,287,181	1,794,435
Other assets and prepaid power contract	15,905,525	17,056,600
Derivative asset	1,271,567	1,222,465
Total other assets	18,464,273	20,073,500
DEFERRED OUTFLOWS OF RESOURCES		
Accumulated decrease in fair value of hedging derivatives	1,666,422	593,888
Total assets and deferred outflow of resources	$ 277,641,618	$ 280,620,042

See accompanying notes.

LIABILITIES, DEFERRED INFLOW OF RESOURCES AND NET POSITION

	December 31, 2013	December 31, 2012 As Restated
CURRENT LIABILITIES		
Accounts payable	$ 3,511,740	$ 2,991,204
Current portion of long-term debt	3,628,001	3,517,909
Consumers deposits	462,726	351,434
Other current and accrued liabilities	2,916,608	3,117,804
Total current liabilities	10,519,075	9,978,351
NONCURRENT LIABILITIES		
Compensated absences	107,096	143,839
Long-term debt	133,104,889	136,834,355
Derivative liability	1,666,422	593,888
Total noncurrent liabilities	134,878,407	137,572,082
DEFERRED INFLOWS OF RESOURCES		
Regulatory liability - rate stablization	2,800,000	1,600,000
Accumulated increase in fair value of hedging derivatives	1,271,567	1,222,465
Regulatory liability - CIAC	27,623,640	28,461,655
Total deferred inflows of resources	31,695,207	31,284,120
NET POSITION		
Net investment in capital assets	83,917,588	83,437,537
Restricted – bond funds	12,164,533	12,155,694
Restricted – rate stabilization fund	-	800,000
Unrestricted	4,466,808	5,392,258
Total net position	100,548,929	101,785,489
Total liabilities, deferred inflow of resources and net position	$ 277,641,618	$ 280,620,042

See accompanying notes.

PUBLIC UTILITY DISTRICT NO. 1 OF KLICKITAT COUNTY – MCAG No. 1785

COMBINED STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION

	Years Ended December 31, 2013	2012 As Restated
OPERATING REVENUES		
Electric system		
Sales to retail customers	$ 24,574,092	$ 22,400,123
Sales to wholesale and transmission customers	15,490,708	13,845,508
Water/wastewater systems	1,448,854	1,542,975
Total operating revenues	41,513,654	37,788,606
OPERATING EXPENSES		
Power expense	10,908,587	10,026,127
Operations expense	11,624,111	11,120,075
Maintenance expense	2,184,501	2,444,687
Administrative and general expense	3,705,015	4,083,952
Depreciation expense	8,807,353	11,804,653
Tax expense	1,822,232	1,564,178
Total operating expenses	39,051,799	41,043,672
OPERATING (LOSS) INCOME	2,461,855	(3,255,066)
NON-OPERATING REVENUE/(EXPENSE)		
Interest income	257,804	160,418
Other non-operating revenues	1,032,389	1,215,324
Interest expense	(6,897,157)	(6,547,673)
Other expense	-	(9,118)
Total non-operating expense	(5,606,964)	(5,181,049)
LOSS BEFORE CAPITAL CONTRIBUTIONS AND GRANTS	(3,145,109)	(8,436,115)
CAPITAL CONTRIBUTIONS AND GRANTS	1,908,549	3,883,930
CHANGE IN NET POSITION	(1,236,560)	(4,552,185)
NET POSITION, beginning of year	101,785,489	139,830,179
EFFECT OF RESTATEMENT		(33,492,505)
NET POSITION, beginning of year (restated)		106,337,674
NET POSITION, end of year	$ 100,548,929	$ 101,785,489

See accompanying notes.

COMBINED STATEMENTS OF CASH FLOWS

	Years Ended December 31, 2013	2012 As Restated
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from customers	$ 42,153,838	$ 37,571,907
Payments to suppliers for goods and services	(20,722,087)	(22,763,561)
Payments to employees for services	(6,278,680)	(6,963,749)
Taxes paid	(1,702,388)	(1,525,377)
Net change in cash flows from operating activities	13,450,683	6,319,220
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES		
Proceeds from BPA transmission deposits	507,254	401,305
Other non-operating income	1,032,389	1,215,324
Net change in cash flows from non-capital financing activities	1,539,643	1,616,629
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Principal payments on long-term debt	(3,517,908)	(3,441,909)
Issuance of long-term debt	96,747	158,605
Interest payments	(7,104,210)	(6,698,892)
Capital contributions and grants	1,070,534	3,045,915
Other assets - preliminary engineering	(29,284)	(163,768)
Capital expenditures	(7,154,633)	(6,605,461)
Net change in cash flows from capital and related financing activities	(16,638,754)	(13,705,510)
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest received	257,991	158,166
Net change in cash flows from investing activities	257,991	158,166
NET CHANGE IN CASH AND CASH EQUIVALENTS	(1,390,437)	(5,611,495)
CASH AND CASH EQUIVALENTS, beginning of year	26,944,345	32,555,840
CASH AND CASH EQUIVALENTS, end of year	$ 25,553,908	$ 26,944,345

	Years Ended December 31, 2013	Years Ended December 31, 2012 As Restated
RECONCILIATION OF OPERATING INCOME TO NET CASH FROM OPERATING ACTIVITIES		
OPERATING INCOME (LOSS)	$ 2,461,855	$ (3,255,066)
ADJUSTMENTS TO RECONCILE OPERATING INCOME TO NET CASH FROM OPERATING ACTIVITIES		
Depreciation expense	8,807,353	11,804,653
Amortization of prepaid power contract	1,180,359	1,180,359
CHANGES IN OPERATING ASSETS AND LIABILITIES		
Receivables and unbilled revenue	(671,108)	(1,091,101)
Materials and supplies	75,609	(140,125)
Prepayments	(6,114)	(387,953)
Accounts payable	520,536	(2,241,143)
Customer deposits	111,292	74,402
Other current and accrued liabilities	(192,356)	(378,211)
Compensated absences	(36,743)	(46,595)
Deferred credits and other liabilities	1,200,000	800,000
Total adjustments	10,988,828	9,574,286
Net cash from operating activities	$ 13,450,683	$ 6,319,220

Note 1 – Organization and Significant Accounting Policies

Organization and combined financial statements – Public Utility District No. 1 of Klickitat County, Washington (the District) is a municipal corporation governed by an elected three-person Board of Commissioners. The District's reporting entity is comprised of the combined electric system, eight water systems and five wastewater systems. All significant intercompany balances and transactions have been eliminated from the combined amounts reported. The District has no component units. The District's service area covers approximately 1,680 square miles in Klickitat County. The District also serves small areas in the surrounding counties of Yakima, Skamania, and Benton. As of December 31, 2013 the District had 12,324 electric, 1,124 water, and 1,187 wastewater customers. The District's wholesale activity is a significant part of the electric system business lines. Wholesale revenues are generated from the sale of the output from the Landfill Gas project, and from the White Creek Wind I power purchase contract. The District owns 13% of the generated output from the White Creek Wind I 205 MW project.

Basis of accounting and presentation – The accounting policies of the District conform to generally accepted accounting principles (GAAP) as applicable to proprietary funds of governments using the full accrual basis of accounting. The Governmental Accounting Standards Board (GASB) is the accepted standard setting body for establishing governmental accounting and financial reporting principles. Accounting records are maintained in accordance with methods prescribed by the State Auditor under the authority of Chapter 43.09 RCW, the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission (FERC) for the Electric System and the Uniform System of Accounts for Class A & B Water Utilities prescribed by the National Association of Regulatory Utility Commissioners for the Water System.

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

Accounts receivable and allowance for uncollectible accounts – Accounts receivable are recorded when invoices are issued and are written off when they are determined to be uncollectible. The allowance for uncollectible accounts includes amounts estimated through an evaluation of specific accounts, based on the best available facts and circumstances, of customers that may be unable to meet their financial obligations, and a reserve is recorded based on historical experience. The allowance for uncollectible accounts at December 31, 2013 and 2012 was $597,554 and $596,201, respectively.

Other receivables – Other receivables consists of amounts due from customers for small material purchases, certain aid in construction billings, repairs to damaged plant and equipment from accidents caused by others, funding requests to granting or loaning agencies, customers who take primary electric service from the District or have a power sales contract, and other miscellaneous items that may require invoicing that would not normally be entered into the customer service billing system.

Note 1 – Organization and Significant Accounting Policies (continued)

Materials and supplies – Materials and supplies provide for additions, maintenance and repairs to utility plant and are stated at average cost.

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

Capital assets (utility plant) – Utility plant is stated at original cost, contract price or fair value if donated (see Note 3). Costs include labor, materials and related indirect costs, such as engineering, transportation and allowance for funds (i.e. interest) used during construction. Additions, renewals and betterments with a minimum cost of $500 per item are capitalized. Repairs and minor replacements are charged to operating expenses. In the case of disposals, unless there is a major retirement or a general plant asset is retired, the cost of property and any removal cost less salvage are charged to accumulated depreciation when property is retired. Depreciation is computed using straight-line group rates; 3% for distribution plant, 2.75% for transmission plant, and 1.67% to 2.5% for generating plant. Depreciation of water and wastewater plant has been computed over useful lives of 25 to 40 years. General plant composite rates range from 2.2% to 14.4%. During 2013, the District revised the useful lives of certain in-service assets. This was treated as a change in accounting estimate and resulted in a decrease in depreciation expense of $3,259,971 for the year ended December 31, 2013.

Derivative instruments – During 2012 the District adopted GASB Statement No. 53, Accounting and Financial Reporting for Derivative Instruments. Subject to certain exceptions GASB Statement No. 53 requires every derivative instrument be recorded on the statement of net position as an asset or liability measured at its fair value, and changes in the derivative's fair value to be recognized in earnings unless such derivatives meet specific hedge accounting criteria to be determined as effective.

It is the District's policy to document and apply as appropriate the normal purchase and normal sales exception under GASB Statement No. 53. The District has reviewed its various contractual arrangements to determine applicability of these standards. Purchases and sales of forward electricity and option contracts that require physical delivery and which are expected to be used or sold by the reporting entity in the normal course of business are generally considered "normal purchases and normal sales." These transactions are excluded under GASB Statement No. 53 and therefore are not required to be recorded at fair value in the financial statements. Certain put and call options and financial swaps for electricity are considered to be derivatives under GASB Statement No. 53, and do not generally meet the "normal purchases and normal sales" criteria. See Note 8 for further discussion of the District's derivative instruments and risk management.

Unamortized debt expense and premium – Bond issue costs are expensed as incurred. Bond premiums are amortized to interest expense, using the weighted average method over the term of the bonds.

Note 1 – Organization and Significant Accounting Policies (continued)

Other investments – Consists of investment in White Creek Public LLC, carried on the equity basis of accounting.

Transmission deposits – Consists of deposits for certain transmission services paid to Bonneville Power Administration (BPA).

Unamortized prepaid power contract – Consists of prepaid power amortized using the straight-line method over the term of the contract (see Note 4).

Compensated absences – Compensated absences are absences for which employees will be paid, such as vacation and sick leave. The District records compensated absences as an expense and liability when earned. District employees are entitled to Personal Time Off (PTO) based upon length of continuous service which is payable upon resignation, retirement or death. There is a 700-hour cap on PTO accrual, determined according to the employees' anniversary dates. After the annual transfer of PTO hours into Volunteer Employee Beneficiary Association (VEBA) or deferred comp, any hours over the 700-hour cap will be forfeited. At separation, if an employee is not eligible to retire, they may cash out their PTO bank at a schedule governed by years of service.

Fair value of financial instruments – The carrying amounts of current assets, including restricted cash, and current liabilities approximate fair value due to the short-term maturity of those instruments.

Net position – Net position consist of:

- **Net investment in capital assets** – This component of net position consists of capital assets, net of accumulated depreciation, and unspent bond proceeds less outstanding balances of any bonds and other borrowings that are attributable to the acquisition, construction, or improvement of those assets.

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

- **Unrestricted** – This component of net position consists of net position that does not meet the definition of "restricted" or "net investment in capital assets."

Regulatory liability - rate stabilization – The District has established a rate stabilization account to reduce significant year-to-year variations in rates. Amounts deposited into the account are excluded from the statement of revenues, expenses and changes in net position in accordance with regulated operations. Revenue will be recognized in subsequent periods when it is withdrawn in accordance with rate decisions and debt service covenants.

Note 1 – Organization and Significant Accounting Policies (continued)

Regulatory liability - CIAC – The District has deferred certain contributions in aid of construction (CIAC) to future periods matching the time when the revenues and expenses are included in rates. The deferred balance is amortized as revenues on the statement of revenues, expenses and changes in net position.

Revenues and expenses – Operating revenues and expenses result from providing services and producing and delivering goods in connection with the District's principal ongoing operations. Operating revenues are recognized when billed and expenses are recognized when incurred. In addition, the District recognizes unbilled revenue, revenues from services provided, but not yet billed. The principal operating revenues of the District are charges to customers for electric, water and wastewater service. Operating expenses for the District include the cost of sales and services, maintenance, administrative expenses, depreciation on capital assets and taxes. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

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

Capital contributions – Capital contributions are District-mandated customer connection charges used to fund construction of system properties necessary to extend service to a new customer.

Use of estimates – The preparation of combined financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the combined financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates in the District's financial statements include the allowance for doubtful accounts, bad debt expense, useful lives of plant and related depreciation expense.

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

Note 1 – Organization and Significant Accounting Policies (continued)

Interest rate risk – The District's investment policy limits investment maturities to less than five years from the date of purchase unless authorized by the General Manager and Chief Financial Officer for a specific purpose. During 2013 and 2012 investments were in the State Treasurer's LGIP, which has a weighted average portfolio maturity of less than 90 days and beginning December 2012 added the ability to invest in a Bank of the West Money Market Plus Public Funds account.

Credit risk – In accordance with the Revised Code of Washington, District bond resolutions and District internal investment policies, all investments are direct obligations of the U.S. Government, deposits in the LGIP, or deposits with financial institutions recognized as qualified public depositories of the State of Washington. The District's cash deposits are covered by federal depository insurance or protected against loss by deposit with financial institutions recognized as qualified public depositories of the State of Washington. The District intends to hold deposits and securities until maturity.

Concentration of credit risk – District policies allow the entire portfolio to be invested in direct United States Government guaranteed obligations or in the LGIP. No other investment may exceed half of portfolio market value. The LGIP, a 2a7-like pool as defined by GASB Statement No. 31 and the Securities and Exchange Commission, invests in high quality, short-term investments; all LGIP money market securities must be rated A-1 by Standard & Poor's Corporation or P1 by Moody's Investor Services, Inc. The LGIP weighted average maturity must not exceed 90 days and no single investment may exceed 762 days in maturity. Withdrawals in excess of $10 million are available on a one day notice. The LGIP Annual Report is available on the Washington State Treasurer's website.

Note 2 – Deposits and Investments

Cash and cash equivalents consist of the following at December 31:

	Restricted Cash Equivalents	Unrestricted Cash and Cash Equivalents	Total 2013	Total 2012
Construction funds	$ -	$ -	$ -	$ 1,486,603
Special funds	15,567,025	-	15,567,025	15,167,025
Cash – general funds	-	9,986,883	9,986,883	10,290,717
Totals	$ 15,567,025	$ 9,986,883	$ 25,553,908	$ 26,944,345

Note 3 – Capital Assets (Utility Plant)

The following are changes in capital assets for the year ended December 31, 2013:

Description	Balance 01/01/2013	Additions	Retirements and Transfers	Balance 12/31/2013
Capital assets not being depreciated				
Organization	$ 14,767	$ -	$ -	$ 14,767
Franchises and consents	211,427	-	-	211,427
Land and land rights	1,653,055	33,528	-	1,686,583
Construction work in progress	3,797,441	6,966,798	7,509,636	3,254,603
	5,676,690	7,000,326	7,509,636	5,167,380
Capital assets being depreciated				
Electric plant				
Distribution plant	107,737,981	3,285,671	564,113	110,459,539
Transmission plant	53,399,845	800,797	25,637	54,175,005
Generating plant	97,331,155	3,224,951	64,692	100,491,414
Water and wastewater plant	19,707,427	42,191	1,102	19,748,516
General plant	10,072,602	704,219	369,017	10,407,804
	288,249,010	8,057,829	1,024,561	295,282,278
Total capital assets	293,925,700	15,058,155	8,534,197	300,449,658
Accumulated depreciation	(71,622,502)	(11,931,944)	3,755,266	(79,799,180)
Net capital assets	$ 222,303,198	$ 3,126,211	$ 4,778,931	$ 220,650,478

Note 4 – Other Assets and Prepaid Power Contract

Other assets and prepaid power contract as of December 31 consist of the following:

	2013	2012
Prepaid power contract, net of current portion	$ 15,344,688	$ 16,525,044
Preliminary investigation charges	560,837	531,556
	$ 15,905,525	$ 17,056,600

Note 4 – Other Assets and Prepaid Power Contract (continued)

Prepaid power contract – The District entered into a 20-year Energy Purchase Agreement for the White Creek Wind I Facility, which became effective January 1, 2008. Under this Agreement, the District had rights to 26% of the output from the 205 MW facility and was obligated to pay the same percentage of the reimbursable operating expenses. In June 2008, the District completed a transaction with Lewis PUD to sell 10% of the 26% share of the White Creek Wind I project power output. In December 2008, the District also sold 3% of the remaining 16% share of the White Creek Wind I project power output to Benton PUD. The gain on the sale of White Creek power rights was $23,678,404. The remaining portion of the project is amortized on a straight-line basis over the remaining term of the contract.

Note 5 – Long-Term Debt

The following are changes in long-term debt for the year ended December 31, 2013:

	Balance 01/01/2013	Additions	Payments/ Amortization	Balance 12/31/2013	Due Within One Year
Electric revenue bonds	$ 135,995,000	$ -	$ 3,325,000	$ 132,670,000	$ 3,430,000
Unamortized bond premium	2,205,570	-	198,212	2,007,358	-
W/WW revenue bonds	195,500	-	23,000	172,500	23,000
W/WW loans	1,956,194	96,746	169,908	1,883,032	175,001
Total long-term debt	$ 140,352,264	$ 96,746	$ 3,716,120	$136,732,890	$ 3,628,001

Substantially all electric revenues are pledged as security for the electric revenue bonds and substantially all water/wastewater revenues are pledged as security for the water/wastewater revenue bonds. Water/wastewater loans are secured by water/wastewater assets. Electric revenue bonds carry fixed and variable interest rates ranging from 2.030% to 6.680%, for the years ended December 31, 2013 and 2012. The water/wastewater revenue bonds have a 5.0% fixed rate. The loans from the Public Work Trust Fund (PWTF) carry fixed rates from 0.0% to 3.0% and the State Revolving Fund (SRF) loans have fixed rates of 0.0% to 1.0%. Electric revenue bonds mature through December 1, 2031, water/wastewater bonds mature through September 1, 2021 and the PWTF and SRF loans mature through June 1, 2032. There is $12,164,533 as of December 31, 2013, in restricted assets of the District representing revenue bond reserve requirements, construction funds and debt service accounts for the various indentures. There are a number of other limitations and restrictions contained in the various bond indentures.

Note 5 – Long-Term Debt (continued)

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

Electric Revenue Bonds

Year(s)	Principal	Interest	Totals
2014	$ 3,430,000	$ 7,148,388	$ 10,578,388
2015	3,565,000	7,017,534	10,582,534
2016	3,710,000	6,869,052	10,579,052
2017	5,405,000	6,694,883	12,099,883
2018	5,685,000	6,415,078	12,100,078
2019–23	38,280,000	25,767,644	64,047,644
2024–28	45,170,000	15,477,701	60,647,701
2029–31	27,425,000	3,282,780	30,707,780
	$ 132,670,000	$ 78,673,060	$ 211,343,060

Water/Wastewater Revenue Bonds

Year(s)	Principal	Interest	Totals
2014	$ 23,000	$ 8,313	$ 31,313
2015	26,000	7,163	33,163
2016	29,000	5,788	34,788
2017	29,000	4,338	33,338
2018	28,000	2,938	30,938
2019–21	37,500	1,875	39,375
	$ 172,500	$ 30,415	$ 202,915

Water/Wastewater PWTF & SRF Loans

Year(s)	Principal	Interest	Totals
2014	$ 175,001	$ 7,638	$ 182,639
2015	175,001	7,155	182,156
2016	175,000	6,631	181,631
2017	130,088	6,107	136,195
2018	130,088	5,584	135,672
2019–23	641,140	20,063	661,203
2024–28	436,346	7,668	444,014
2029–32	20,368	255	20,623
	$ 1,883,032	$ 61,101	$ 1,944,133
Total	$ 134,725,532	$ 78,764,576	$ 213,490,108

Note 5 – Long-Term Debt (continued)

At December 31, 2012, the District's 2001 Electric Revenue Bonds in the amount of $1,252,200 were considered defeased. This refunded bond constitutes a contingent liability of the District only to the extent that cash and investments presently in the control of the refunding trustees are not sufficient to meet debt service requirements, and are therefore excluded from the combined financial statements because the likelihood of additional funding requirements is considered remote. These bonds were paid in full during December 2013.

Note 6 – Retirement Benefits

1. Pension plan

Substantially all of the District's 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 – PO 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 Statement 27, Accounting for Pensions by State and Local Government Employers and Statement 50, Pension Disclosures, and Amendment of GASB Statements 25 and 27.

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

Plan description – The Legislature established PERS in 1974. Membership in the system includes elected officials; state employees; employees of the Supreme, Appeals and Superior courts; employees of legislative committees; employees of district and municipal courts; and employees of local governments. Membership also includes higher education employees not participating in higher education retirement programs. Approximately 49 percent of PERS salaries are accounted for by state employment. PERS retirement benefit provisions are established in Chapters 41.34 and 41.40 RCW and may be amended only by the State Legislature.

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.

Note 6 – Retirement Benefits (continued)

PERS members who joined the system by September 30, 1977 are Plan 1 members. Those who joined on or after October 1, 1977 but before 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. Employees who fail to choose within 90 days default to PERS Plan 3.

PERS is comprised of and reported as three separate plans for accounting purposes: Plan 1, Plan 2/3, and Plan 3. Plan 1 accounts for the defined benefits of Plan 1 members. Plan 2/3 accounts for the defined benefits of Plan 2 members, and the defined benefit portion of benefits for Plan 3 members. Plan 3 accounts for the defined benefit contribution portion of benefits for Plan 3 members. Although members can only be a member of either Plan 2 or Plan 3, the defined benefit portions of Plan 2 and Plan 3 are accounted for in the same pension trust fund. All assets of this Plan 2/3 may legally be used to pay the defined benefits of any of the Plan 2 or Plan 3 members or beneficiaries, as defined by the terms of the plan. Therefore, Plan 2/3 is considered to be a single plan for accounting purposes.

PERS Plan 1 and Plan 2 retirement benefits are financed from a combination of investment earnings and employer and employee contributions. Employee contributions to the PERS Plan 1 and Plan 2 defined benefit plan accrue interest at a rate specified by the Director of DRS. During DRS' Fiscal Year 2013, the rate was five and one-half percent compounded quarterly. Members in PERS Plan 1 and Plan 2 can elect to withdraw total employee contributions and interest thereon, in lieu of any retirement benefit, upon separation from PERS-covered employment.

PERS Plan 1 members are vested after the completion of five years of eligible service. Plan 1 members are eligible for retirement from active status at any age with at least 30 years of service, at age 55 with 25 years of service, or at the age of 60 with five years of service. Plan 1 members retiring from inactive status prior to the age of 65 may receive actuarial reduced benefits. The monthly benefit is two percent of the average final compensation (AFC) per year of service, but the benefit may not exceed 60 percent of the AFC. The AFC is the monthly average of the 24 consecutive highest-paid service credit months. Plan 1 retirement benefits are actuarially reduced to reflect the choice, if made, of a survivor option. Plan 1 members may elect to receive an optional cost of living allowance (COLA) that provides for automatic annual adjustment based on the Consumer Price Index. The adjustment is capped at three percent annually. To offset the cost of this annual adjustment, the benefit is reduced. PERS Plan 1 provides duty and non-duty disability benefits. Duty disability retirement benefits from disablement prior to the age of 60 consists of a temporary life annuity. The benefit 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, at which time the benefit is converted to the member's service retirement amount. A member with five years of covered employment is eligible for non-duty disability retirement.

Note 6 – Retirement Benefits (continued)

Prior to the age of 55, the benefit amount is two percent of the AFC for each year of services reduced by two percent for each year that the member's age is less than 55. The total benefit is limited to 60 percent of the AFC and is actuarially reduced to reflect the choice of a survivor option. Plan 1 members may elect to receive an optional COLA amount (based on the Consumer Price Index), capped at three percent annually. To offset the cost of annual adjustment, the benefit is reduced.

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 two percent of the AFC per year of service. The AFC is the monthly average of the 60 consecutive highest-paid service months. There is no cap on years of service credit; and a cost of living allowance is granted (based on the Consumer Price Index), capped at three percent annually. 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, if hired prior to May 1, 2013: (1) with a benefit that is reduced by three percent for each year before age 65; or (2) with a benefit that has a smaller (or no) reduction (depending on age) that imposes stricter return-to-work rules. PERS Plan 2 members hired on or after May 1, 2013 have the option to retire early by accepting a reduction of five percent for each year of retirement before age 65. This option is available only to those who are age 55 or older and have at least 30 years of service. PERS Plan 2 retirement benefits are actuarially reduced to reflect the choice, if made, of a survivor option.

Plan 3 has a dual benefit structure. Employer contributions finance a defined benefit component, and member contributions finance a defined contribution component. As established by Chapter 41.34 RCW, employee contribution rates to the defined contribution component range from five percent to 15 percent of salaries, based on member choice. Members who do not choose a contribution rate default to a five percent rate. There are currently no requirements for employer contributions to the defined contribution component of PERS Plan 3. Plan 3 defined contribution retirement benefits are dependent upon the results of investment activities. Members may elect to self-direct the investment of their contributions. Any expense incurred in conjunction with self-direct investments is paid by members. Absent a member's self-direction, Plan 3 contributions are invested in the Retirement Strategy Fund that assumes the member will retire at age 65. For DRS' Fiscal Year 2013 Plan 3 employee contributions were $99.0 million, and plan refunds paid out were $69.4 million. The defined benefit portion of PERS Plan 3 provides members a monthly benefit that is one percent of the AFC per year of service. The AFC is the monthly average of the 60 consecutive highest-paid service months. Effective June 7, 2006, Plan 3 members are vested in the defined benefit portion of their plan after ten years of service; or after five years of service, if twelve months of that service are earned after age 44; or after five service credit years earned in PERS Plan 2 prior to June 1, 2003. Plan 3 members are immediately vested in the defined contribution portion of their plan.

Note 6 – Retirement Benefits (continued)

Vested Plan 3 members are eligible to retire with full benefits at age 65, or they may retire early with the following conditions and benefits: (1) 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; (2) If they have 30 service credit years and are at least age 55 old, and were hired before May 1, 2013, they have the choice of a benefit that is reduced by three percent for each year before age 65; or a benefit with a small (or no) reduction factor (depending on age) that imposes stricter return-to-work rules; or (3) If they have 30 service credit years, are at least 55 years old, and were hired after May 1, 2013, they have the option to retire early by accepting a reduction of 5 percent for each year before age 65. PERS Plan 3 benefits are actuarially reduced to reflect the choice, if made, of a survivor option.

PERS Plan 2 and Plan 3 provided disability benefits. There is minimum amount of service credit required for eligibility. The Plan 2 amount benefit is two percent of the AFC per year of service. For Plan 3, the monthly benefit amount is one percent 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 three percent annually.

PERS members meeting specific eligibility requirements have options available to enhance their retirement benefits. Some of these options are available to their survivors. A one-time duty-related death benefit is provided to the beneficiary or the estate of a PERS member who dies 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 the member's covered employment, if found eligible by the Department of Labor and Industries.

From January 1, 2007 through December 31, 2007, judicial members of PERS were given the choice to elect participation in the Judicial Benefit Multiplier (JBM) Program enacted in 2006. Justices and judges in PERS Plan 1 and Plan 2 were able to make an irrevocable election to pay increased contributions that would fund a retirement benefit with a 3.5 percent multiplier. The benefit would be capped at 75 percent of AFC. Judges in PERS Plan 3 could elect a 1.6 percent of pay per year of service benefit, capped at 37.5 percent of AFC.

Newly elected or appointed justices and judges who chose to become PERS members on or after January 1, 2007, or who had not previously opted into PERS membership, were required to participate in the JBM Program.

Note 6 – Retirement Benefits (continued)

There are 1,176 participating employers in PERS. Membership in PERS consisted of the following as of the latest actuarial valuation date for the plans of June 30, 2012:

Retirees and beneficiaries receiving benefits	85,328
Terminated plan members entitled to but not yet receiving benefits	31,047
Active plan members vested	107,073
Active plan members non-vested	43,633
Total	267,081

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 PERS Plan 1 are established by statute at 6 percent for state agencies and local government unit employees, and at 7.5 percent for state government elected officials. The employer and employee contribution rates for Plan 2 and the employer contribution rate for Plan 3 are developed by the Office of the State Actuary to fully fund Plan 2 and the defined benefits portion for Plan 3. Under PERS Plan 3, employer contributions finance the defined benefit portion of the plan, and member contributions finance the defined contribution portion. The Plan 3 employee contribution rates range from 5 to 15 percent.

As a result of the implementation of the Judicial Benefit Multiplier Program in January 2007, a second tier of employer and employee rates were 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 the 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, were as follows:

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

* The employer rates include the employer administration expense fee currently set at 0.18%.

** The employer rate for state elected officials is 13.73% for Plan 1, 9.21% for Plan 2 and Plan 3.

*** Plan 3 defined benefit portion only.

**** The employee rate for state elected officials is 7.50% for Plan 1, and 4.92% for Plan 2.

***** Variable from 5% to 15% maximum based on rate selected by the PERS 3 member.

Note 6 – Retirement Benefits (continued)

Both the 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	$ 6,585	$ 474,641	$ 26,358
2012	$ 5,087	$ 404,638	$ 24,320
2011	$ 9,522	$ 655,744	$ 35,680

2. Post employment benefits plan other than pensions

Plan description – In addition to pension benefits, the District provides post employment health care benefits. District members are eligible for retiree medical benefits after becoming eligible for service retirement pension benefits under Plan 2 of the PERS (age 65 with 5 years of service; age 55 with 20 years of service). Currently former members who are entitled to a deferred vested pension benefit are not eligible to receive medical benefits after pension benefit commencement. Survivors of members who die are not eligible for medical benefits.

Funding policy – The funding policy is based upon the pay-as-you-go financing requirements.

Annual OPEB cost and net OPEB obligation – The District's annual other postemployment benefit (OPEB) cost is based upon the annual required contribution (ARC), an amount actuarially determined in accordance with the parameters of GASB 45. The ARC represents a 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 as of January 1, 2011.

The District's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for years ended December 31 were as follows:

Fiscal Year Ended	Annual OPEB Cost	Cost Contributed	Net OPEB Obligation
12/31/2013	$ 100,347	65.36%	$ 616,485
12/31/2012	$ 101,310	143.45%	$ 581,727
12/31/2011	$ 102,491	195.76%	$ 625,745

Funding status and funding progress – As of January 1, 2011, the most recent valuation date, the plan was 0% funded. The accrued liability for benefits was $1.3 million, and the actuarial value of assets was $0, resulting in a UAAL of $1.3 million.

Note 6 – Retirement Benefits (continued)

The following table presents a schedule of funding progress for the District's OPEB Plan:

Valuation Date	Actuarial Value of Assets	Accrual Accrued Liability	Unfunded Actuarial Accrued Liabilities (UAAL)	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll
1/1/2008	$ -	$ 4,784,699	$ 4,784,699	0%	N/A	N/A
1/1/2011	$ -	$ 1,291,085	$ 1,291,085	0%	N/A	N/A

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

Note 7 – Segment Information – Enterprise Funds

The District operates an electric, eight water, and five wastewater utilities which are primarily financed by user charges. The key financial data for the years ended December 31, 2013 and 2012 is as follows:

Condensed statement of net position:

	Electric System	Water-Wastewater Systems	Total 2013	Total 2012 *As restated*
Assets				
Current, restricted, other assets and deferred outflows	$ 53,448,513	$ 3,542,627	$ 56,991,140	$ 58,316,844
Capital assets	204,559,209	16,091,269	220,650,478	222,303,198
Total assets and deferred outflows	$ 258,007,722	$ 19,633,896	$ 277,641,618	$ 280,620,042
Liabilities				
Current liabilities	$ 10,137,886	$ 381,189	$ 10,519,075	$ 9,978,351
Noncurrent liabilities and deferred inflows	164,716,080	1,857,534	166,573,614	168,856,202
Total liabilities and deferred inflows	174,853,966	2,238,723	$177,092,689	178,834,553
Net position				
Net investment in capital assets	68,809,243	15,108,345	83,917,588	83,437,537
Restricted	12,164,533	-	12,164,533	12,955,694
Unrestricted	2,179,980	2,286,828	4,466,808	5,392,258
Total net position	83,153,756	17,395,173	100,548,929	101,785,489
Total liabilities, deferred inflows and net position	$ 258,007,722	$ 19,633,896	$ 277,641,618	$ 280,620,042

Note 7 – Segment Information – Enterprise Funds (continued)

Condensed statements of revenues, expenses, and changes in net position:

	Electric System	Water-Wastewater Systems	Total 2013	Total 2012
				As restated
Operating revenues	$ 40,064,800	$ 1,448,854	$ 41,513,654	$ 37,788,606
Operating expenses	29,296,257	948,189	30,244,446	29,239,019
Depreciation	8,231,758	575,595	8,807,353	11,804,653
Operating income	2,536,785	(74,930)	2,461,855	(3,255,066)
Non-operating revenues (expenses)				
Interest income	225,480	32,324	257,804	160,418
Interest expense	(6,857,421)	(39,736)	(6,897,157)	(6,547,673)
Other non-operating revenue (expense), net	1,034,695	(2,306)	1,032,389	1,206,206
Capital contributions and grants	1,608,378	300,171	1,908,549	3,883,930
Change in net position	(1,452,083)	215,523	(1,236,560)	(4,552,185)
Net position, beginning of year	84,585,908	17,199,581	101,785,489	106,337,674
Net position, end of year	$ 83,133,825	$ 17,415,104	$ 100,548,929	$ 101,785,489

Note 8 – Power Risk Management

As of December 31, 2013, the District had the following derivative instruments outstanding:

	Changes in Fair Value		Fair Value at December 31, 2013		
	Classification	Amount	Classification	Amount	Notional
Cash Flow Hedges:					
Financial Swap Forward	Deferred Inflow	$ 1,271,567	Derivative Asset	$ 1,271,567	169,335 MWH
	Deferred Outflow	$ 1,666,422	Derivative Liability	$ 1,666,422	169,335 MWH

The fair values of the financial swap contracts were based on the futures price curve for the Mid-Columbia Intercontinental Exchange for electricity.

Objective and strategies – The District enters into derivative energy transactions to hedge its known or expected positions within its approved Risk Management Policy. Decisions are made to enter into forward transactions to protect its financial position specifically to deal with long and short positions as determined by projected load and resource balance positions.

Note 8 – Power Risk Management (continued)

Generally, several strategies are employed to hedge the District's resource portfolio, including:

- *Surplus Purchased Power Resources* – the District hedges projected surpluses in future periods by selling power or by purchasing put options. Surplus power is generally sold forward at a fixed-price, either physically or financially, when the probability of surplus is very high; surplus power is hedged through the purchase of physical or financial put options when the projected surplus is less certain, but nevertheless expected to be available under expected scenarios. From time to time the District will sell physical power forward in the next calendar month at a price based on the Mid-Columbia index to perfect financial forward sales while settle based on the same index.

Credit risk – The District has developed a credit policy that establishes guidelines for setting credit limits and monitoring credit exposure on a continuous basis. The policy addresses frequency of counterparty credit evaluations, credit limits per specific counterparty and counterparty credit concentration limits. Commodity transactions, both physical and financial, are entered into only with counterparties approved by the District's Risk Management Committee for creditworthiness. The District had 5 counterparties with approved credit limits for electric power sales and purchases as of December 31, 2013. Counterparty credit limits are based on The Energy Authority's (TEA) (See Note 12) proprietary credit rating system and other factors. Credit ratings for counterparties range from "not-rated" to AAA, with a majority of counterparties rated between BBB- and AA.

Basis risk – The District proactively works to eliminate or minimize basis risk on energy transactions by entering into derivative transactions that settle pursuant to an index derived from market transactions at the point physical delivery is expected to take place. There are no derivative transactions outstanding that carry basis risk as of December 31, 2013. As applicable, all power related transactions are to be settled on the relevant Mid-Columbia index, and all gas transactions are to be settled on the relevant Sumas/Huntingdon index. The District has ready access to electric transmission and natural gas transportation capacity at those respective trading points.

Termination risk – Hedging derivative contracts may be terminated by mutual agreement of the Board and the counterparty, or upon the occurrence of a termination event. Termination events include non-payment, non-delivery, deterioration of creditworthiness, or other material adverse changes. During the year ended December 31, 2013, there were no terminations.

Note 9 – Risk Management and Self Insurance

Unemployment insurance – The District maintains insurance against most normal hazards, except for unemployment insurance, where the District has elected to become self-insured for all losses. The District reimburses the State Employment Security Department for actual costs upon receipt of any claim. The District does not estimate any future liability as the amount is not significant.

Public utility risk management services – The District, along with seventeen other public utility districts and one joint operating agency, is a member of the Public Utility Risk Management Services self-insurance fund. The program provides members with various liability, property, and health insurance coverage in three separate pools.

The District has not accrued a liability for any outstanding claims of the self-insured pools, including incurred-but-not-reported health and welfare claims, as the amount cannot be reasonably estimated. Management believes the claims, for those that are successful, will not have a significant impact on the financial position of the District.

The District is a participant in the liability pool, which maintains a base self-insured retention level of $1,000,000, funded reserves ranging from $1,500,000 to $2,000,000, and individual member deductibles of $250. The liability pool provides the District with shared excess coverage of $60,000,000 general liability, $10,000,000 professional liability, and $10,000,000 per occurrence Directors and Officers liability.

The District is also a participant in the property pool, which maintains a self-insured retention level of $250,000, funded reserves ranging from $500,000 to $750,000, and varying deductibles of $250 on most property and $75,000 on the H. W. Hill Landfill Gas project. The property pool provides the District with $175,000,000 shared excess coverage, attaching at the self-insured retention level for all property risks except flood and earthquake, which attach at 2% of total insured value. Any gap between the self-insured level and excess insurance is funded half by the property pool and half by the affected member.

The District also participates in the health and welfare pool. Participating members are billed each month for shared costs (administration costs to operate the pool, mail order prescription plan costs, and stop loss carrier costs), claims by the members covered employees and dependents, and any shared claims for members who exceeded stop loss limits.

Note 10 – Joint Ventures

Conservation and Renewable Energy System (CARES) – The District, along with seven other public utility districts, is a member of CARES, a municipal corporation and joint operating agency of the State of Washington. CARES was formed pursuant to RCW Chapter 43.52. The purpose of CARES is to develop and acquire conservation, renewable and high efficiency resources consistent with the Northwest Conservation and Electric Power Plan. CARES issued Conservation Project Revenue Bonds which are tax-exempt and unconditionally guaranteed by the BPA. The District has not contributed any money to CARES for several years. The District has no equity interest or liability for CARES operations.

McNary North Fishway Hydroelectric Project – On August 14, 1995, the District and Northern Wasco County PUD entered into an Ownership Agreement to jointly construct and operate the McNary North Fishway Hydroelectric Project. The project was completed in September 1997 and is generating approximately ten megawatts (10 MW) of electricity. Both the District and Northern Wasco County PUD share equally in the output, as well as the construction and operation costs of the Project. The District contributed $404,000 and $450,000 in 2013 and 2012, respectively.

Last Mile Electrical Cooperative (LMEC) – The District, along with seven other public utility districts and two other organizations, is a member of LMEC, a non-profit cooperative. LMEC was formed pursuant to RCW Chapter 24.06. The purpose of LMEC is to develop wind and other renewable energy projects. At this time, LMEC has not issued any debt and is solely funded by its members. The District has no equity interest or liability for the LMEC operations at this time.

White Creek Public, LLC & White Creek Project, LLC – The District, along with Cowlitz PUD, formed White Creek Public, LLC to participate in White Creek Project, LLC which also includes as members Tanner Electric Co-op and Lakeview Light & Power. Early development of the project was done by the utilities involved, but prior to the end of 2007 the project was sold to Prudential and Lehman Brothers. Energy purchase agreements were signed by the utilities for 20 years of power that began commercial operation on November 21, 2007 (see Note 4). The percentage owned by each utility was determined based upon their contribution made during the original development stage. Phases 1 and 2 of White Creek Wind I have a total of 89 2.3 MW wind turbines for an anticipated output of 205 MW. Both phases were in production as of November 21, 2007. In 2013 and 2012, the District's investment in the project of ($16,590) and ($11,317), respectively, consisted of a share of the remaining assets. These amounts have been shown on the balance sheet as other investments and transmission deposits.

Note 11 – Contingencies

Lawsuits – The District is a defendant in various lawsuits. Although the outcome of these lawsuits is not presently determinable, it is the opinion of District management that resolution of these matters will not have a material adverse effect on the financial condition of the District.

Construction financing – On April 17, 2001 the District entered into a thirty (30) year agreement with Goldendale Energy, Inc. in order to provide for the transmission of the electric energy to be produced at Goldendale Energy Inc. generating facility from the E.E. Clouse Substation to Bonneville's Harvalum Substation. The generating facility was sold through bankruptcy auction in February 2007 to Puget Sound Energy. The District established a new letter of credit for the transmission line service, which the District built and operates for the generation facility. The letter of credit covers the net present value of the remaining contract amount including the debt outstanding.

Grants – Grants received by the District are subject to audit by the granting agency and may result in certain costs being disallowed and required to be returned. Management believes it has complied with grant guidelines and the likelihood of disallowed costs is remote.

Note 12 – Power Contracts

Effective October 1, 2011, the District entered into a Slice/Block Agreement with the BPA. The provisions of this agreement establishes the terms under which the District is committed to purchase its power for a period of seventeen years. The Slice/Block Agreement specifies that BPA rates are variable and includes provisions for various adjustments depending on actual load and BPA costs. In addition, the Slice portion of the agreement includes a true-up provision that allows BPA to recover Slice costs not previously recovered during the fiscal year. BPA assesses this true up on an annual basis. The true up is paid, or refunded if a credit, during the next fiscal year.

The Slice portion of the agreement commits the District to purchase a certain fixed percentage of BPA generation which varies depending on the available water and may result in power that is surplus to the District's needs and which the District intends to sell on the open market. The Block portion of the agreement specifies a specific amount of MWs BPA will supply to the district. This amount is adjusted per the contract on a yearly basis.

Note 13 – Generation Assets

H. W. Hill Landfill Gas project is rated a 26.0 MW plant that takes methane gas from the regional landfill and produces electricity from five 2.1 MW reciprocating combustion engines. 2.0 MW's of the output from this project is sold to a public utility and the balance sold on the spot market.

McNary Dam Hydroelectric project is a 10 MW plant that the District shares joint ownership with Northern Wasco Peoples Utility District in The Dalles, Oregon. The facility is located on the north shore fish bypass area of McNary Dam and received a 50-year license on September 30, 1991. Of the 5 MW's the District receives, 4.5 MW's are declared to load.

Note 14 – Union Contracts

The District has a contract with the International Brotherhood of Electrical Workers which covers the electrical line workers employed by the District. The District signed a new contract with the union which expires on March 31, 2015.

Note 15 – Adoption of New Accounting Pronouncement and Change in Accounting Policy

In March 2012, the GASB issued Statement No. 65, Items Previously Reported as Assets and Liabilities. This statement provides guidance for reclassifying certain items as deferred outflows of resources or deferred inflows of resources. The statement further requires reclassification of certain items previously recorded as assets and liabilities to be presented as expense or revenues. The District expensed bond issuance costs previously deferred and amortized.

The District also changed their application of accounting policy for Regulatory Liabilities in order to (1) match depreciation expense from large contributions in aid of construction with the associated revenue streams and (2) match the District's rate stabilization investment account.

Note 15 – Adoption of New Accounting Pronouncement and Change in Accounting Policy (continued)

The following table shows restated amounts of effected balances within the financial statements:

	2012 As Previously Reported	Effect of Restatement	2012 as Restated
Restatement due to implementation of GASB 65:			
Statement of net position			
Other assets and prepaid power contract	$ 20,279,515		$ 17,056,600
Unamortized debt expense		(3,222,915)	
Net position - Net investment in capital assets	86,660,452	(3,222,915)	83,437,537
Statement of revenues, expenses and changes in net position			
Amortization expense	169,920	(169,920)	-
Restatement due to implementation of regulatory accounting:			
Statement of net position			
Deferred inflow of resources			
Regulatory liability - rate stabilization	-	1,600,000	1,600,000
Regulatory liability - CIAC	-	28,461,655	28,461,655
Restricted net position	2,400,000	(1,600,000)	800,000
Unrestricted net position	33,853,913	(28,461,655)	5,392,258
Statement of revenues, expenses and changes in net position			
Sales to retail customers	23,200,123	(800,000)	22,400,123
Capital contributions and grants	3,045,915	838,015	3,883,930
Change in Net Position due to restatement			
Net position beginning of year	139,830,179	(33,492,505)	106,337,674
Net position end of year	$ 135,070,059	$ (33,284,570)	$ 101,785,489