Report of Independent Auditors and
Combined Financial Statements for

Public Utility District No. 1 of Klickitat County

December 31, 2014 and 2013

MOSS-ADAMS LLP

Certified Public Accountants | Business Consultants

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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, 2014 and 2013 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, 2014 and 2013 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.

Other Matter

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 4 through 14 be presented to supplement the combined financial statements. Such information, although not a part of the 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 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 combined financial statements, and other knowledge we obtained during our audit of the 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, Oregon
June 1, 2015

DIRECTORY OF OFFICIALS

Office	Official	Term	Term Expiration
Board of Commissioners			
President	Ray A. Mosbrucker	6 years	December 2016
Vice President	Randy L. Knowles	6 years	December 2018
Secretary	Dan G. Gunkel	6 years	December 2020
Appointed Officials			
General Manager	James R. Smith	1313 S. Columbus Goldendale, WA 98620	
Attorney	Pacifica Law Group LLP	1191 2nd Avenue, Suite 2000 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, 2014 and 2013, with additional comparative data for 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, nine 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, 2014, the District had 12,431 electric, 1,124 water and 1,188 wastewater customers. The District's electric wholesale activities and transmission business line 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, 2014 and 2013 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.

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 as capital contributions over the lives of the assets

Condensed Comparative Financial Information

Combined statement of net position

	2014	2013	2012 *As restated*
Capital assets	$ 217,168,640	$ 220,650,478	$ 222,303,198
Current, restricted, and other assets and deferred outflow of resources	54,446,077	56,991,140	58,316,844
Total assets and deferred outflows of resources	$ 271,614,717	$ 277,641,618	$ 280,620,042
Long-term liabilities and deferred inflow of resources	$ 162,481,798	$ 166,573,614	$ 168,856,202
Current liabilities	9,555,967	10,519,075	9,978,351
Total liabilities and deferred inflow of resources	172,037,765	177,092,689	178,834,553
Net investment in capital assets	$ 83,867,975	$ 83,917,588	$ 83,437,537
Restricted - bond funds	12,178,945	12,164,533	12,155,694
Restricted - rate stabilization fund	-	-	800,000
Unrestricted	3,530,032	4,466,808	5,392,258
Total net position	99,576,952	100,548,929	101,785,489
Total liabilities, deferred inflow of resources and net position	$ 271,614,717	$ 277,641,618	$ 280,620,042

Financial Highlights – 2014

- For the year ended December 31, 2014, the District met its compliance and financial policy obligations with a debt service coverage ratio of 1.49.

- As is done annually, District management met with each local community where it provides water and/or wastewater services. These meetings allow the District to review operations, financial performance and projected future projects, and obtain feedback from community members. Following a public rate hearing, rates were revised for five of nine water systems and two of five wastewater systems. Rate increases ranged from 1% to 5%.

- In January of 2014, Klickitat County experienced a severe ice storm, which affected both distribution and transmission customers. Mutual aid was provided by Northern Wasco, Skamania and Cowlitz PUDs. A section of the District's 230 kV transmission line, which serves several wind projects, fell due to ice accumulation and was damaged beyond repair. Emergency efforts were initiated to rebuild the section as soon as possible to restore transmission service. Total cost to rebuild the destroyed line was $1,086,814. Per contract terms, reimbursement for the entire cost was received from the original owners of the line, who had previously designed, built and donated the asset to the District.

- The District received $1.39 million from electric customer Contributions in Aid of Construction (CAIC) related to construction and line extension projects. This reflects a 69% increase over 2013. Klickitat County is experiencing substantial growth in agricultural and vitacultural activities.

- Approximately $1.7 million of Regulatory Liability was recognized as Contributions in Aid of Construction (CAIC) in 2014. Regulatory accounting treatment had been applied to the value of assets donated to the District, and a portion of the deferred CAIC will be recognized annually throughout the lives of those assets.

- The District's $2.5 million Credit Facility Agreement with an FDIC-insured financial institution was extended to August 1, 2015.

- A second draw was taken from the District's Public Works Trust Fund $500,000 loan for the Lyle Water System Project in the amount of $314,795. The loan has a 0.50% interest rate and 20 year term.

- The District received the second half of committed funding from the Klickitat County Landfill Gas Improvement Fund in the amount of $125,000 for benefit of the new Bickleton Water System under construction.

- 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 $5,331.791.

- 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.

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 Analysis

Capital Activity

2013 to 2014:
Total utility plant increased by $4.9 million in 2014. The largest contributor to the increase was the Electric Distribution Plant category with approximately $2.9 million of added capital. In January, 2014, Klickitat County suffered a major ice storm, which caused a portion of the District's 230 kV transmission line to fall. The downed section was damaged beyond repair and had to be rebuilt. The District expensed the book value of the destroyed line, which was $869,948 at the time of the storm, and capitalized $1,086,814 of costs to rebuild the section. Other projects during the year included Darland Transmission Rebuild, 3 Mountain Village Underground Rebuild, Sonova Road Portable Substation, deployment of a 230 kV SCADA (Supervisory Control and Data Acquisition) System, Landfill Gas generation project compressor system modifications, and the Ponderosa Park Water System Reservoir and Pipeline Project.

2012 to 2013:
Total utility plant for the District increased $6.5 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 design. Additionally, the District capitalized the remaining construction costs of the Landfill Gas II Project.

Debt Activity

2013 to 2014:
During 2014, the District paid electric bond principal payments of $3,340,000 and water/wastewater loan payments of $198,000. A second draw was taken from the District's Public Works Trust Fund Loan in the amount of $314,795 to fund the Lyle Water System Project. The District also purchased a residential property in Roosevelt, Washington to support the Landfill Gas generation project. The purchase was funded with an $85,000 bank loan.

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.

Current, Restricted, and Other Activity

2013 to 2014:
The District's total Receivables dropped by 9.7% compared to 2013. Materials and supplies inventory increased by $304,000. The value of the District's derivative assets related to its Risk Management activities ended 2014 at $3.0 million, a 142% increase over 2013.

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.

Overall Results of Operations

2013 to 2014:
The District's 2014 Operating Income was lower than 2013 by 43% but remained positive. 2014 saw financial pressures from unusually cold weather conditions in the First Quarter of 2014 and falling energy market power prices.

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.

Electric system operating results

	2014	2013	2012 *As restated*
Operating revenues	$ 43,471,178	$ 40,064,800	$ 36,286,740
Operating expenses	41,266,324	37,528,015	39,565,360
Operating income (loss)	2,204,854	2,536,785	(3,278,620)
Net non-operating revenue (expense)	(5,649,717)	(5,597,246)	(5,163,050)
Capital contributions	3,126,557	1,608,378	2,720,574
Change in net position	$ (318,306)	$ (1,452,083)	$ (5,721,096)

Operating Revenues

2013 to 2014:
There was an 8.5% increase in Total Operating Revenues in 2014. The significant contributors were a 114% increase in revenue from market sales of our share of excess BPA-generated power per our Slice Agreement and a full year of increased retail rates that had been adopted in the 2nd Quarter of 2013.

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.

Operating Expenses

2013 to 2014:
Operating expenses increased 10.0% in 2014. In addition to a full year of the BPA increase implemented in October, 2013, much colder than usual conditions in the First Quarter of 2014 required additional power purchases at market prices to meet our load requirements. Transmission expenses include approximately $900,000 of book value of a destroyed portion of transmission line as a result of an ice storm in the same period. Also, major repairs of the Landfill Gas steam turbine generator were completed during 2014.

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.

Non-Operating Revenue/(Expense)

2013 to 2014:
A drop in interest income, as a result of decreasing interest rates applicable to the District's monetary investments, was the main contributor to the negative change in the District's 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.

Capital Contributions

2013 to 2014:
Electric capital contributions rebounded in 2014 with a 94.3% increase over 2013. We saw strong growth from agricultural and viticultural activities in Klickitat County.

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.

Water and wastewater systems operating results

	2014	2013	2012 *As restated*
Operating revenues	$ 1,485,743	$ 1,448,854	$ 1,501,866
Operating expenses	2,282,326	1,523,784	640,297
Operating income (loss)	(796,583)	(74,930)	861,569
Net non-operating revenue/(expense)	4,785	(9,718)	(17,999)
Capital contributions and grants	138,127	300,171	325,341
Change in net position	$ (653,671)	$ 215,523	$ 1,168,911

Operating Revenues

2013 to 2014:
Operating revenues from 2014 water and wastewater services were 2.5% above 2013, attributable mainly to rate increases.

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.

Operating Expenses

2013 to 2014:
The District experienced an increase in water and wastewater expenses from 2013. There were additional testing and lab fees based on a varying multi-year testing schedule, and increased labor and supply costs related to maintenance of the systems.

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.

Non-Operating Revenue/(Expense)

2013 to 2014:
Water and Wastewater non-operating revenue/(expense) increased over 2013 resulting from an increase in other revenue and drop in interest expense.

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

Capital Contributions and Grants

2013 to 2014:
Water and Wastewater customer capital contributions remained small in 2014, reflecting slow growth in new construction and related utility connections. The District received the second half of committed grant funding from the Klickitat County Landfill Gas Improvement Fund in the amount of $125,000 for benefit of the new Bickleton Water System under construction.

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).

The District Looking Forward

The District is expecting challenges related to its long position in the energy market. Lower energy prices have deteriorated financial projections past 2017. The Board of Commissioners and Management are continuing to explore and implement actions necessary to ensure the immediate and long-term financial stability of the utility. Management is committed to identifying ways to maximize the significant investments made in the District's assets, looking for additional revenue opportunities, and exercising cost containment efforts wherever possible.

COMBINED STATEMENTS OF NET POSITION

ASSETS AND DEFERRED OUTFLOW OF RESOURCES

	December 31, 2014	December 31, 2013
CURRENT ASSETS		
Cash and cash equivalents	$ 8,865,010	$ 9,986,883
Notes receivable	139,409	163,809
Accounts receivable, net	1,534,352	1,063,642
Unbilled revenue	1,552,891	1,678,961
Other receivables	3,799,343	4,831,169
Materials and supplies	1,990,279	1,685,829
Prepayments	983,916	702,768
Current portion of prepaid power contract	1,180,359	1,180,359
Total current assets	20,045,559	21,293,420
RESTRICTED CASH EQUIVALENTS		
Special funds, bonds	12,767,025	12,767,025
Special funds, power cost stabilization	2,800,000	2,800,000
Total restricted cash equivalents	15,567,025	15,567,025
CAPITAL ASSETS		
Total plant in service	301,591,834	297,195,055
Construction work in progress	3,831,346	3,254,603
Total utility plant	305,423,180	300,449,658
Accumulated provision for depreciation	(88,254,540)	(79,799,180)
Net capital assets	217,168,640	220,650,478
OTHER ASSETS		
Other investments and transmission deposits	705,786	1,287,181
Other assets and prepaid power contract	15,008,342	15,905,525
Derivative asset	3,081,340	1,271,567
Total other assets	18,795,468	18,464,273
DEFERRED OUTFLOWS OF RESOURCES		
Accumulated decrease in fair value of hedging derivatives	38,025	1,666,422
Total assets and deferred outflow of resources	$ 271,614,717	$ 277,641,618

See accompanying notes.

LIABILITIES, DEFERRED INFLOW OF RESOURCES AND NET POSITION

	December 31, 2014	December 31, 2013
CURRENT LIABILITIES		
Accounts payable	$ 2,023,342	$ 3,511,740
Current portion of long-term debt	3,790,114	3,628,001
Consumers deposits	264,003	462,726
Other current and accrued liabilities	3,478,508	2,916,608
Total current liabilities	9,555,967	10,519,075
NONCURRENT LIABILITIES		
Compensated absences	73,581	107,096
Long-term debt	129,510,551	133,104,889
Derivative liability	38,025	1,666,422
Total noncurrent liabilities	129,622,157	134,878,407
DEFERRED INFLOWS OF RESOURCES		
Regulatory liability - rate stablization	2,800,000	2,800,000
Accumulated increase in fair value of hedging derivatives	3,081,340	1,271,567
Regulatory liability - CIAC	26,978,301	27,623,640
Total deferred inflows of resources	32,859,641	31,695,207
NET POSITION		
Net investment in capital assets	83,867,975	83,917,588
Restricted – bond funds	12,178,945	12,164,533
Unrestricted	3,530,032	4,466,808
Total net position	99,576,952	100,548,929
Total liabilities, deferred inflow of resources and net position	$ 271,614,717	$ 277,641,618

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, 2014	2013
OPERATING REVENUES		
Electric system		
Sales to retail customers	$ 26,446,425	$ 24,574,092
Sales to wholesale and transmission customers	17,024,753	15,490,708
Water/wastewater systems	1,485,743	1,448,854
Total operating revenues	44,956,921	41,513,654
OPERATING EXPENSES		
Power expense	12,676,986	10,908,587
Operations expense	13,537,638	11,624,111
Maintenance expense	2,446,882	2,184,501
Administrative and general expense	4,019,854	3,705,015
Depreciation expense	9,058,896	8,807,353
Tax expense	1,808,394	1,822,232
Total operating expenses	43,548,650	39,051,799
OPERATING INCOME	1,408,271	2,461,855
NON-OPERATING REVENUE/(EXPENSE)		
Interest income	216,960	257,804
Other non-operating revenues	1,023,729	1,032,389
Interest expense	(6,885,621)	(6,897,157)
Total non-operating expense	(5,644,932)	(5,606,964)
LOSS BEFORE CAPITAL CONTRIBUTIONS AND GRANTS	(4,236,661)	(3,145,109)
CAPITAL CONTRIBUTIONS AND GRANTS	3,264,684	1,908,549
CHANGE IN NET POSITION	(971,977)	(1,236,560)
NET POSITION, beginning of year	100,548,929	101,785,489
NET POSITION, end of year	$ 99,576,952	$ 100,548,929

See accompanying notes.

PUBLIC UTILITY DISTRICT NO. 1 OF KLICKITAT COUNTY – MCAG No. 1785
COMBINED STATEMENTS OF CASH FLOWS

	Years Ended December 31, 2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from customers	$ 45,467,889	$ 42,153,838
Payments to suppliers for goods and services	(26,040,264)	(20,722,087)
Payments to employees for services	(6,520,804)	(6,278,680)
Taxes paid	(1,842,793)	(1,702,388)
Net change in cash flows from operating activities	11,064,028	13,450,683
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES		
Proceeds from BPA transmission deposits	581,395	507,254
Other non-operating income	1,023,729	1,032,389
Net change in cash flows from non-capital financing activities	1,605,124	1,539,643
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Principal payments on long-term debt	(3,633,807)	(3,517,908)
Issuance of long-term debt	399,795	96,747
Interest payments	(7,098,246)	(7,104,210)
Capital contributions and grants	3,489,329	1,070,534
Other assets - preliminary engineering	(283,173)	(29,284)
Capital expenditures	(6,883,778)	(7,154,633)
Net change in cash flows from capital and related financing activities	(14,009,880)	(16,638,754)
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest received	218,855	257,991
Net change in cash flows from investing activities	218,855	257,991
NET CHANGE IN CASH AND CASH EQUIVALENTS	(1,121,873)	(1,390,437)
CASH AND CASH EQUIVALENTS, beginning of year	25,553,908	26,944,345
CASH AND CASH EQUIVALENTS, end of year	$ 24,432,035	$ 25,553,908

See accompanying notes.

	Years Ended December 31, 2014	2013
RECONCILIATION OF OPERATING INCOME TO NET CASH FROM OPERATING ACTIVITIES		
OPERATING INCOME	$ 1,408,271	$ 2,461,855
ADJUSTMENTS TO RECONCILE OPERATING INCOME TO NET CASH FROM OPERATING ACTIVITIES		
Depreciation expense	9,058,896	8,807,353
Amortization of prepaid power contract	1,180,359	1,180,359
CHANGES IN OPERATING ASSETS AND LIABILITIES		
Receivables and unbilled revenue	709,691	(671,108)
Materials and supplies	(304,450)	75,609
Prepayments	(281,148)	(6,114)
Accounts payable	(1,051,665)	520,536
Customer deposits	(198,723)	111,292
Other current and accrued liabilities	576,312	(192,356)
Compensated absences	(33,515)	(36,743)
Deferred credits and other liabilities	-	1,200,000
Total adjustments	9,655,757	10,988,828
Net cash from operating activities	$ 11,064,028	$ 13,450,683

See accompanying notes.

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, nine 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, 2014 the District had 12,431 electric, 1,124 water, and 1,188 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, 2014 and 2013 was $57,411 and $597,554, 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 – The District has 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.

Debt expense and unamortized 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 capital contributions 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 2 – Deposits and Investments

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

	Restricted Cash Equivalents	Unrestricted Cash and Cash Equivalents	Total 2014	Total 2013
Special funds, bonds	$ 12,767,025	$ -	$ 12,767,025	$ 12,767,025
Special funds, power cost stabilization	2,800,000	-	2,800,000	2,800,000
Cash – general funds	-	8,865,010	8,865,010	9,986,883
Totals	$ 15,567,025	$ 8,865,010	$ 24,432,035	$ 25,553,908

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 or his designee for a specific purpose. During 2014 and 2013 investments were in the State Treasurer's LGIP, which has a weighted average portfolio maturity of less than 90 days, as well as a Money Market Plus Public Funds account at an FDIC-insured financial institution.

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 3 – Capital Assets (Utility Plant)

The following are changes in capital assets for the year ended December 31, 2014:

Description	Balance 01/01/2014	Additions	Retirements and Transfers	Balance 12/31/2014
Capital assets not being depreciated				
Organization	$ 14,767	$ -	$ -	$ 14,767
Franchises and consents	211,427	-	-	211,427
Land and land rights	1,686,583	15,357	-	1,701,940
Construction work in progress	3,254,603	6,756,703	6,179,960	3,831,346
	5,167,380	6,772,060	6,179,960	5,759,480
Capital assets being depreciated				
Electric plant				
Distribution plant	110,459,539	3,324,029	456,526	113,327,042
Transmission plant	54,175,005	1,476,959	1,008,780	54,643,184
Generating plant	100,491,414	431,125	437,460	100,485,079
Water and wastewater plant	19,748,516	757,001	359	20,505,158
General plant	10,407,804	366,181	70,748	10,703,237
	295,282,278	6,355,295	1,973,873	299,663,700
Total capital assets	300,449,658	13,127,355	8,153,833	305,423,180
Accumulated depreciation	(79,799,180)	(8,999,064)	(543,704)	(88,254,540)
Net capital assets	$ 220,650,478	$ 4,128,291	$ 7,610,129	$ 217,168,640

Note 3 – Capital Assets (Utility Plant) (continued)

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	$ 12,289,463	$ 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:

	2014	2013
Prepaid power contract, net of current portion	$ 14,164,332	$ 15,344,688
Preliminary investigation charges	844,010	560,837
	$ 15,008,342	$ 15,905,525

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, 2014:

	Balance 01/01/2014	Additions	Payments/ Amortization	Balance 12/31/2014	Due Within One Year
Electric revenue bonds	$ 132,670,000	$ 85,000	$ 3,435,806	$ 129,319,194	$ 3,571,624
Unamortized bond premium	2,007,358	-	198,214	1,809,144	-
W/WW revenue bonds	172,500	-	23,000	149,500	26,000
W/WW loans	1,883,032	314,795	175,000	2,022,827	192,490
Total long-term debt	$ 136,732,890	$ 399,795	$ 3,832,020	$133,300,665	$ 3,790,114

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

Note 5 – Long-Term Debt (continued)

Substantially all electric revenues are pledged as security for the electric revenue bonds and substantially all water/wastewater (W/WW) 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 interest rates ranging from 1.470% to 7.038%, for the years ended December 31, 2014 and 2013. 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 $12,767,025 as of December 31, 2014, 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, 2014:

Electric Revenue Bonds

Year(s)	Principal	Interest	Totals
2015	$ 3,571,624	$ 7,017,534	$ 10,589,158
2016	3,717,522	6,869,052	10,586,574
2017	5,412,843	6,694,883	12,107,726
2018	5,693,178	6,415,078	12,108,256
2019	5,993,528	6,109,350	12,102,878
2020–24	41,505,499	24,726,538	66,232,037
2025–29	44,720,000	13,022,696	57,742,696
2030–31	18,705,000	1,669,541	20,374,541
	$ 129,319,194	$ 72,524,672	$ 201,843,866

Water/Wastewater Revenue Bonds

Year(s)	Principal	Interest	Totals
2015	$ 26,000	$ 7,213	$ 33,213
2016	29,000	5,838	34,838
2017	29,000	4,388	33,388
2018	28,000	2,938	30,938
2019	29,000	1,513	30,513
2020–21	8,500	360	8,860
	$ 149,500	$ 22,250	$ 171,750

Water/Wastewater PWTF & SRF Loans

Year(s)	Principal	Interest	Totals
2015	$ 192,490	$ 7,780	$ 200,270
2016	192,490	8,118	200,608
2017	147,576	7,507	155,083
2018	147,576	6,895	154,471
2019	147,576	6,284	153,860
2020–24	711,286	22,300	733,586
2025–29	416,091	7,905	423,996
2030–32	67,742	677	68,419
	$ 2,022,827	$ 67,466	$ 2,090,293
Total	$ 131,491,521	$ 72,614,388	$ 204,105,909

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.

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.

Note 6 – Retirement Benefits (continued)

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 2014, 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.

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.

Note 6 – Retirement Benefits (continued)

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	150,706
Terminated plan members non-vested	101,131
Total	368,212

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, 2014, 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
2014	$ 10,594	$ 920,847	$ 57,365
2013	6,585	474,641	26,358

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, 2014.

The District's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, are contained in the other current and accrued liabilities line item on the combined statements of net position. The net OPEB obligation for years ended December 31 were as follows:

Fiscal Year Ended	Annual OPEB Cost	Percentage of OPEB	Net OPEB Obligation
12/31/2014	$ 114,703	45.83%	$ 678,615
12/31/2013	100,347	65.36%	616,485

Funding status and funding progress – As of January 1, 2014, the most recent valuation date, the plan was 0% funded. The accrued liability for benefits was $1.2 million, and the actuarial value of assets was $0, resulting in an Unfunded Actuarial Accrued Liability (UAAL) of $1.2 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
1/1/2011	$ -	$ 1,291,085	$ 1,291,085	0%	N/A	N/A
1/1/2014	-	1,217,649	1,217,649	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, nine water, and five wastewater utilities which are primarily financed by user charges. The key financial data for the years ended December 31, 2014 and 2013 is as follows:

Condensed statement of net position:

	Electric System	Water-Wastewater Systems	Total 2014	Total 2013
Assets				
Current, restricted, other assets and deferred outflows	$ 50,932,203	$ 3,513,874	$ 54,446,077	$ 56,991,140
Capital assets	201,107,332	16,061,308	217,168,640	220,650,478
Total assets and deferred outflows	$ 252,039,535	$ 19,575,182	$ 271,614,717	$ 277,641,618
Liabilities				
Current liabilities	$ 8,976,825	$ 579,142	$ 9,555,967	$ 10,519,075
Noncurrent liabilities and deferred inflows	160,527,961	1,953,837	162,481,798	166,573,614
Total liabilities and deferred inflows	169,504,786	2,532,979	172,037,765	177,092,689
Net position				
Net investment in capital assets	69,978,995	13,888,980	83,867,975	83,917,588
Restricted	12,178,945	-	12,178,945	12,164,533
Unrestricted	873,102	2,656,930	3,530,032	4,466,808
Total net position	83,031,042	16,545,910	99,576,952	100,548,929
Total liabilities, deferred inflows and net position	$ 252,535,828	$ 19,078,889	$ 271,614,717	$ 277,641,618

Note 7 – Segment Information – Enterprise Funds (continued)

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

	Electric System	Water-Wastewater Systems	Total 2014	Total 2013
Operating revenues	$ 43,471,178	$ 1,485,743	$ 44,956,921	$ 41,513,654
Operating expenses	32,794,274	1,695,480	34,489,754	30,244,446
Depreciation	8,472,050	586,846	9,058,896	8,807,353
Operating income	2,204,854	(796,583)	1,408,271	2,461,855
Non-operating revenues (expenses)				
Interest income	193,252	23,708	216,960	257,804
Interest expense	(6,851,689)	(33,932)	(6,885,621)	(6,897,157)
Other non-operating revenue (expense), net	1,008,720	15,009	1,023,729	1,032,389
Capital contributions and grants	3,126,557	138,127	3,264,684	1,908,549
Change in net position	(318,306)	(653,671)	(971,977)	(1,236,560)
Net position, beginning of year	83,349,348	17,199,581	100,548,929	101,785,489
Net position, end of year	$ 83,031,042	$ 16,545,910	$ 99,576,952	$ 100,548,929

Note 8 – Power Risk Management

As of December 31, 2014, the District had the following derivative instruments outstanding:

	Changes in Fair Value		Fair Value at December 31, 2014		
	Classification	Amount	Classification	Amount	Notional
Cash Flow Hedges:					
Financial Swap Forward	Deferred Inflow	$ 3,081,340	Derivative Asset	$ 3,081,340	169,335 MWH
Financial Swap Forward	Deferred Outflow	$ 38,025	Derivative Liability	$ 38,025	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 which 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 7 counterparties with approved credit limits for electric power sales and purchases as of December 31, 2014. Counterparty credit limits are based on The Energy Authority's (TEA) 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, 2014. 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 years ended December 31, 2014 and 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 with the Employment Security Department applying an experience rating that dictates payment amounts. 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 (PURMS) 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 these claims, for those that are successful, will not have a significant impact on the financial position of the District.

The District has also not accrued a liability for any outstanding claims regarding recent wildfire activity, most notably the Mile Marker 28 fire. In July 2013, a wildfire broke out from in the vicinity of an electrical transformer located on active timber lands. The Washington Department of Transportation is currently conducting an investigation as to the cause of and any damages that may have resulted from the fire. Complaints have been filed by a timber company working the area as well as a local Native American tribe. The State of Washington may also attempt to recoup fire suppression costs.

PURMS has joined the District to aid in the investigation of determining fault and if any damages may be attributable. As of December 31, 2014, any such damages cannot be reasonably estimated. Management believes that with the shared insurance pools described below, these events will not have a significant impact on the District's financial position.

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.

Note 9 – Risk Management and Self Insurance (continued)

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 $575,000 and $404,000 in 2014 and 2013, 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 2014 and 2013, the District's investment in the project of ($18,885) and ($16,590), 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 as well as the Water/Wastewater Workers which covers these workers employed by the District. The District signed a new contract with the unions in April 2015, which expires in March 2020. The parties have agreed to open the contract no later than July 2017 with regard to wages and healthcare, the Patient Protection and Affordable Care Act (PPACA) Excise Tax on Cadillac Plans implementation in 2018.