



Report of Independent Auditors and
Combined Financial Statements
with Supplementary Information for

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

December 31, 2016 and 2015

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 the 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, 2016 and 2015, 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 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 audit. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the 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.

REPORT OF INDEPENDENT AUDITORS (continued)

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

Opinion

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of the District as of December 31, 2016 and 2015, 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, schedule of proportionate share of the net pension liability and the schedule of contributions 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.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated May 30, 2017, on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control over financial reporting and compliance.

Miss Adams UP

Portland, Oregon

May 30, 2017

**PUBLIC UTILITY DISTRICT NO. 1 OF KLICKITAT COUNTY -
MCAG No. 1785
DIRECTORY OF OFFICIALS**

<u>Office</u>	<u>Official</u>	<u>Term</u>	<u>Term Expiration</u>
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	

PUBLIC UTILITY DISTRICT NO. 1 OF KLICKITAT COUNTY – MCAG No. 1785 MANAGEMENT’S DISCUSSION AND ANALYSIS

This section provides an overview and analysis of key data presented in the basic combined financial statements for the years ended December 31, 2016 and 2015, with additional comparative data for 2014. 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, 2016, the District had 12,752 electric, 1,192 water and 1,221 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, 2016 and 2015, are comprised of:

Statement of Net Position: This statement presents information on the District’s assets, deferred outflows of resources and liabilities and deferred inflows of resources, 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.

**PUBLIC UTILITY DISTRICT NO. 1 OF KLICKITAT COUNTY –
MCAG No. 1785
MANAGEMENT’S DISCUSSION AND ANALYSIS**

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.

Condensed Comparative Financial Information

Combined Statements of Net Position

	2016	2015	2014 <i>as restated</i>
Capital assets	\$ 211,543,341	\$ 213,780,010	\$ 217,168,640
Current, restricted, and other assets and deferred outflow of resources	63,654,401	76,061,472	54,745,275
Total assets and deferred outflows of resources	\$ 275,197,742	\$ 289,841,482	\$ 271,913,915
Long-term liabilities and deferred inflow of resources	\$ 168,155,638	\$ 184,918,394	\$ 168,979,008
Current liabilities	10,914,688	10,300,901	9,555,967
Total liabilities and deferred inflow of resources	179,070,326	195,219,295	178,534,975
Net investment in capital assets	84,290,643	75,249,720	83,867,975
Restricted – bond funds	9,735,473	10,698,073	12,178,945
Unrestricted	2,101,300	8,674,394	(2,667,980)
Total net position	96,127,416	94,622,187	93,378,940
Total liabilities, deferred inflow of resources and net position	\$ 275,197,742	\$ 289,841,482	\$ 271,913,915

**PUBLIC UTILITY DISTRICT NO. 1 OF KLICKITAT COUNTY –
MCAG No. 1785
MANAGEMENT’S DISCUSSION AND ANALYSIS**

Financial Highlights – 2016

- The District redeemed the 2006B bonds that were redeemable in December 2016 in the amount of \$8,775,000 plus accrued interest in the amount of \$225,875.
- Following the public 2016 budget / rate hearing, the Board of Commissioner’s adopted a bifurcated rate increase to balance the District operating, maintenance, and capital budgets for 2016. The first increase of 3% took effect on January 1, 2016, with the second rate increase of 3% effective on July 1, 2016. The increases were applied to all retail rate classes, and to both the base fees and energy charges.
- On an annual basis the District meets with each unincorporated community where water and wastewater services are provided to review annual operations, financial performance and any expected future system projects. Following a public hearing to review rates, water and wastewater rates were increased on 9 of the 14 systems owned and operated by the District, varying between 1% and 5%, decreased on one system by 10%, and not changed on 4 systems. The rate increases took effect on June 1, 2016.
- Wholesale generation revenues continued to decline in 2016 as in 2015, due to lowering energy market pricing. This trend has been experienced throughout the utility industry. District revenues declined 17.3% from the previous year. The decline was anticipated during the budgeting process for 2016 and thus the need for retail rate increases along with tightening of operation and maintenance budgets, which were set at 2015 levels.
- The District has continued to employ The Energy Authority (TEA) to manage our marketing of power sales and purchases to maximize the value of our power portfolio. TEA also assists in Risk Management practices utilized at the District and the strategy for hedging trades has increased over time and has become an integral part of reducing our exposure to declining market pricing.
- The transmission service revenues for the District (\$5,264,742) are a constant business line. The contracts with the various wind generators and the Goldendale Energy Center, owned by Puget Sound Energy, currently run through 2032 for most projects.
- The McNary Dam Fish-Bypass Generation Project crane failure during 2015 was repaired early in 2016. Once the repair was completed turbine runner upgrade commenced; however, due to the extent of damage caused by the failure, additional necessary upgrades, and the annual outage required by the Army Corps of Engineers, who operate the Federal Dam, the project was offline all of 2016. The District was reimbursed for business interruption from the crane failure in the amount of \$357,576 during 2016.
- The District received \$1,255,279 for customer Contributions in Aid of Construction (CAIC). These dollars are related to the customer’s share for utility infrastructure and line extensions.

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- Policy Bulletin No. 9, Electric System Financial Policy, sets the annual Debt Service Coverage at 1.50. The District through concerted efforts on fiscal management met this policy target of 1.50 in 2016, which is an improvement over the 2015 level of 1.46 considering the continuing decline in wholesale revenues of 17%.

Financial Highlights – 2015

- The District issued \$49,235,000 of Electric System Tax-Exempt Revenue and Refunding Bonds and \$32,035,000 of Electric System Taxable Revenue Refunding Bonds on September 10, 2015. The purpose of the bond issue was to finance and reimburse the District for costs related to capital improvements to the Electric System and to defease and refund a portion of the District’s outstanding 2006 Electric System Bond obligation. The net Tax-Exempt Interest Rate was 4.232389% and Taxable Interest Rate 3.53308%.
- \$10,000,000 of the 2015 Bond proceeds is available to fund planned Electric System capital improvements.
- Related to the 2015 Bond Issue and the District’s outstanding parity debt, Fitch Rating Agency maintained its A- rating and Moody’s Investors Services maintained its A2 rating of the District.
- The District incurred \$649,527 of bond issuance costs in 2015. An election was made, with the approval of the District’s Board of Commissioners, to apply Regulatory Accounting policies and procedures to the bond issuance costs, which will equally expense the costs annually over the term of the debt.
- Following a public rate hearing, the Board of Commissioners raised electrical rates 9% in all retail categories effective June 1, 2015.
- District Management met with each local community where it provides water and wastewater services to review annual operations, financial performance, and projected future projects. Following a public rate hearing, water and wastewater rates were raised for 10 of the 14 systems owned by the District effective June 1, 2015. The increases ranged from 1% to 5%.
- The District’s Wholesale Generation business line experienced a steady decline in energy market power prices during 2015, which resulted in a drop in wholesale generation revenue by 11% from 2014.
- 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.

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MANAGEMENT’S DISCUSSION AND ANALYSIS**

- 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 in 2015 was \$5,338,028.
- During 2015, there was an equipment failure of a crane located at the McNary Dam Fish-Bypass Generation Project, which resulted in significant damage to the 10MW turbine generator. Repairs commenced immediately and will continue into 2016. The District has a 50% ownership share of the McNary Generation Project.
- A federal U.S. Department of Agriculture (USDA) grant and loan for \$650,000 and \$200,000, respectively, was obtained to fund the infrastructure of the Bickleton Water System. Additional grant funds were also obtained from the Klickitat County Landfill Improvement Fund.
- The District, as a sub recipient of Klickitat County, was awarded a Community Development Block Grant (CDBG) in the amount of \$750,000 to apply towards the \$896,000 water project planned for the Wishram Water System.
- The Board of Commissioners approved changes to the District’s Electric System Financial Policy (Policy Bulletin No. 9) at its June 23, 2015 Board Meeting. Policy guideline for Days Cash on Hand was set to 160 and Debt Service Coverage Ratio to 1.5.
- The District’s \$2.5 million Credit Facility Agreement with an FDIC-insured financial institution was extended to August 1, 2017.

Financial Analysis

Capital Activity

2015 to 2016:

District utility plant increased \$4.7 million in 2016. Capital additions of Distribution station equipment, poles, towers and fixtures, overhead and underground conductors and devices, and transformers accounted for 52% of the increase. A couple of projects during 2016 worth noting were the Bickleton water system and the Landfill Gas turbine generator #1 failed in July 2016 and was rebuilt.

2014 to 2015:

Total utility plant saw an increase of \$5.5 million in 2015. Capital additions of distribution station equipment, poles, towers and fixtures, overhead and underground conductors and devices, and transformers accounted for 62.0% of the increase. Additionally, Construction Work in Progress (CWIP) increased by 10.3% from 2014. Notable projects during 2015 included the Mercer Sundale Project, M.A. Collins Portable Substation, Maryhill Loops Fire Rebuild, High Prairie Poles, and Gas Cleaning System Modifications at the H. W. Hill Landfill Gas Plant.

**PUBLIC UTILITY DISTRICT NO. 1 OF KLICKITAT COUNTY –
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Debt Activity

2015 to 2016:

As detailed in the Financial Highlights – 2016 section above, the District paid off the 2006B bonds to take advantage of the early call provisions to save on interest payments over the life of the debt. In 2016 the utility reduced outstanding debt by \$13.6 million in principal and made interest payments of \$6.4 million.

2014 to 2015:

As detailed in the Financial Highlights – 2015 section above, the District issued Electric Revenue and Refunding Bonds totaling \$81,270,000 during 2015. The bond issue refunded a portion of the District’s 2006 Revenue Bonds and provided funds for capital improvements. The District’s entire Electric debt now spans to 2036 with a relatively smooth debt service schedule. During 2015, Electric and Water/Wastewater principal repayments totaled \$4,400,000 and \$218,490, respectively. The District obtained a \$200,000 USDA loan to partially fund the Bickleton Water System project.

Current, Restricted, and Other Activity

2015 to 2016:

District current assets declined by \$6.3 million in 2016 compared to 2015. The main factor was due to paying off the 2006B Bonds early and plant additions, thus reducing cash on hand. Restricted cash also saw a decline as well due to the payoff. The District was no longer required to maintain a bond reserve fund for the 2006B bonds, (\$1.01m). The District also used construction funds of \$1.7 million to fund utility plant additions.

2014 to 2015:

Total Current Assets saw a 40.5% rise over the prior year. Cash and Cash Equivalents increased by \$7.4 million, primarily the result of reimbursement by the 2015 Bond Proceeds for eligible capital expenditures prior to the bond issue. Accounts Receivable and Unbilled Revenue were responsible for \$0.8 million of the rise. Restricted Cash Equivalents rose by \$8.6 million, the result of the 2015 Bond Construction Fund and a decrease in the 2006 Bond Fund requirement due to partial refunding. Other Activity increased by 19.5% with drivers being Deferred Loss on 2006 Bond Refunding of \$2.9 million and Preliminary Investigation of \$1.0 million. The District also implemented GASB 68, which increased deferred outflows of resources by \$1 million and pension liability by \$2.3 million and decreased deferred inflows of resources by \$0.9 million.

**PUBLIC UTILITY DISTRICT NO. 1 OF KLICKITAT COUNTY –
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MANAGEMENT’S DISCUSSION AND ANALYSIS**

Overall Results of Operations

2015 to 2016:

2016 was a year of intense effort to reduce expenses by adhering to budget constraints, thus overall operating increases over 2015 by \$2.5 million or 137%. The reduction in operating revenues for wholesale and transmission was partially offset by retail rates increases of 3% on January 1st and another 3% on July 1st.

2014 to 2015:

2015 Operating Income increased over 2014 by \$800,000 or 84%. The drop in Wholesale Generation Revenue was offset by retail rate increases. Operating Expenses were lower than 2014, which resulted in it being the major contributor to the increase in Operating Income.

Electric System Operating Results

	<u>2016</u>	<u>2015</u>	<u>2014</u> <i>as restated</i>
Operating revenues	\$ 43,709,405	\$ 43,777,979	\$ 43,471,178
Operating expenses	<u>38,980,634</u>	<u>42,039,227</u>	<u>41,671,964</u>
Operating income	4,728,771	1,738,752	1,799,214
Net non-operating revenue (expense)	(4,979,644)	(3,539,791)	(5,649,717)
Capital contributions	<u>2,122,277</u>	<u>1,988,648</u>	<u>3,126,557</u>
Change in net position	<u>\$ 1,871,404</u>	<u>\$ 187,609</u>	<u>\$ (723,946)</u>

Operating Revenues

2015 to 2016:

Operating revenues increased by \$69 thousand from 2015 due to lower wholesale revenues. The decrease was minimized by retail rate increases of 3% in January and July.

2014 to 2015:

Operating revenues remained stable from 2014, primarily due to the 9% retail rate increase effective June 1, 2015 less the \$500,000 transfer to the rate stabilization fund.

**PUBLIC UTILITY DISTRICT NO. 1 OF KLICKITAT COUNTY –
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MANAGEMENT’S DISCUSSION AND ANALYSIS**

Operating Expenses

2015 to 2016:

Operating expenses decreased by \$3 million compared to 2015. The majority was in power expense. The utility monitored expenses in all categories closely throughout the year and made a concerted effort to control any variable expense.

2014 to 2015:

Operating expenses increased a meager 0.8% in 2015. A number of employee positions were vacant during the year and cost containment efforts by staff helped contribute to the minimal increase in expenses.

Non-Operating Revenue/(Expense)

2015 to 2016:

Net non-operating expense increased by \$1.45 million in 2016. The comparison with 2015 shows that interest expense returned to normal based on outstanding debt since there was no refunding activity during 2016 on bonds outstanding.

2014 to 2015:

Net Non-Operating Revenue/ (Expense) was lower by \$2.1 million compared to 2014. The two primary drivers of this change were an interest income adjustment related to the District’s transmission deposit with the Bonneville Power Administration and a drop in interest expense due to the refunding of the 2006 Revenue Bonds in 2015.

Capital Contributions

2015 to 2016:

Capital contributions were relatively consistent with the prior year.

2014 to 2015:

Electric capital contributions were 36.3% lower than 2014; however, customer cash contributions in aid of construction were over \$1.0 million for the year. Agricultural growth continued strong.

**PUBLIC UTILITY DISTRICT NO. 1 OF KLICKITAT COUNTY –
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MANAGEMENT’S DISCUSSION AND ANALYSIS**

Water and Wastewater Systems Operating Results

	<u>2016</u>	<u>2015</u>	<u>2014</u> <i>as restated</i>
Operating revenues	\$ 1,213,152	\$ 1,478,695	\$ 1,485,743
Operating expenses	<u>1,560,986</u>	<u>1,369,641</u>	<u>2,282,326</u>
Operating income	(347,834)	109,054	(796,583)
Net non-operating revenue (expense)	(18,341)	(11,359)	4,785
Capital contributions and grants	<u>-</u>	<u>957,943</u>	<u>138,127</u>
Change in net position	<u>\$ (366,175)</u>	<u>\$ 1,055,638</u>	<u>\$ (653,671)</u>

Operating Revenues

2015 to 2016:

Operating Revenues decreased by \$266 thousand in 2016 compared to 2015. Some of the decrease was due to a 10% reduction in Klickitat’s community water rates along with general county wide economic conditions of a rural area.

2014 to 2015:

Operating Revenues were 0.5% lower than 2014. The main reason for the drop was a change in the reporting of revenues related to the two systems that are owned by other entities, but operated by the District. Effective in 2015, their financial activity was no longer reported in the District’s financial statements, but was included in 2014.

Operating Expenses

2015 to 2016:

Operating Expenses were up 14% over 2015. Results were impacted by inflation, returning to a normal staffing level for operators, and the addition of a new water system in Bickleton.

2014 to 2015:

Operating Expenses were lower than 2014 by 40.0%. Similar to Operating Revenues, beginning in 2015, we are no longer reporting the financial activity of the two systems operated by the District but owned by other entities. Also contributing to the change were single year water and wastewater system expense adjustments in 2014.

**PUBLIC UTILITY DISTRICT NO. 1 OF KLICKITAT COUNTY –
MCAG No. 1785
MANAGEMENT’S DISCUSSION AND ANALYSIS**

Non-Operating Revenue/(Expense)

2015 to 2016:

A small increase of \$7 thousand was incurred in fiscal year 2016.

2014 to 2015:

The change in Non-Operating Revenue/ (Expense) is primarily related to the reporting change of the two water and wastewater systems as detailed above.

Capital Contributions and Grants

2015 to 2016:

Capital contributions were significantly lower in 2016, \$957 thousand. The decrease was from the large grant funds for the Bickleton water system was received in 2015 and the utility had no large projects during 2016.

2014 to 2015:

Water and Wastewater Capital Contributions and Grants saw a sharp increase in 2015. The Bickleton Water System received grants totaling \$650,000 from USDA and \$205,428 from Klickitat County in 2015. Slow growth in new construction and related utility connections continued during 2015.

The District Looking Forward

During 2017, the District will switch our Bonneville Power Administration power and transmission contracts. The utility will be shifting from the Slice power product to a Load following contract beginning on October 1, 2017, and transferring from a point to point transmission contract to a network contract. The District will continue to utilize hedging of both power purchases and sales to minimize exposure to the volatile energy markets. The utility has embarked on an addition to our Landfill Gas generation project with additional gas cleaning system to market the gas as renewable fuel. The project financing has been secured and a contract has been signed with an off taker that guarantees the repayment of the additional debt and puts the project on a path towards better net margins well into the future. The project is scheduled to commence operating in mid-year 2018. The District in the meantime has negotiated a power sale deal to keep the project run under current status until the cleaning system is online. A couple of other areas of interest is the work on finalizing a water right lease of considerable value to the District and the negotiation to purchase an existing transmission line within our service territory owed by another entity. The District is also upgrading a vital substation on the West end of the county this will help support the system well into the future. We will also continue to explore ways to improve our non-retail revenues as well as remain diligent in our cost controls.

**PUBLIC UTILITY DISTRICT NO. 1 OF KLICKITAT COUNTY –
MCAG No. 1785
COMBINED STATEMENTS OF NET POSITION**

ASSETS AND DEFERRED OUTFLOW OF RESOURCES

	December 31,	
	2016	2015
CURRENT ASSETS		
Cash and cash equivalents	\$ 10,151,134	\$ 15,770,021
Notes receivable	64,479	96,349
Accounts receivable, net	1,897,545	1,770,390
Unbilled revenue	1,908,153	2,150,696
Other receivables	3,326,235	3,753,773
Materials and supplies	1,877,020	1,988,634
Prepayments	1,002,032	958,227
Current portion of prepaid power contract	1,180,359	1,180,359
Total current assets	<u>21,406,957</u>	<u>27,668,449</u>
RESTRICTED CASH EQUIVALENTS		
Special funds, bonds	10,266,300	11,276,222
Special funds, construction	8,392,571	10,141,395
Special funds, power cost stabilization	3,300,000	3,300,000
Total restricted cash equivalents	<u>21,958,871</u>	<u>24,717,617</u>
CAPITAL ASSETS		
Total plant in service	311,400,296	306,654,309
Construction work in progress	5,341,876	4,227,753
Total utility plant	316,742,172	310,882,062
Accumulated provision for depreciation	(105,198,831)	(97,102,052)
Net capital assets	<u>211,543,341</u>	<u>213,780,010</u>
OTHER ASSETS		
Other investments and transmission deposits	536,874	1,183,901
Other assets and prepaid power contract	13,960,111	14,903,041
Derivative asset	657,896	2,830,889
Regulatory asset – issuance costs	611,505	647,900
Total other assets	<u>15,766,386</u>	<u>19,565,731</u>
DEFERRED OUTFLOWS OF RESOURCES		
Pension	1,473,308	1,211,524
Accumulated decrease in fair value of hedging derivatives	334,737	-
Deferred loss on refunding	2,714,142	2,898,151
Total deferred outflows of resources	<u>4,522,187</u>	<u>4,109,675</u>
Total assets and deferred outflows of resources	<u>\$ 275,197,742</u>	<u>\$ 289,841,482</u>

**PUBLIC UTILITY DISTRICT NO. 1 OF KLICKITAT COUNTY –
MCAG No. 1785
COMBINED STATEMENTS OF NET POSITION**

LIABILITIES, DEFERRED INFLOW OF RESOURCES, AND NET POSITION

	December 31,	
	2016	2015
CURRENT LIABILITIES		
Accounts payable	\$ 2,751,921	\$ 2,525,933
Current portion of long-term debt	4,464,447	3,938,397
Consumers deposits	425,277	280,469
Other current and accrued liabilities	3,273,043	3,556,102
Total current liabilities	10,914,688	10,300,901
NONCURRENT LIABILITIES		
Long-term debt	131,180,822	144,733,288
Net pension liability	6,815,429	6,885,902
Derivative liability	334,737	-
Total noncurrent liabilities	138,330,988	151,619,190
DEFERRED INFLOWS OF RESOURCES		
Pension	622,450	1,057,013
Regulatory liability – rate stabilization	3,300,000	3,300,000
Accumulated increase in fair value of hedging derivatives	657,896	2,830,889
Regulatory liability – CIAC	25,244,304	26,111,302
Total deferred inflows of resources	29,824,650	33,299,204
NET POSITION		
Net investment in capital assets	84,290,643	75,249,720
Restricted – bond funds	9,735,473	10,698,073
Unrestricted	2,101,300	8,674,394
Total net position	96,127,416	94,622,187
Total liabilities, deferred inflows of resources and net position	\$ 275,197,742	\$ 289,841,482

**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,	
	<u>2016</u>	<u>2015</u>
OPERATING REVENUES		
Electric system		
Sales to retail customers	\$ 29,838,950	\$ 28,038,320
Sales to wholesale and transmission customers	13,870,455	15,739,659
Water/wastewater systems	<u>1,213,152</u>	<u>1,478,695</u>
Total operating revenues	<u>44,922,557</u>	<u>45,256,674</u>
OPERATING EXPENSES		
Power expense	10,998,806	12,339,684
Operations expense	12,718,319	12,500,326
Maintenance expense	2,775,936	2,697,908
Administrative and general expense	3,377,599	4,424,668
Depreciation expense	8,597,156	9,504,604
Tax expense	<u>2,073,804</u>	<u>1,941,678</u>
Total operating expenses	<u>40,541,620</u>	<u>43,408,868</u>
OPERATING INCOME	<u>4,380,937</u>	<u>1,847,806</u>
NON-OPERATING REVENUE/(EXPENSE)		
Interest income	305,164	1,272,655
Other non-operating revenues	1,213,408	1,152,178
Interest expense	(6,424,482)	(5,860,152)
Other expenses	<u>(92,075)</u>	<u>(115,831)</u>
Total non-operating expense	<u>(4,997,985)</u>	<u>(3,551,150)</u>
LOSS BEFORE CAPITAL CONTRIBUTIONS AND GRANTS	(617,048)	(1,703,344)
CAPITAL CONTRIBUTIONS AND GRANTS	<u>2,122,277</u>	<u>2,946,591</u>
CHANGE IN NET POSITION	<u>1,505,229</u>	<u>1,243,247</u>
NET POSITION, beginning of year	<u>94,622,187</u>	<u>93,378,940</u>
NET POSITION, end of year	<u>\$ 96,127,416</u>	<u>\$ 94,622,187</u>

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

	Years Ended December 31,	
	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from customers	\$ 45,636,635	\$ 45,031,745
Payments to suppliers for goods and services	(22,442,328)	(26,785,254)
Payments to employees for services	(6,880,076)	(6,565,762)
Taxes paid	(2,114,066)	(2,002,405)
Net change in cash flows from operating activities	<u>14,200,165</u>	<u>9,678,324</u>
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES		
Proceeds from (payments on) BPA transmission deposits	647,027	(478,115)
Other non-operating income	1,121,333	1,036,347
Net change in cash flows from non-capital financing activities	<u>1,768,360</u>	<u>558,232</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Principal payments on long-term debt	(12,716,696)	(4,625,114)
Issuance of long-term debt and premium	2,263	20,222,762
Interest payments	(6,599,778)	(5,936,001)
Capital contributions and grants	1,255,279	2,079,592
Other assets – preliminary engineering	(237,429)	(1,075,055)
Capital expenditures	(6,360,487)	(6,115,974)
Net change in cash flows from capital and related financing activities	<u>(24,656,848)</u>	<u>4,550,210</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest received	310,690	1,268,837
Net change in cash flows from investing activities	<u>310,690</u>	<u>1,268,837</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	(8,377,633)	16,055,603
CASH AND CASH EQUIVALENTS, beginning of year	<u>40,487,638</u>	<u>24,432,035</u>
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 32,110,005</u>	<u>\$ 40,487,638</u>

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

	Years Ended December 31,	
	2016	2015
RECONCILIATION OF OPERATING INCOME TO NET CASH FROM OPERATING ACTIVITIES		
OPERATING INCOME	\$ 4,380,937	\$ 1,847,806
ADJUSTMENTS TO RECONCILE OPERATING INCOME TO NET CASH FROM OPERATING ACTIVITIES		
Depreciation expense	8,597,156	9,504,604
Pension related items	(766,820)	533,379
Amortization of prepaid power contract	1,180,359	1,180,356
Deferred loss on refunding	-	(3,038,999)
Regulatory assets - issuance costs amortization	36,395	-
CHANGES IN OPERATING ASSETS AND LIABILITIES		
Receivables and unbilled revenue	569,270	(741,395)
Materials and supplies	111,614	1,645
Prepayments	(43,805)	25,689
Regulatory asset - issuance costs	-	(647,900)
Accounts payable	225,988	502,591
Customer deposits	144,808	16,466
Other current and accrued liabilities	(235,737)	67,663
Compensated absences	-	(73,581)
Regulatory liability - rate stabilization	-	500,000
Total adjustments	9,819,228	7,830,518
Net cash from operating activities	\$ 14,200,165	\$ 9,678,324

PUBLIC UTILITY DISTRICT NO. 1 OF KLICKITAT COUNTY –
MCAG No. 1785
NOTES TO COMBINED FINANCIAL STATEMENTS

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, 2016, the District had 12,752 electric, 1,192 water and 1,221 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 II 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 and 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, 2016 and 2015, was \$94,965 and \$78,741, respectively.

Other receivables – Other receivables consist 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. No allowance for doubtful accounts was deemed necessary as of December 31, 2016 and 2015.

**PUBLIC UTILITY DISTRICT NO. 1 OF KLICKITAT COUNTY –
MCAG No. 1785
NOTES TO COMBINED FINANCIAL STATEMENTS**

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%.

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.

Change in accounting principle – In February 2015, GASB issued Statement No. 72, Fair value Measurement and Application, effective for financial statements for year beginning after June 15, 2015. This statement clarifies the definition of fair value, establishes general principles for measuring fair value, provides additional fair value application guidance, and enhances disclosures about fair value measurements. The District implemented this statement during fiscal year and had no investments that were required to be reported in accordance with GASB Statement No. 72, other than derivative instruments.

PUBLIC UTILITY DISTRICT NO. 1 OF KLICKITAT COUNTY –
MCAG No. 1785
NOTES TO COMBINED FINANCIAL STATEMENTS

Note 1 – Organization and Significant Accounting Policies (continued)

In accordance with GASB 72, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price). Fair value is a market-based measurement for a particular asset or liability based on assumptions that market participants would use in pricing the asset or liability.

Valuation inputs are assumptions that market participants use in pricing an asset or liability. The hierarchy of inputs used to generate the valuation is classified into three different levels:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities at the measurement date.
- Level 2 inputs include quoted prices for similar assets or liabilities in markets that are active; quoted prices for identical or similar assets or liabilities in markets that are not active; and inputs other than quoted prices that are observable for an asset, either directly or indirectly.
- Level 3 inputs are unobservable inputs from the asset or liability where there is very little market activity and they should be used only when relevant Level 1 and Level 2 inputs are unavailable.

Fair value measurements are performed on a recurring basis. The fair value of swap contracts as of December 31, 2016 and 2015, were based on the future price curve for the Mid-Columbia Intercontinental Exchange for electricity. The observability of inputs used to perform the measurement results in the swap fair value being categorized as Level 2 on the fair value hierarchy.

Debt expense, unamortized premium and loss on refunding – Bond issue costs are generally expensed as incurred. However, the District utilized regulatory accounting for bond issuance costs and as such, amortizes them consistent with rate making decisions. Bond premiums are amortized to interest expense, using the weighted average method over the term of the bonds. Loss on refunding is amortized over the shorter of the new or previous bonds.

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).

**PUBLIC UTILITY DISTRICT NO. 1 OF KLICKITAT COUNTY –
MCAG No. 1785
NOTES TO COMBINED FINANCIAL STATEMENTS**

Note 1 – Organization and Significant Accounting Policies (continued)

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 compensation, 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 consists 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.

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.

**PUBLIC UTILITY DISTRICT NO. 1 OF KLICKITAT COUNTY –
MCAG No. 1785
NOTES TO COMBINED FINANCIAL STATEMENTS**

Note 1 – Organization and Significant Accounting Policies (continued)

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.

Pensions – For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of all state sponsored pension plans and additions to/deductions from those plans’ fiduciary net position have been determined on the same basis as they are reported by the Washington State Department of Retirement Systems. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

**PUBLIC UTILITY DISTRICT NO. 1 OF KLICKITAT COUNTY –
MCAG No. 1785
NOTES TO COMBINED FINANCIAL STATEMENTS**

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 2016	Total 2015
Special funds, bonds	\$ 10,266,300	\$ -	\$ 10,266,300	\$ 11,276,222
Special funds, construction	8,392,571	-	8,392,571	10,141,395
Special funds, power cost stabilization	3,300,000	-	3,300,000	3,300,000
Cash – general funds	-	10,151,134	10,151,134	15,770,021
Totals	<u>\$ 21,958,871</u>	<u>\$ 10,151,134</u>	<u>\$ 32,110,005</u>	<u>\$ 40,487,638</u>

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 2016 and 2015, 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.

**PUBLIC UTILITY DISTRICT NO. 1 OF KLICKITAT COUNTY –
MCAG No. 1785
NOTES TO COMBINED FINANCIAL STATEMENTS**

Note 3 – Capital Assets (Utility Plant)

The following are changes in capital assets for the year ended December 31, 2016:

Description	Balance 01/01/2016	Additions	Retirements and Transfers	Balance 12/31/2016
Capital assets not being depreciated				
Organization	\$ 14,767	\$ -	\$ -	\$ 14,767
Franchises and consents	211,427	-	-	211,427
Land and land rights	1,698,140	81,806	-	1,779,946
Construction work in progress	4,227,753	6,301,003	5,186,880	5,341,876
	<u>6,152,087</u>	<u>6,382,809</u>	<u>5,186,880</u>	<u>7,348,016</u>
Capital assets being depreciated				
Electric plant				
Distribution plant	116,892,792	2,565,076	290,455	119,167,413
Transmission plant	54,841,173	126,753	30,068	54,937,858
Generating plant	103,060,485	682,324	-	103,742,809
Water and wastewater plant	20,647,950	1,485,505	-	22,133,455
General plant	9,287,575	428,278	303,232	9,412,621
	<u>304,729,975</u>	<u>5,287,936</u>	<u>623,755</u>	<u>309,394,156</u>
Total capital assets	310,882,062	11,670,745	5,810,635	316,742,172
Accumulated depreciation	<u>(97,102,052)</u>	<u>(8,732,210)</u>	<u>635,431</u>	<u>(105,198,831)</u>
Net capital assets	<u>\$ 213,780,010</u>	<u>\$ 2,938,535</u>	<u>\$ 6,446,066</u>	<u>\$ 211,543,341</u>

**PUBLIC UTILITY DISTRICT NO. 1 OF KLICKITAT COUNTY –
MCAG No. 1785
NOTES TO COMBINED FINANCIAL STATEMENTS**

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

The following are changes in capital assets for the year ended December 31, 2015:

Description	Balance 01/01/2015	Additions	Retirements and Transfers	Balance 12/31/2015
Capital assets not being depreciated				
Organization	\$ 14,767	\$ -	\$ -	\$ 14,767
Franchises and consents	211,427	-	-	211,427
Land and land rights	1,701,940	-	3,800	1,698,140
Construction work in progress	3,831,346	5,900,800	5,504,393	4,227,753
	<u>5,759,480</u>	<u>5,900,800</u>	<u>5,508,193</u>	<u>6,152,087</u>
Capital assets being depreciated				
Electric plant				
Distribution plant	113,327,042	4,034,037	468,287	116,892,792
Transmission plant	54,643,184	241,759	43,770	54,841,173
Generating plant	100,485,079	2,575,406	-	103,060,485
Water and wastewater plant	20,505,158	142,792	-	20,647,950
General plant	10,703,237	532,878	1,948,540	9,287,575
	<u>299,663,700</u>	<u>7,526,872</u>	<u>2,460,597</u>	<u>304,729,975</u>
Total capital assets	305,423,180	13,427,672	7,968,790	310,882,062
Accumulated depreciation	<u>(88,254,540)</u>	<u>(9,648,881)</u>	<u>801,369</u>	<u>(97,102,052)</u>
Net capital assets	<u>\$ 217,168,640</u>	<u>\$ 3,778,791</u>	<u>\$ 8,770,159</u>	<u>\$ 213,780,010</u>

Note 4 – Other Assets and Prepaid Power Contract

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

	2016	2015
Prepaid power contract, net of current portion	\$ 11,803,620	\$ 12,983,976
Preliminary investigation charges	<u>2,156,491</u>	<u>1,919,065</u>
	<u>\$ 13,960,111</u>	<u>\$ 14,903,041</u>

**PUBLIC UTILITY DISTRICT NO. 1 OF KLUCKITAT COUNTY –
MCAG No. 1785
NOTES TO COMBINED FINANCIAL STATEMENTS**

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, 2016:

	Balance 01/01/2016	Additions	Payments/ Amortization	Balance 12/31/2016	Due Within One Year
Electric revenue bonds and loan	\$ 143,606,907	\$ -	\$ 12,427,500	\$ 131,179,407	\$ 4,307,871
Unamortized bond premium	2,904,496	-	311,983	2,592,513	-
W/WW revenue bonds	123,500	-	88,000	35,500	9,000
W/WW loans	2,036,782	2,263	201,196	1,837,849	147,576
Total long-term debt	\$ 148,671,685	\$ 2,263	\$ 13,028,679	\$ 135,645,269	\$ 4,464,447

The following are changes in long-term debt for the year ended December 31, 2015:

	Balance 01/01/2015	Additions	Payments/ Amortization	Balance 12/31/2015	Due Within One Year
Electric revenue bonds	\$ 129,319,194	\$ 18,694,337	\$ 4,406,624	\$ 143,606,907	\$ 3,716,907
Unamortized bond premium	1,809,144	1,321,980	226,628	2,904,496	-
W/WW revenue bonds	149,500	-	26,000	123,500	29,000
W/WW loans	2,022,827	206,445	192,490	2,036,782	192,490
Total long-term debt	\$ 133,300,665	\$ 20,222,762	\$ 4,851,742	\$ 148,671,685	\$ 3,938,397

**PUBLIC UTILITY DISTRICT NO. 1 OF KLICKITAT COUNTY –
MCAG No. 1785
NOTES TO COMBINED FINANCIAL STATEMENTS**

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 0.993% to 7.038% for the year ended December 31, 2016, and from 0.993% to 5.0% for the year ended December 31, 2015. The electric system also has one loan that carries a fixed interest rate of 3.68%. 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 0.5%, the State Revolving Fund (SRF) loans have fixed rates of 0.0% to 1.0% and the USDA of 2.125%. Electric revenue bonds mature through December 1, 2036, water/wastewater bonds mature through September 1, 2021, and the PWTF and SRF loans mature through 2055. There is \$18,658,871 as of December 31, 2016, 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.

Future maturities are as follows as of December 31, 2016:

Electric Revenue Bonds and Loan			
Year(s)	Principal	Interest	Totals
2017	\$ 4,307,871	\$ 6,287,764	\$ 10,595,635
2018	4,428,207	6,166,976	10,595,183
2019	4,573,557	6,026,009	10,599,566
2020	4,733,923	5,865,464	10,599,387
2021–25	26,760,849	26,206,696	52,967,545
2026–30	33,585,000	18,932,864	52,517,864
2031–35	42,930,000	8,250,938	51,180,938
2036	9,860,000	394,400	10,254,400
	<u>\$ 131,179,407</u>	<u>\$ 78,131,111</u>	<u>\$ 209,310,518</u>

Water/Wastewater Revenue Bonds			
Year(s)	Principal	Interest	Totals
2017	\$ 9,000	\$ 1,661	\$ 10,661
2018	9,000	1,213	10,213
2019	9,000	763	9,763
2020	6,500	313	6,813
2021	2,000	50	2,050
	<u>\$ 35,500</u>	<u>\$ 4,000</u>	<u>\$ 39,500</u>

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Note 5 – Long-Term Debt (continued)

Water/Wastewater PWTf, SRF and USDA Loans			
Year(s)	Principal	Interest	Totals
2017	\$ 147,576	\$ 10,553	\$ 158,129
2018	151,050	10,589	161,639
2019	151,124	9,888	161,012
2020	151,200	9,491	160,691
2021–25	713,271	41,351	754,622
2026–30	329,825	31,000	360,825
2031–35	68,971	19,675	88,646
2036-40	26,450	149,921	176,371
2041-45	29,379	9,241	38,620
2046-50	32,644	5,976	38,620
2051-55	36,359	2,357	38,716
	\$ 1,837,849	\$ 300,042	\$ 2,137,891

Note 6 – Retirement Benefits

The following table represents the aggregate pension amounts for all plans subject to the requirements of the GASB Statement 68, *Accounting and Financial Reporting for Pensions* for the year 2016:

Aggregate Pension Amounts – All Plans		
Pension liabilities	\$	6,815,429
Deferred outflows of resources	\$	1,473,308
Deferred inflows of resources	\$	622,450
Pension credit	\$	49,895

State Sponsored Pension Plans

Substantially all 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 state Legislature establishes, and amends, laws pertaining to the creation and administration of all public retirement systems.

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Note 6 – Retirement Benefits (continued)

The Department of Retirement Systems (DRS), a department within the primary government of the State of Washington, issues a publicly available comprehensive annual financial report (CAFR) that includes financial statements and required supplementary information for each plan. The DRS CAFR may be obtained by writing to:

Department of Retirement Systems
Communications Unit
P.O. Box 48380
Olympia, WA 98540-8380

Or the DRS CAFR may be downloaded from the DRS website at www.drs.wa.gov.

Public Employees' Retirement System (PERS)

PERS members include elected officials; state employees; employees of the Supreme, Appeals and Superior Courts; employees of the legislature; employees of district and municipal courts; employees of local governments; and higher education employees not participating in higher education retirement programs. PERS is comprised of three separate pension plans for membership purposes. PERS plans 1 and 2 are defined benefit plans, and PERS plan 3 is a defined benefit plan with a defined contribution component.

PERS Plan 1 provides retirement, disability and death benefits. Retirement benefits are determined as two percent of the member's average final compensation (AFC) times the member's years of service. The AFC is the average of the member's 24 highest consecutive service months. Members are eligible for retirement from active status at any age with at least 30 years of service, at age 55 with at least 25 years of service, or at age 60 with at least five years of service. Members retiring from active status prior to the age of 65 may receive actuarially reduced benefits. Retirement benefits are actuarially reduced to reflect the choice of a survivor benefit. Other benefits include duty and non-duty disability payments, an optional cost-of-living adjustment (COLA), and a one-time duty-related death benefit, if found eligible by the Department of Labor and Industries. PERS 1 members were vested after the completion of five years of eligible service. The plan was closed to new entrants on September 30, 1977.

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Note 6 – Retirement Benefits (continued)

Contributions

The **PERS Plan 1** member contribution rate is established by State statute at 6 percent. The employer contribution rate is developed by the Office of the State Actuary and includes an administrative expense component. Each biennium, the state Pension Funding Council adopts Plan 1 employer contribution rates. The PERS Plan 1 required contribution rates (expressed as a percentage of covered payroll) for 2016 were as follows:

PERS Plan 1	2016	2015
Actual Contribution Rates		
Employer	6.00%	6.00%
Employee	11.18%	9.21 - 11.18%

The District’s actual contributions to the plan were \$312,274 and \$296,743 for the years ended December 31, 2016 and 2015, respectively.

PERS Plan 2/3 provides retirement, disability and death benefits. Retirement benefits are determined as two percent of the member’s average final compensation (AFC) times the member’s years of service for Plan 2 and 1 percent of AFC for Plan 3. The AFC is the average of the member’s 60 highest-paid consecutive service months. There is no cap on years of service credit. Members are eligible for retirement with a full benefit at 65 with at least five years of service credit. Retirement before age 65 is considered an early retirement. PERS Plan 2/3 members who have at least 20 years (PERS 2) or 10 years (PERS 3) of service credit and are 55 years of age or older, are eligible for early retirement with a benefit that is reduced by a factor that varies according to age for each year before age 65. PERS Plan 2/3 members who have 30 or more years of service credit and are at least 55 years old can retire under one of two provisions:

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

PERS Plan 2/3 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 credit. PERS Plan 2/3 retirement benefits are also actuarially reduced to reflect the choice of a survivor benefit. Other PERS Plan 2/3 benefits include duty and non-duty disability payments, a cost-of-living allowance (based on the CPI), capped at three percent annually and a one-time duty related death benefit, if found eligible by the Department of Labor and Industries. PERS 2 members are vested after completing five years of eligible service.

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Note 6 – Retirement Benefits (continued)

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 12 months of that service are earned after age 44.

PERS Plan 3 defined contribution benefits are totally dependent on employee contributions and investment earnings on those contributions. PERS Plan 3 members choose their contribution rate upon joining membership and have a chance to change rates upon changing employers. As established by statute, Plan 3 required defined contribution rates are set at a minimum of 5 percent and escalate to 15 percent with a choice of six options. Employers do not contribute to the defined contribution benefits. PERS Plan 3 members are immediately vested in the defined contribution portion of their plan.

Contributions

The **PERS Plan 2/3** employer and employee contribution rates are developed by the Office of the State Actuary to fully fund Plan 2 and the defined benefit portion of Plan 3. The Plan 2/3 employer rates include a component to address the PERS Plan 1 UAAL and an administrative expense. Each biennium, the state Pension Funding Council adopts Plan 2 employer and employee contribution rates and Plan 3 contribution rates. The PERS Plan 2/3 required contribution rates (expressed as a percentage of covered payroll) for 2016 were as follows:

PERS Plan 2		
<u>Actual Contribution Rates</u>	<u>2016</u>	<u>2015</u>
Employer	11.18%	9.21 - 11.18%
Employee	6.12%	6.12%

PERS Plan 3		
<u>Actual Contribution Rates</u>	<u>2016</u>	<u>2015</u>
Employer	11.18%	9.21 - 11.18%
Employee	5 - 15%	5 - 15%

The District’s actual contributions to the plan were \$404,651 and \$379,656 for the years ended December 31, 2016 and 2015, respectively.

Actuarial Assumptions

The total pension liability (TPL) for each of the DRS plans was determined using the most recent actuarial valuation completed in 2016, with a valuation date of June 30, 2015. The actuarial assumptions used in the valuation were based on the results of the Office of the State Actuary’s (OSA) *2007-2012 Experience Study*.

**PUBLIC UTILITY DISTRICT NO. 1 OF KLICKITAT COUNTY –
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Note 6 – Retirement Benefits (continued)

Additional assumptions for subsequent events and law changes are current as of the 2015 actuarial valuation report. The TPL was calculated as of the valuation date and rolled forward to the measurement date of June 30, 2016.

Plan liabilities were rolled forward from June 30, 2015 to June 30, 2016, reflecting each plan's normal cost (using the entry-age cost method), assumed interest and actual benefit payments. The total pension liability as of June 30, 2016 was determined using the following actuarial assumptions:

- **Inflation:** 3% total economic inflation; 3.75% salary inflation.
- **Salary increases:** In addition to the base 3.75% salary inflation assumption, salaries are also expected to grow by promotions and longevity.
- **Investment rate of return:** 7.5%.

Mortality rates were based on the RP-2000 report's Combined Healthy Table and Combined Disabled Table, published by the Society of Actuaries. The OSA applied offsets to the base table and recognized future improvements in mortality by projecting the mortality rates using 100 percent Scale BB. Mortality rates are applied on a generational basis; meaning, each member is assumed to receive additional mortality improvements in each future year throughout his or her lifetime.

Discount Rate

The discount rate used to measure the total pension liability for all DRS plans was 7.5 percent.

To determine that rate, an asset sufficiency test included an assumed 7.7 percent long-term discount rate to determine funding liabilities for calculating future contribution rate requirements. (All plans use 7.7 percent except LEOFF 2, which has assumed 7.5 percent). Consistent with the long-term expected rate of return, a 7.5 percent future investment rate of return on invested assets was assumed for the test. Contributions from plan members and employers are assumed to continue being made at contractually required rates. Based on these assumptions, the pension plans' fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return of 7.5 percent was used to determine the total liability.

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Note 6 – Retirement Benefits (continued)

Long-Term Expected Rate of Return

The long-term expected rate of return on the DRS pension plan investments of 7.5 percent was determined using a building-block-method. The Washington State Investment Board (WSIB) used a best estimate of expected future rates of return (expected returns, net of pension plan investment expense, including inflation) to develop each major asset class. Those expected returns make up one component of WSIB’s capital market assumptions. The WSIB uses the capital market assumptions and their target asset allocation to simulate future investment returns at various future times. The long-term expected rate of return of 7.5 percent approximately equals the median of the simulated investment returns over a 50-year time horizon.

Estimated Rates of Return by Asset Class

Best estimates of arithmetic real rates of return for each major asset class included in the pension plan’s target asset allocation as of June 30, 2016, are summarized in the table below. The inflation component used to create the table is 2.2 percent and represents the WSIB’s most recent long-term estimate of broad economic inflation.

Asset Class	Target Allocation	% Long-Term Expected Real Rate of Return Arithmetic	
		2016	2015
Fixed Income	20%	1.70%	1.70%
Tangible Assets	5%	4.40%	4.40%
Real Estate	15%	5.80%	5.80%
Global Equity	37%	6.60%	6.60%
Private Equity	23%	9.60%	9.60%
	<u>100%</u>		

**PUBLIC UTILITY DISTRICT NO. 1 OF KLICKITAT COUNTY –
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Note 6 – Retirement Benefits (continued)

Sensitivity of NPL

The table below presents the District’s proportionate share of the net pension liability calculated using the discount rate of 7.5 percent, as well as what the District’s proportionate share of the net pension liability (assets) would be if it were calculated using a discount rate that is 1-percentage point lower (6.5 percent) or 1-percentage point higher (8.5 percent) than the current rate.

	<u>1% Decrease (6.5%)</u>	<u>Current Discount Rate (7.5%)</u>	<u>1% Increase (8.5%)</u>
PERS 1	\$ 3,733,686	\$ 3,096,184	\$ 2,547,574
PERS 2/3	\$ 6,847,800	\$ 3,719,245	\$ (1,936,082)

Pension Plan Fiduciary Net Position

Detailed information about the State’s pension plans’ fiduciary net position is available in the separately issued DRS financial report.

Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

At December 31, 2016 and 2015, the District reported a total pension liability of \$6,815,429 and \$6,885,902 for its proportionate share of the net pension liability.

At June 30, the District’s proportionate share of the collective net pension liabilities was as follows:

	<u>Proportionate Share 6/30/16</u>	<u>Proportionate Share 6/30/15</u>	<u>Change in Proportion</u>
PERS 1	0.057652%	0.070364%	-0.012712%
PERS 2/3	0.073869%	0.089705%	-0.015836%

Employer contribution transmittals received and processed by the DRS for the fiscal year ended June 30 are used as the basis for determining each employer’s proportionate share of the collective pension amounts reported by the DRS in the *Schedules of Employer and Nonemployer Allocations*.

The collective net pension liability was measured as of June 30, 2016, and the actuarial valuation date on which the total pension liability is based was as of June 30, 2015, with update procedures used to roll forward the total pension liability to the measurement date.

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Note 6 – Retirement Benefits (continued)

Pension Expense/(Credit)

For the year ended December 31, 2016 and 2015, the District recognized pension expense/(credit) of (\$49,895) and \$533,379, respectively.

Deferred Outflows of Resources and Deferred Inflows of Resources

At December 31, 2016, the District reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	2016		2015	
	Deferred Outflows of Resources	Deferred Inflows of Resources	Deferred Outflows of Resources	Deferred Inflows of Resources
PERS 1				
Differences between expected and actual experience	\$ -	\$ -	\$ -	\$ -
Net difference between projected and actual investment earnings on pension plan investments	77,957	-	-	201,374
Changes of assumptions	-	-	-	-
Changes in proportion and differences between contributions and proportionate share of contributions	-	-	-	-
Contributions subsequent to the measurement date	158,580	-	167,961	-
Total	\$ 236,537	\$ -	\$ 167,961	\$ 201,374
PERS 2/3				
Differences between expected and actual experience	\$ 198,047	\$ 122,778	\$ 340,715	\$ -
Net difference between projected and actual investment earnings on pension plan investments	455,129	-	-	855,639
Changes of assumptions	38,441	-	5,164	-
Changes in proportion and differences between contributions and proportionate share of contributions	338,035	499,672	478,884	-
Contributions subsequent to the measurement date	207,119	-	218,800	-
Total	\$ 1,236,771	\$ 622,450	\$ 1,043,563	\$ 855,639
Combined PERS 1 & PERS 2/3				
Differences between expected and actual experience	\$ 198,047	\$ 122,778	\$ 340,715	\$ -
Net difference between projected and actual investment earnings on pension plan investments	533,086	-	-	1,057,013
Changes of assumptions	38,441	-	5,164	-
Changes in proportion and differences between contributions and proportionate share of contributions	338,035	499,672	478,884	-
Contributions subsequent to the measurement date	365,699	-	386,761	-
Total	\$ 1,473,308	\$ 622,450	\$ 1,211,524	\$ 1,057,013

PUBLIC UTILITY DISTRICT NO. 1 OF KLICKITAT COUNTY –
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Note 6 – Retirement Benefits (continued)

Deferred outflows of resources related to pensions resulting from the District’s contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended December 31, 2016. Other amounts reported as deferred outflows and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Year Ended December 31,	PERS 1
2017	\$ (19,195)
2018	(19,195)
2019	71,595
2020	44,752
Year Ended December 31,	PERS 2/3
2017	\$ (12,730)
2018	(12,730)
2019	248,188
2020	184,474

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, 2016 and 2015, is as follows:

Condensed statement of net position:

	Electric System	Water- Wastewater Systems	Total 2016	Total 2015
Assets				
Current, restricted, other assets and deferred outflows	\$ 60,045,391	\$ 3,609,010	\$ 63,654,401	\$ 76,061,472
Capital assets	195,052,079	16,491,262	211,543,341	213,780,010
Total assets and deferred outflows	<u>\$ 255,097,470</u>	<u>\$ 20,100,272</u>	<u>\$ 275,197,742</u>	<u>\$ 289,841,482</u>
Liabilities				
Current liabilities	\$ 9,250,401	\$ 1,664,287	\$ 10,914,688	\$ 10,300,901
Noncurrent liabilities and deferred inflows	166,438,867	1,716,771	168,155,638	184,918,394
Total liabilities and deferred inflows	<u>175,689,268</u>	<u>3,381,058</u>	<u>179,070,326</u>	<u>195,219,295</u>
Net position				
Net investment in capital assets	69,672,729	14,617,914	84,290,643	75,249,720
Restricted	9,735,473	-	9,735,473	10,698,073
Unrestricted	-	2,101,300	2,101,300	8,674,394
Total net position	<u>79,408,202</u>	<u>16,719,214</u>	<u>96,127,416</u>	<u>94,622,187</u>
Total liabilities, deferred inflows and net position	<u>\$ 255,097,470</u>	<u>\$ 20,100,272</u>	<u>\$ 275,197,742</u>	<u>\$ 289,841,482</u>

**PUBLIC UTILITY DISTRICT NO. 1 OF KLICKITAT COUNTY –
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Note 7 – Segment Information – Enterprise Funds (continued)

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

	Electric System	Water- Wastewater Systems	Total 2016	Total 2015
Operating revenues	\$ 43,709,405	\$ 1,213,152	\$ 44,922,557	\$ 45,256,674
Operating expenses	31,021,922	922,542	31,944,464	33,904,264
Depreciation	7,958,712	638,444	8,597,156	9,504,604
Operating income	4,728,771	(347,834)	4,380,937	1,847,806
Non-operating revenues (expenses)				
Interest income	276,108	29,056	305,164	1,272,655
Interest expense	(6,393,292)	(31,190)	(6,424,482)	(5,860,152)
Other non-operating revenue (expense), net	1,137,540	(16,207)	1,121,333	1,036,347
Capital contributions and grants	2,122,277	-	2,122,277	2,946,591
Change in net position	1,871,404	(366,175)	1,505,229	1,243,247
Net position, beginning of year	77,020,639	17,601,548	94,622,187	93,378,940
Net position, end of year	<u>\$ 78,892,043</u>	<u>\$ 17,235,373</u>	<u>\$ 96,127,416</u>	<u>\$ 94,622,187</u>

Note 8 – Power Risk Management

As of December 31, 2016, the District had the following derivative instruments outstanding:

	Changes in Fair Value		Fair Value at December 31, 2016	
	Classification	Amount	Classification	Amount
Cash Flow Hedges:				
Financial Swap Forward	Deferred Inflow	\$ 657,896	Derivative Asset	\$ 657,896
Financial Swap Forward	Deferred Outflow	\$ 334,737	Derivative Liability	\$ 334,737

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.

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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. 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, 2016. 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, 2016 and 2015, there were no terminations.

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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 coverages 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 Old Highway 8 and Mile Marker 28 fires.

Old Highway 8 Fire

The statute of limitations has passed and one claim from the Washington Department of Natural Resources has been submitted in the amount of approximately \$1.6 million and possible attorney fees and interest. Mediation has been scheduled for late April of 2017. As potential damages are within the limit of occurrence of the shared insurance pool, management does not believe this will significantly impact the District's financial position.

Mile Marker 28 Fire

In July 2013, a wildfire broke out in the vicinity of an electrical power line located on active timber lands. The Washington Department of Natural Resources has conducted an investigation as to the cause of and any damages that may have resulted from the fire. Two complaints have been filed by: Bureau of Indian Affairs (BIA) on behalf of Yakama Nation and the Washington Department of Natural Resources (DNR).

Though the statute of limitations has not passed, current claims are as follows: BIA claim for \$65 million and DNR claim of approximately \$3 to \$5 million. Management believes there is substantial doubt regarding the initial investigation report and, as such, does not believe damages are estimable. The District has access to the shared insurance pool, noted below of \$35 million per occurrence.

PURMS, the insurance carrier for the District, is providing legal representation for both fires. The District's deductible is \$1,000,000, which is shared by the pool.

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Note 9 – Risk Management and Self-Insurance (continued)

The District is a participant in the liability pool, which provides the District with shared excess coverage of \$35,000,000 general liability, and \$35,000,000 per occurrence Directors and Officers liability.

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 \$1,750,000 and \$1,375,000 in 2016 and 2015, 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 2016 and 2015, the District's investment in the project of (\$48,301) and (\$22,078), respectively, consisted of a share of the remaining assets. These amounts have been shown on the balance sheet as other investments and transmission deposits.

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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. See also Note 9.

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 as 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.

**PUBLIC UTILITY DISTRICT NO. 1 OF KLICKITAT COUNTY -
MCAG No. 1785
NOTES TO COMBINED FINANCIAL STATEMENTS**

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 MWs of the output from this project was sold to a public utility until October 31, 2015, 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 People's 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. The District receives 4.5 MWs, which 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.

REQUIRED SUPPLEMENTARY INFORMATION

**PUBLIC UTILITY DISTRICT NO. 1 OF KLUCKITAT COUNTY –
SCHEDULE OF PROPORTIONATE SHARE OF THE NET PENSION LIABILITY
LAST TEN YEARS***

PERS 1

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Proportion of the net pension asset	0.057652%	0.070364%	0.059667%
Proportionate share of the net pension liability	\$ 3,096,184	\$ 3,680,692	\$ 3,005,753
Covered-employee payroll	\$ -	\$ 9,584	\$ 69,230
Proportionate share of the net pension liability as percentage of covered-employee payroll	0%	38405%	4342%
Plan's fiduciary net position	\$ 7,558,312	\$ 7,558,312	\$ 7,941,557
Plan fiduciary net position as a percentage of the total pension liability	57%	59%	61%

PERS 2/3

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Proportion of the net pension asset	0.073869%	0.089705%	0.748220%
Proportionate share of the net pension liability	\$ 3,719,245	\$ 3,205,210	\$ 1,512,423
Covered-employee payroll	\$ 6,630,605	\$ 6,497,821	\$ 6,516,242
Proportionate share of the net pension liability as percentage of covered-employee payroll	56%	49%	23%
Plan's fiduciary net position	\$ 30,482,624	\$ 29,511,959	\$ 28,098,809
Plan fiduciary net position as a percentage of the total pension liability	86%	89%	93%

* - Additional years will be added as information is obtained.

**PUBLIC UTILITY DISTRICT NO. 1 OF KCLICKITAT COUNTY –
SCHEDULE OF CONTRIBUTIONS
LAST TEN YEARS***

PERS 1

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Contractually required contribution (actuarially determined)	\$ -	\$ 3,924	\$ 6,386
Contributions in relation to the actuarially determined contribution	<u>-</u>	<u>(3,924)</u>	<u>(6,386)</u>
Contribution deficiency (excess)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Covered-employee payroll	\$ -	\$ 9,584	\$ 69,230
Contributions as a percentage of covered-employee payroll	0%	41%	9%

PERS 2/3

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Contractually required contribution (actuarially determined)	\$ 416,332	\$ 323,562	\$ 601,937
Contributions in relation to the actuarially determined contribution	<u>(416,332)</u>	<u>(323,562)</u>	<u>(601,937)</u>
Contribution deficiency (excess)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Covered-employee payroll	\$ 6,630,605	\$ 6,497,821	\$ 6,516,242
Contributions as a percentage of covered-employee payroll	6%	5%	9%

* - Additional years will be added as information is obtained.

REPORT OF INDEPENDENT AUDITORS ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

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

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States, the financial statements of Public Utility District No. 1 of Klickitat County (the District), which comprise the combined statement of net position as of December 31, 2016, and the related combined statement of revenues, expenses and changes in net position and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated May 30, 2017.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the District's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we do not express an opinion on the effectiveness of the District's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

**REPORT OF INDEPENDENT AUDITORS ON INTERNAL CONTROL OVER FINANCIAL
REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF
FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS (continued)**

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District's individual and combined financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Miss Adams UP

Portland, Oregon
May 30, 2017