



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

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

December 31, 2014 and 2013

MOSS-ADAMS_{LLP}

Certified Public Accountants | Business Consultants

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REPORT OF INDEPENDENT AUDITORS

Board of Commissioners
Public Utility District No. 1 of Lewis County
Chehalis, Washington

Report on the Financial Statements

We have audited the accompanying combined and separate financial statements of Public Utility No. 1 of Lewis County's Electric System and Cowlitz Falls System (the District) which comprise the combined and separate statement of net position as of December 31, 2014, and the related combined and separate statements of revenues, expenses and changes in net position and cash flows for the year then ended, and the combined statement of net position as of December 31, 2013, 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.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

REPORT OF INDEPENDENT AUDITORS (continued)

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Public Utility District No. 1 of Lewis County's Electric System and Cowlitz Falls System as of December 31, 2014 and 2013 and the results of its operations and its cash flows for the years then ended in conformity 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 accompanying management discussion and analysis be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the 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 29, 2015 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.

A handwritten signature in blue ink that reads "Moss Adams LLP". The signature is written in a cursive, flowing style.

Portland, Oregon
May 29, 2015

PUBLIC UTILITY DISTRICT NO. 1 OF LEWIS COUNTY MANAGEMENT'S DISCUSSION AND ANALYSIS

This discussion and analysis is designed to provide an overview of Public Utility District No. 1 of Lewis County, Washington (the District) financial activities for the year ended December 31, 2014, with comparable information for 2013 and 2012. This required supplementary information should be read in conjunction with the District's financial statements and notes to financial statements.

The District is a municipal corporation incorporated in 1936 to serve the citizens of Lewis County, Washington. The District is governed by a three-member board of locally elected commissioners, independent of the county government. The District manages and operates two systems: Electric Distribution System (Electric System) and the Cowlitz Falls Hydroelectric Generation Project (Cowlitz Falls System).

Overview of the Financial Statements

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

Basic Financial Statements

The Statement of Net Position presents the District's net position as the difference between assets and deferred outflows of resources, and liabilities and deferred inflows of resources. The Statement of Net Position provides information about the nature and amount of investments in resources (assets), the consumption of net position in one period that are applicable to future periods (deferred outflows of resources), the obligations to creditors (liabilities), and the acquisition of net position that are applicable to future periods (deferred inflows of resources).

The Statement of Revenues, Expenses, and Changes in Net Position reports the revenues and expenses during the periods indicated and identify operating activity separately from non-operating activity.

The Statement of Cash Flows provides information about the District's cash flows from operating activities, capital and related financing activities, investing activities, and noncapital financing activities, and presents a reconciliation of net operating income to net cash provided by operating activities.

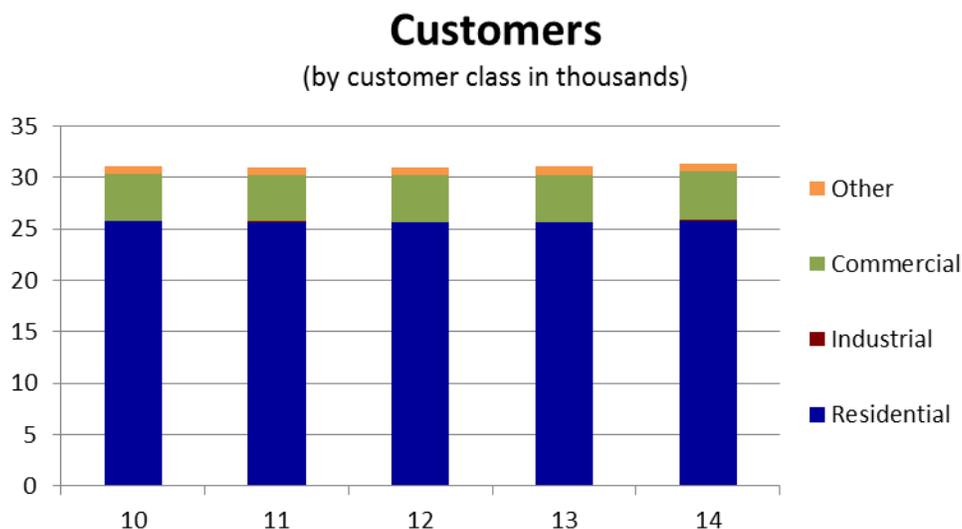
Notes to the Financial Statements

The notes to the financial statements provide additional information that is essential to a full understanding of the figures provided in the basic financial statements.

PUBLIC UTILITY DISTRICT NO. 1 OF LEWIS COUNTY MANAGEMENT'S DISCUSSION AND ANALYSIS

ELECTRIC DISTRIBUTION SYSTEM

The Electric System provides electric service throughout Lewis County with the exception of the City of Centralia who is served by the City's Municipal Light and Power Department. Currently, the District serves 31,826 customers within approximately 2,530 square miles comprising 3,398 miles of distribution line and services. Power supplies are primarily provided to the District through purchase power contracts with Bonneville Power Administration (BPA). Weather and economic climate are the primary conditions that influence electricity sales. Generally, extreme temperatures increase sales to customers who use electricity for cooling and heating, while moderate temperatures produce moderate sales. Seasonal influences exist from industrial customers that are related to agriculture products peaking during the District's summer months in contrast to residential customers peaking during the winter months from heating. Economic conditions have improved in Lewis County over the past couple of years and the District's growth has expanded along the Interstate 5 corridor.



Financial Summary and Analysis

During 2014, the Electric System's net operating income before other revenues (expenses) and contributed capital was \$646,000, which was a change of \$1.86 million from 2013. The factors influencing these results in 2014 include:

- Total operating revenues increased by \$4.81 million or 7.8%.
 - Revenues from sales to customers increased \$2.1 million or 3.8% due to the rate increase effective March 2014.
 - Revenues from wholesale increased \$2.9 million or 53.4% due to increased volume and better pricing.
 - Other operating revenues increased \$152,000 or 6.9% primarily due to increased wheeling revenues.
 - The Board of Commissioners approved the transfer of \$1.475 million to the rate stabilization account, an increase of \$343,000.

**PUBLIC UTILITY DISTRICT NO. 1 OF LEWIS COUNTY
MANAGEMENT'S DISCUSSION AND ANALYSIS**

- Total operating expenses increased by \$2.95 million or 4.7%.
 - Purchase power expense increased by \$2.07 million or 4.9% primarily due to increased market purchases.
 - Other operating expense increased by \$191,900 or 2.2% primarily due to increased wheeling and distribution expenses.
 - Maintenance expense increased by \$402,400 or 10.9% primarily due to increased distribution line maintenance.
 - Depreciation expense increased by \$111,400 or 2.8% as a result of capital additions.
 - Taxes increased by \$174,600 or 4.4% primarily as a result of higher retail sales.

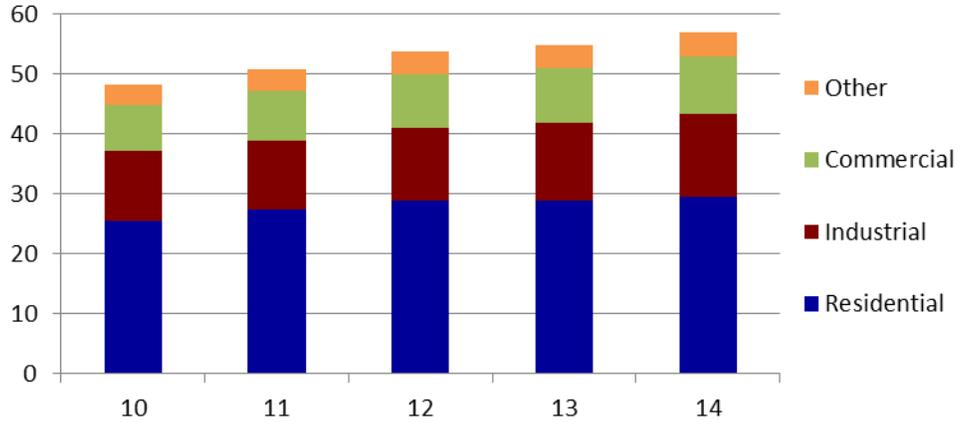
Selected Financial Data

	(in thousands)		
	2014	2013	2012
Operating revenues	\$ 66,233	\$ 61,418	\$ 61,502
Operating expenses	65,587	62,636	59,343
Net operating revenues	646	(1,218)	2,159
Other revenues (expenses) and contributed capital	(614)	(920)	(542)
Change in net position	\$ 32	\$ (2,137)	\$ 1,617
Total assets and deferred outflows	\$ 173,198	\$ 174,929	\$ 176,505
Total liabilities and deferred inflows	41,542	43,305	42,744
Net investment in capital assets	117,447	116,371	115,627
Unrestricted net position	13,047	14,100	16,856
Restricted for debt service	162	152	278
Restricted - other	1,000	1,000	1,000

**PUBLIC UTILITY DISTRICT NO. 1 OF LEWIS COUNTY
MANAGEMENT'S DISCUSSION AND ANALYSIS**

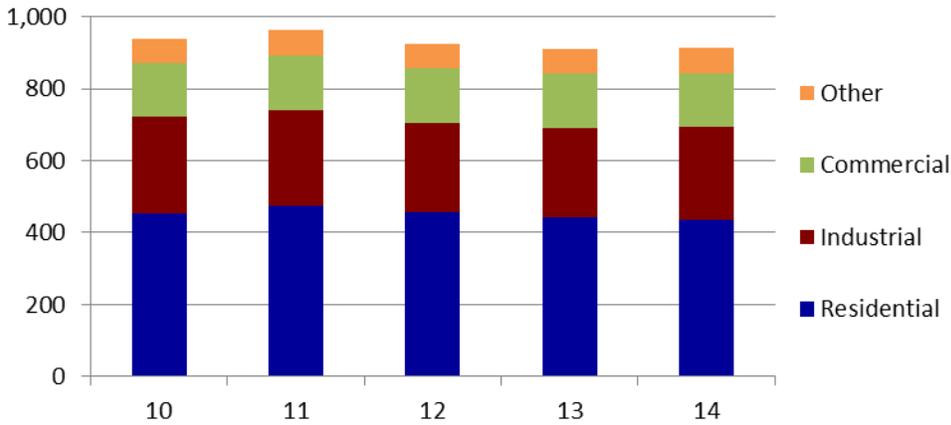
Retail Revenues

(by customer class in millions of dollars)



Retail Sales

(by customer class in millions of kilowatt-hours)



**PUBLIC UTILITY DISTRICT NO. 1 OF LEWIS COUNTY
MANAGEMENT'S DISCUSSION AND ANALYSIS**

Capital Asset and Long-Term Debt Activity

As of December 31, 2014, the Electric System had \$169.5 million invested in a variety of capital assets in service. This represents an increase of \$4.5 million or 2.7% from 2013. As of December 31, 2013, the Electric Distribution System had \$165 million invested in a variety of capital assets in service. This represents an increase of \$4.2 million or 2.6% from 2012. Capital construction is provided for through a combination of construction fees, cash flow from revenues, and represents normal additions to the system.

	(in thousands)		
	2014	2013	2012
Intangible and land	\$ 4,944	\$ 4,944	\$ 4,945
Distribution plant	118,097	114,534	110,883
Transmission plant	22,536	22,481	22,045
Hydraulic plant	1,180	1,180	1,180
General plant	22,821	21,908	21,729
	<u>\$ 169,578</u>	<u>\$ 165,047</u>	<u>\$ 160,782</u>
Total plant in service			

In 2014, revenue bonds outstanding were \$28.485 million, which is a decrease of \$1.765 million or 5.8% from 2013. In 2013, revenue bonds outstanding were \$30.25 million, which is a decrease of \$1.68 million or 5.3% from 2012.

Power Supply

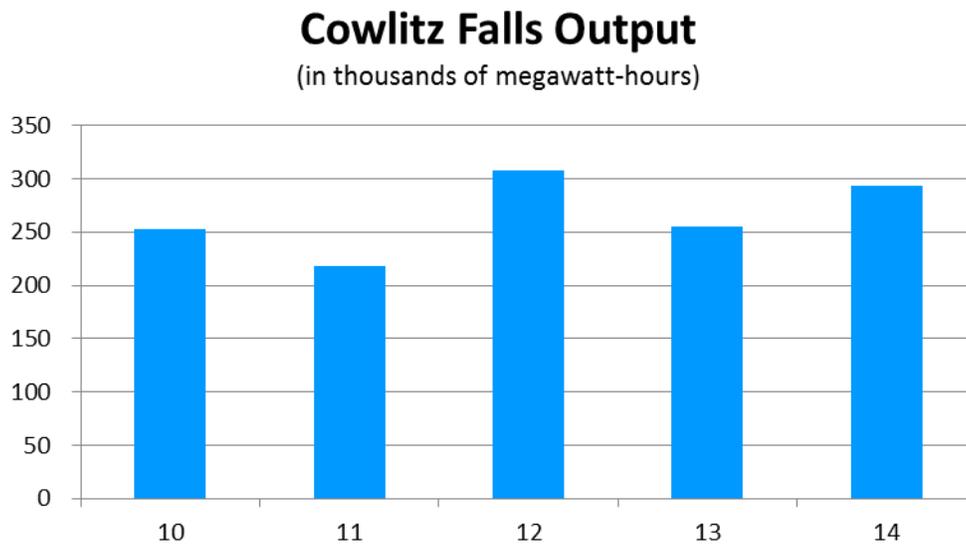
The District signed a 20-year Block and Slice Power Agreement with BPA on December 1, 2008, with the contract taking effect on October 1, 2011. The District also purchases wind power in order to comply with Initiative 937 renewable resources requirements.

PUBLIC UTILITY DISTRICT NO. 1 OF LEWIS COUNTY MANAGEMENT'S DISCUSSION AND ANALYSIS

COWLITZ FALLS HYDROELECTRIC GENERATION PROJECT

The District operates the Cowlitz Falls Project (System or Project) located on the upper Cowlitz River in eastern Lewis County. The powerhouse contains two Kaplan turbine generating units with net installed capacity of 35 MW each. Average annual generation is estimated at 261 million kilowatt hours.

Project operation depends upon the “run of the river” to produce the maximum amount of electric energy.



Financial Summary and Analysis

Revenues for the Cowlitz Falls Project are recognized on the basis of the Amendatory Power Purchase Contract between the District and BPA. Through this contract, BPA receives all output from the Cowlitz Falls Project in exchange for payment of all operation and maintenance costs and debt service on the Cowlitz Falls Project revenue bonds.

**PUBLIC UTILITY DISTRICT NO. 1 OF LEWIS COUNTY
MANAGEMENT'S DISCUSSION AND ANALYSIS**

Selected Financial Data

	(in thousands)		
	2014	2013	2012
Operating revenues	\$ 10,519	\$ 14,302	\$ 14,104
Operating expenses	6,678	7,965	7,961
Net operating revenues	3,841	6,337	6,143
Other expenses	3,841	6,337	6,143
Change in net position	\$ -	\$ -	\$ -
Total assets	\$ 99,796	\$ 103,904	\$ 105,139
Total liabilities	99,796	103,904	105,139
Net position	-	-	-

Capital Assets and Long-Term Debt Activity

Capital invested in plant was \$158.1 million and plant net of depreciation was \$89.9 million in 2014. Total Cowlitz Falls Project plant in service as of December 31, 2014, 2013 and 2012 consisted of the following:

	(in thousands)		
	2014	2013	2012
Production plant	\$ 155,392	\$ 155,392	\$ 155,392
Transmission plant	2,175	2,175	2,175
General plant	563	534	534
Total plant in service	\$ 158,130	\$ 158,101	\$ 158,101

In July 2013, \$87.995 million in Cowlitz Falls Hydroelectric Project Revenue Refunding Bonds were issued to refund the outstanding Revenue Refunding Bonds, Series 2003 maturing on and after October 1, 2014. In 2014, revenue bonds outstanding were \$85.055 million, which is a decrease of \$2.94 million or 3.3% from 2013. In 2013, revenue bonds outstanding were \$87.995 million, which is a decrease of \$16.655 million or 15.9% from 2012.

Requests for Information

The basic financial statements, notes, and management's discussion and analysis are designed to provide a general overview of the District's finances. Questions concerning any of the information provided in this report should be directed to the District at 321 NW Pacific Ave, Chehalis, WA 98532.

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PUBLIC UTILITY DISTRICT NO. 1 OF LEWIS COUNTY
STATEMENT OF NET POSITION

	Electric System	Cowlitz Falls System	December 31,	
			2014 Combined	2013 Combined
CURRENT ASSETS				
Cash and cash equivalents	\$ 14,694,372	\$ 2,547,321	\$ 17,241,693	\$ 18,969,133
Customer and other receivables, net	8,639,073	2,017,200	10,656,273	10,717,592
Inventories	2,948,410	-	2,948,410	3,012,534
Other current assets	176,230	-	176,230	159,371
Current portion of prepaid power and attributes	1,889,538	-	1,889,538	1,889,538
Total current assets	28,347,623	4,564,521	32,912,144	34,748,168
RESTRICTED ASSETS				
Cash and cash equivalents -				
Debt service fund	282,499	-	282,499	280,306
Major catastrophe fund	1,000,000	-	1,000,000	1,000,000
Rate stabilization	2,607,138	-	2,607,138	1,131,811
Total restricted assets	3,889,637	-	3,889,637	2,412,117
UTILITY PLANT				
Utility plant in service	169,578,102	158,130,130	327,708,232	323,147,895
Construction in progress	3,124,079	-	3,124,079	3,461,722
Total utility plant	172,702,181	158,130,130	330,832,311	326,609,617
Less accumulated depreciation	55,255,322	68,170,900	123,426,222	116,711,050
Net utility plant	117,446,859	89,959,230	207,406,089	209,898,567
OTHER ASSETS				
Conservation loans	113,663	-	113,663	113,131
Derivative asset	219,565	-	219,565	63,491
Unamortized prepaid power and attributes	22,674,462	-	22,674,462	24,564,000
Regulatory asset - issuance costs	411,819	810,353	1,222,172	1,375,585
Total other assets	23,419,509	810,353	24,229,862	26,116,207
DEFERRED OUTFLOWS OF RESOURCES				
Accumulated decrease in fair value of hedging derivatives	94,037	-	94,037	639,142
Deferred loss on refunding	-	4,461,626	4,461,626	5,018,767
TOTAL ASSETS AND DEFERRED OUTFLOWS OF RESOURCES	\$ 173,197,665	\$ 99,795,730	\$ 272,993,395	\$ 278,832,968

PUBLIC UTILITY DISTRICT NO. 1 OF LEWIS COUNTY
STATEMENT OF NET POSITION

	Electric System	Cowlitz Falls System	December 31,	
			2014 Combined	2013 Combined
CURRENT LIABILITIES				
Accounts payable	\$ 830,186	\$ 36,924	\$ 867,110	\$ 1,585,419
Accrued liabilities	6,599,310	276,188	6,875,498	7,259,995
Accrued bond interest	120,559	1,074,853	1,195,412	1,217,422
Accrued OPEB liability	460,438	48,333	508,771	480,184
Operations and maintenance advance	-	2,547,321	2,547,321	2,622,998
Customer deposits	1,481,735	-	1,481,735	1,465,984
Current maturities of long-term debt	1,850,000	3,000,000	4,850,000	4,705,000
Total current liabilities	11,342,228	6,983,619	18,325,847	19,337,002
LONG-TERM DEBT				
Revenue bonds, net	26,635,000	82,055,000	108,690,000	113,540,000
Unamortized premium	549,351	10,754,576	11,303,927	12,418,430
Total long-term debt	27,184,351	92,809,576	119,993,927	125,958,430
OTHER LIABILITIES				
Other credits	94,976	2,535	97,511	79,793
Derivative liability	94,037	-	94,037	639,142
Total liabilities	38,715,592	99,795,730	138,511,322	146,014,367
DEFERRED INFLOWS OF RESOURCES				
Accumulated increase in fair value of hedging derivatives	219,565	-	219,565	63,491
Regulatory liability - rate stabilization	2,607,138	-	2,607,138	1,131,811
NET POSITION				
Net investment in capital assets	117,446,859	(1,388,720)	116,058,139	115,135,976
Restricted:				
Debt service	161,940	-	161,940	152,437
Other	1,000,000	-	1,000,000	1,000,000
Unrestricted	13,046,571	1,388,720	14,435,291	15,334,886
Total net position	131,655,370	-	131,655,370	131,623,299
Total net position, liabilities, and deferred inflows of resources	\$ 173,197,665	\$ 99,795,730	\$ 272,993,395	\$ 278,832,968

PUBLIC UTILITY DISTRICT NO. 1 OF LEWIS COUNTY
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION

	Electric System	Cowlitz Falls System	Years Ended December 31,	
			2014 Combined	2013 Combined
OPERATING REVENUES				
Retail sales – electric energy	\$ 57,024,510	\$ 10,519,330	\$ 67,543,840	\$ 69,221,156
Wholesale – wind and attributes	8,330,843	-	8,330,843	5,429,930
Transfer from/(to) rate stabilization	(1,475,327)	-	(1,475,327)	(1,131,811)
Other operating revenues	2,353,384	-	2,353,384	2,200,723
Total operating revenues	66,233,410	10,519,330	76,752,740	75,719,998
OPERATING EXPENSES				
Power supply	44,531,631	-	44,531,631	42,461,119
Other operating	8,755,360	2,012,527	10,767,887	10,171,459
Maintenance	4,096,464	956,280	5,052,744	4,616,996
Depreciation	4,071,434	3,582,239	7,653,673	9,280,205
Taxes	4,132,190	127,108	4,259,298	4,071,229
Total operating expenses	65,587,079	6,678,154	72,265,233	70,601,008
NET OPERATING INCOME	646,331	3,841,176	4,487,507	5,118,990
OTHER REVENUES (EXPENSES)				
Interest income	44,628	3,923	48,551	51,466
Interest expense	(1,527,114)	(4,343,513)	(5,870,627)	(7,570,288)
Amortization of debt expense, premium, and loss on refunding	7,052	396,895	403,947	(375,752)
Revenue from merchandising	174,649	-	174,649	147,001
Expense of contract work	(139,273)	-	(139,273)	(131,210)
Other income	271,188	101,519	372,707	167,243
Total other expenses	(1,168,870)	(3,841,176)	(5,010,046)	(7,711,540)
NET INCOME	(522,539)	-	(522,539)	(2,592,550)
Contributed capital	554,610	-	554,610	455,098
CHANGE IN NET POSITION	32,071	-	32,071	(2,137,452)
NET POSITION, beginning of year	131,623,299	-	131,623,299	133,760,751
NET POSITION, end of year	\$ 131,655,370	\$ -	\$ 131,655,370	\$ 131,623,299

PUBLIC UTILITY DISTRICT NO. 1 OF LEWIS COUNTY
STATEMENT OF CASH FLOWS

	Year Ended December 31,			
	Electric System	Cowlitz Falls System	2014 Combined	2013 Combined
CASH FLOWS FROM OPERATING ACTIVITIES				
Cash received from customers	\$ 67,955,755	\$ 10,273,705	\$ 78,229,460	\$ 76,907,208
Cash paid to suppliers	(48,458,127)	(2,407,359)	(50,865,486)	(45,976,358)
Cash paid to employees	(7,998,513)	(858,928)	(8,857,441)	(8,314,762)
Cash paid for taxes	(4,132,190)	123,859	(4,008,331)	(3,836,521)
Net cash from operating activities	<u>7,366,925</u>	<u>7,131,277</u>	<u>14,498,202</u>	<u>18,779,567</u>
CASH FLOWS FROM INVESTING ACTIVITIES				
Interest and dividends on investments	44,628	3,923	48,551	51,466
Net conservation loan activity	(532)	-	(532)	(14,426)
Net other income	306,564	101,519	408,083	183,034
Net cash from investing activities	<u>350,660</u>	<u>105,442</u>	<u>456,102</u>	<u>220,074</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES				
Payments on debt	(1,765,000)	-	(1,765,000)	(1,680,000)
Interest paid on bonds	(1,534,424)	-	(1,534,424)	(1,615,065)
Net cash from noncapital financing activities	<u>(3,299,424)</u>	<u>-</u>	<u>(3,299,424)</u>	<u>(3,295,065)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES				
Utility plant additions, net of cost of removal and salvage proceeds	(5,147,014)	(14,183)	(5,161,197)	(4,690,076)
Contributed capital	554,610	-	554,610	455,098
Principal paid on bonds	-	(2,940,000)	(2,940,000)	(6,520,000)
Interest paid on bonds	-	(4,358,213)	(4,358,213)	(6,169,654)
Net cash from capital and related financing activities	<u>(4,592,404)</u>	<u>(7,312,396)</u>	<u>(11,904,800)</u>	<u>(16,924,632)</u>
CHANGE IN CASH AND CASH EQUIVALENTS	(174,243)	(75,677)	(249,920)	(1,220,056)
CASH AND CASH EQUIVALENTS, beginning of year	<u>18,758,252</u>	<u>2,622,998</u>	<u>21,381,250</u>	<u>22,601,306</u>
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 18,584,009</u>	<u>\$ 2,547,321</u>	<u>\$ 21,131,330</u>	<u>\$ 21,381,250</u>
CASH FLOWS FROM OPERATING ACTIVITIES				
Net operating revenues	\$ 646,331	\$ 3,841,176	\$ 4,487,507	\$ 5,118,990
Adjustments to reconcile net operating revenues to net cash from operating activities				
Depreciation	4,071,434	3,582,239	7,653,673	9,280,205
Amortization of prepaid power and attributes	1,889,538	-	1,889,538	1,889,539
Change in assets and liabilities				
Receivables	231,267	(169,948)	61,319	(91,257)
Other current assets	(16,859)	-	(16,859)	72,590
Accounts payable and warrants outstanding	(659,021)	(59,288)	(718,309)	1,034,497
Accrued liabilities	(394,892)	10,395	(384,497)	331,973
Accrued OPEB liability	25,871	2,716	28,587	85,353
Inventories	64,124	-	64,124	(254,567)
Operations and maintenance advance	-	(75,677)	(75,677)	94,962
Customer deposits	15,751	-	15,751	51,694
Regulatory liability - rate stabilization	1,475,327	-	1,475,327	1,131,811
Deferred credits	18,054	(336)	17,718	33,777
Net cash from operating activities	<u>\$ 7,366,925</u>	<u>\$ 7,131,277</u>	<u>\$ 14,498,202</u>	<u>\$ 18,779,567</u>

PUBLIC UTILITY DISTRICT NO. 1 OF LEWIS COUNTY

NOTES TO FINANCIAL STATEMENTS

Note 1 – Nature of Organization and Operations

Public Utility District No. 1 of Lewis County (the District) is a municipal corporation of the State of Washington and is governed by an elected three member board. The District was organized in 1936, pursuant to a general election in accordance with the Enabling Act, and commenced its operations in 1939. The District has its administrative offices in Chehalis, Washington, which is located in southwestern Washington.

The District manages and operates two systems: Electric Distribution System (Electric System) and the Cowlitz Falls Hydroelectric Generation Project (Cowlitz Falls System or Project). The Electric System provides electric service to substantially all of Lewis County, except for the City of Centralia. The District constructed and, beginning in June 1994, operates the Cowlitz Falls Hydroelectric Dam on the upper Cowlitz River in eastern Lewis County, Washington (see Note 8). The Electric System and Cowlitz Falls System are separate operating systems.

Note 2 – Summary of Significant Accounting Policies

Reporting entity – In evaluating how to define the government, for financial reporting purposes, management has considered the District's financial reporting entity. The financial reporting entity consists of the District and component units. Component units are legally separate organizations for which the District is financially accountable and other organizations for which the District is not accountable but for which the nature and significance of their relationship with the District are such that the exclusion would cause the District's financial statements to be misleading or incomplete. Based upon this criterion, the District has no component units.

Basis of accounting and presentation – The District is considered an enterprise and operates as a proprietary fund. The financial statements of the District have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America (GAAP) as applied to governmental units. The District has applied all applicable Governmental Accounting Standards Board (GASB) pronouncements.

Effective January 1, 2013, the Board adopted GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*. The Statement requires reclassification of certain items previously reported as assets or liabilities to deferred outflows of resources or deferred inflows of resources.

In addition, certain items previously reported as assets and liabilities are now recognized as outflows of resources (expenses) or inflows of resources (revenues). GASB Concepts Statement No. 4, *Elements of Financial Statements*, specifies recognition of deferred outflows and deferred inflows should be limited to instances specifically identified in authoritative GASB pronouncements. Statement No. 65 amends items previously classified as assets and liabilities to be consistent with GASB Concept Statement No. 4. Statement No. 65 also limits the use of the term deferred in financial statement presentations.

PUBLIC UTILITY DISTRICT NO. 1 OF LEWIS COUNTY
NOTES TO FINANCIAL STATEMENTS

Note 2 – Summary of Significant Accounting Policies (continued)

Implementation of Statement No. 65 resulted in the reclassification of unamortized bond issuance costs from an asset to a regulatory asset included in other assets on the Statements of Net Position. Unamortized losses on bond refunding were reclassified from a liability to a deferred outflow. These reclassifications were done during the year ended December 31, 2013. There was no effect on income for 2013 or net position at the beginning of 2013.

The Uniform System of Accounts, as prescribed by the Federal Energy Regulatory Commission (FERC), is the basis for the District's accounting policies. The accounting records of the District are maintained in accordance with methods prescribed by the State Auditor under authority of Chapter 43.09 RCW.

The accompanying financial statements include the individual and combined statements of financial position of the Electric System and Cowlitz Falls System and the results of operations and cash flows for each system.

Concentration of credit risk – The District's financial instruments that are exposed to concentrations of credit risk consist primarily of cash, temporary investments and receivables.

The District maintains its cash and temporary investments in bank deposit accounts which exceed federally insured limits. However, all deposits are made with state-approved depositories and are protected under the State's Public Deposit Protection Commission (PDPC).

Credit is extended to customers generally without collateral requirements, however, deposits are obtained from certain customers and formal shut-off procedures are in place.

Utility plant – Utility plant assets are stated at cost (see Note 4). Cost includes contracted services, direct labor and materials, interest capitalized during construction, and certain overhead items. For the Electric System, the provision for depreciation is determined by the straight-line method over the estimated useful lives of the assets (as specified by FERC for utility plant) ranging from three to fifty years. The cost of maintenance and repairs is expensed as incurred; renewals, replacements and betterments are capitalized. Capitalization threshold is \$1,000. For the Cowlitz Falls Project, depreciation, renewals, and replacements are recognized on the basis of the Amendatory Power Purchase Contract between the District and BPA (see Note 8).

The actual or average cost of property replaced or renewed is removed from utility plant and such cost plus removal cost less salvage is charged to accumulated depreciation.

Cash equivalents – The District considers all highly liquid investments, including restricted cash, with a maturity of three months or less to be cash equivalents.

PUBLIC UTILITY DISTRICT NO. 1 OF LEWIS COUNTY

NOTES TO FINANCIAL STATEMENTS

Note 2 – Summary of Significant Accounting Policies (continued)

Restricted cash and investments – Restricted cash and investments consist of Board restricted funds set aside and invested by the District in a major catastrophe fund, rate stabilization account and investments restricted by bond resolution. The major catastrophe fund balance provides the District with emergency funds should the District face a catastrophe, such as a major wind storm or other extraordinary event.

Customer and other receivables – Accounts receivable are recorded when invoices are issued and are written off when they are determined to be uncollectible. The allowance for doubtful accounts is estimated based on the District's historical losses, review of specific problem accounts, the existing economic conditions, and the financial stability of its customers. Generally, the District considers accounts receivable past due after 30 days. The allowance for doubtful accounts for the Electric System was \$501,282 and \$563,650 at December 31, 2014 and 2013, respectively. No allowance was deemed necessary for the Cowlitz Falls System.

Inventories – Inventories consist primarily of materials and supplies for construction and maintenance of utility plant and are valued at the lower of average cost or market.

Unamortized bond premiums and loss on refunding – Bond premiums relating to revenue bonds are amortized by the effective interest method over the life of bond issues using a weighted average of the face amount of bonds outstanding. Losses on refunding are amortized over the life of the old or new bonds, whichever is shorter.

Regulatory assets – unamortized bond issue costs – Unamortized bond issue costs represent the remaining expense related to various debt issuances. The asset is amortized over the duration of the related debt and recognition of these costs is included in the rate making process.

Deferred inflow of resources – The District has deferred revenues to be recognized in future periods in accordance with regulatory accounting requirements. The Board authorized the transfer of \$1,475,327 and \$1,131,811 from operating revenues to the rate stabilization account for 2014 and 2013, respectively. Future withdrawals from the rate stabilization account will be used to mitigate potential rate increases or provide for unexpected expenses.

Unamortized prepaid power and attributes – Consists of prepaid power and attributes amortized using the straight-line method over the life of the 2008 Series bonds (see Note 6 – White Creek Wind Project).

PUBLIC UTILITY DISTRICT NO. 1 OF LEWIS COUNTY
NOTES TO FINANCIAL STATEMENTS

Note 2 – Summary of Significant Accounting Policies (continued)

Compensated absences – The District accrues accumulated unpaid personal leave benefits as the obligation is incurred. The accrued liability for unpaid personal leave at December 31, 2014 and 2013 was \$1,475,715 and \$1,378,164, respectively. Employees covered by PERS I (see Note 5) are entitled to, upon retirement, the use of up to 60 days of unused personal leave for calculation of retirement benefits. PERS actuarially determines the cost for these additional benefits and bills the District for a portion of them on a one-time basis. These additional costs do not materially affect the District’s financial statements. Eligible sick leave balances, meeting certain requirements, may either be converted to personal leave according to a schedule or a percent may be cashed out upon retirement.

Operations and maintenance advance – Operations and maintenance advance represents unspent BPA operation and maintenance advances recognized in accordance with the Amendatory Power Purchase Contract with BPA (see Note 8).

Customer deposits – The District requires deposits from certain customers upon request for service. The customer deposits are held to defray potential uncollected accounts and other contingencies. The deposits are refundable under certain circumstances.

Net position – Net position consists primarily of cumulative net income (loss) collected for the payment of utility plant in advance of net accumulated depreciation recognized on such plant. It is the District’s intention to set rates at a level to continue replacing and improving net utility plant. Net position consists of the following components:

- **Net investment in capital assets** – This component of net position consists of capital assets, net of accumulated depreciation, less outstanding balances of any debt borrowings that are attributable to the acquisition, construction or improvement of those assets.
- **Restricted** – This component of net position consists of assets restricted by bond resolutions and assets restricted by Board resolution.
- **Unrestricted** – This component of net position consists of net position that does not meet the definition of “net investment in capital assets” or “restricted.”

Revenue recognition – The District recognizes Electric System revenue as earned. Substantially all residential and small commercial customers are billed bimonthly while large commercial and industrial customers are billed monthly. The District utilizes cycle billing and records revenue billed to its customers when the meters are read. In addition, the District recognizes unbilled revenue, revenues from electric power delivered but not yet billed. At December 31, 2014 and 2013, unbilled revenue was approximately \$3,423,038 and \$3,669,395 respectively. Revenues for the Cowlitz Falls Project are recognized on the basis of the Amendatory Power Purchase Contract between the District and BPA (see Note 8).

Contributed capital – Consists of cash contributions received from customers for the construction of utility plant.

PUBLIC UTILITY DISTRICT NO. 1 OF LEWIS COUNTY

NOTES TO FINANCIAL STATEMENTS

Note 2 – Summary of Significant Accounting Policies (continued)

Use of estimates – The preparation of 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 amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

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 be recognized in earnings unless such derivatives meet specific hedge accounting criteria to be determined as effective. Effective hedges qualify for hedge accounting and such changes in fair values are deferred.

It is the District’s policy to document and apply as appropriate the normal purchase and normal sales 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, natural gas 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 and natural gas are considered to be derivatives under GASB Statement No. 53, and do not generally meet the “normal purchases and normal sales” criteria (see Note 7).

Reclassifications – Certain 2013 balances were reclassified to conform with 2014 presentation.

Note 3 – Cash Equivalents

The District’s investment policies allow for investments in bank certificates of deposit of commercial banks as approved by the State of Washington Public Deposit Protection Commission, or in U.S. Government securities that can be liquidated should it be necessary. Any U.S. Government security purchased shall be purchased through commercial banks qualified as public depositories. All investments shall mature in such amounts and at such times as is anticipated by the District that such moneys will be either reinvested or required to pay District costs. The primary concern of the District shall be the safety of the principal.

The District’s deposits and certificates of deposit are entirely covered by Federal Depository Insurance Corporation (FDIC) or held by state-approved depositories protected under the Commission.

Custodial credit risk is that, in the event of the failure of the counterparty, the District will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. All of the aforementioned cash is held in the District’s name by a third-party custodian.

PUBLIC UTILITY DISTRICT NO. 1 OF LEWIS COUNTY
NOTES TO FINANCIAL STATEMENTS

Note 4 – Utility Plant

Capital assets are defined by the District as assets with initial individual cost of more than \$1,000 and an estimated useful life in excess of one year.

Utility plant activity for the year ended December 31, 2014 is as follows:

	Balance December 31, 2013	Additions	Retirements	Balance December 31, 2014
ELECTRIC SYSTEM				
Utility plant not being depreciated				
Land	\$ 4,822,998	\$ -	\$ -	\$ 4,822,998
Construction in progress	3,461,722	4,343,984	4,681,627	3,124,079
Intangible	121,133	-	-	121,133
Total utility plant not being depreciated	<u>8,405,853</u>	<u>4,343,984</u>	<u>4,681,627</u>	<u>8,068,210</u>
Utility plant being depreciated				
Distribution system	114,534,397	4,549,286	986,740	118,096,943
Transmission system	22,480,803	152,653	97,506	22,535,950
Hydraulic system	1,179,530	-	-	1,179,530
General plant	21,907,848	913,700	-	22,821,548
Total utility plant being depreciated	<u>160,102,578</u>	<u>5,615,639</u>	<u>1,084,246</u>	<u>164,633,971</u>
Less accumulated depreciation for:				
Distribution system	37,209,025	3,069,827	1,228,814	39,050,038
Transmission system	5,864,166	500,682	21,308	6,343,540
Hydraulic system	619,690	20,141	-	639,831
General plant	8,444,271	777,642	-	9,221,913
Total accumulated depreciation	<u>52,137,152</u>	<u>4,368,292</u>	<u>1,250,122</u>	<u>55,255,322</u>
Total utility plant being depreciated, net	<u>107,965,426</u>			<u>109,378,649</u>
Total utility plant, net	<u>\$ 116,371,279</u>			<u>\$ 117,446,859</u>
COWLITZ FALLS SYSTEM GENERATION				
Utility plant not being depreciated				
Land	\$ 7,483,000	\$ -	\$ -	\$ 7,483,000
Utility plant being depreciated				
Hydraulic system	148,212,624	-	-	148,212,624
Transmission system	1,871,394	-	-	1,871,394
General plant	534,169	28,941	-	563,110
Total plant being depreciated	<u>150,618,187</u>	<u>28,941</u>	<u>-</u>	<u>150,647,128</u>
Less accumulated depreciation				
Hydraulic system	64,382,365	3,585,217	-	67,967,582
Transmission system	140,978	9,777	-	150,755
General plant	50,556	2,005	-	52,561
Total accumulated depreciation	<u>64,573,899</u>	<u>3,596,999</u>	<u>-</u>	<u>68,170,898</u>
Total plant being depreciated, net	<u>86,044,288</u>			<u>82,476,230</u>
Total plant, net	<u>\$ 93,527,288</u>			<u>\$ 89,959,230</u>

PUBLIC UTILITY DISTRICT NO. 1 OF LEWIS COUNTY
NOTES TO FINANCIAL STATEMENTS

Note 4 – Utility Plant (continued)

Utility plant activity for the year ended December 31, 2013 is as follows:

	Balance December 31, 2012	Additions	Retirements	Balance December 31, 2013
ELECTRIC SYSTEM				
Utility plant not being depreciated				
Land	\$ 4,823,709	\$ -	\$ 711	\$ 4,822,998
Construction in progress	3,826,139	4,516,823	4,881,240	3,461,722
Intangible	121,133	-	-	121,133
Total utility plant not being depreciated	<u>8,770,981</u>	<u>4,516,823</u>	<u>4,881,951</u>	<u>8,405,853</u>
Utility plant being depreciated				
Distribution system	110,882,927	4,341,429	689,959	114,534,397
Transmission system	22,044,566	489,966	53,729	22,480,803
Hydraulic system	1,179,530	-	-	1,179,530
General plant	21,730,404	454,215	276,771	21,907,848
Total utility plant being depreciated	<u>155,837,427</u>	<u>5,285,610</u>	<u>1,020,459</u>	<u>160,102,578</u>
Less accumulated depreciation for:				
Distribution system	35,148,167	2,974,961	914,103	37,209,025
Transmission system	5,446,036	488,854	70,724	5,864,166
Hydraulic system	599,550	20,140	-	619,690
General plant	7,787,923	777,245	120,897	8,444,271
Total accumulated depreciation	<u>48,981,676</u>	<u>4,261,200</u>	<u>1,105,724</u>	<u>52,137,152</u>
Total utility plant being depreciated, net	<u>106,855,751</u>			<u>107,965,426</u>
Total utility plant, net	<u>\$ 115,626,732</u>			<u>\$ 116,371,279</u>
COWLITZ FALLS SYSTEM GENERATION				
Utility plant not being depreciated				
Land	\$ 7,483,000	\$ -	\$ -	\$ 7,483,000
Utility plant being depreciated				
Hydraulic system	148,212,624	-	-	148,212,624
Transmission system	1,871,394	-	-	1,871,394
General plant	534,169	-	-	534,169
Total plant being depreciated	<u>150,618,187</u>	<u>-</u>	<u>-</u>	<u>150,618,187</u>
Less accumulated depreciation				
Hydraulic system	59,059,472	5,322,893	-	64,382,365
Transmission system	131,201	9,777	-	140,978
General plant	48,551	2,005	-	50,556
Total accumulated depreciation	<u>59,239,224</u>	<u>5,334,675</u>	<u>-</u>	<u>64,573,899</u>
Total plant being depreciated, net	<u>91,378,963</u>			<u>86,044,288</u>
Total plant, net	<u>\$ 98,861,963</u>			<u>\$ 93,527,288</u>

PUBLIC UTILITY DISTRICT NO. 1 OF LEWIS COUNTY
NOTES TO FINANCIAL STATEMENTS

Note 5 – Pension, Deferred Compensation Plan, and Post-Retirement Benefits

Pension – Public Employees Retirement System (PERS) Plans 1, 2, and 3 – Substantially all the District’s full-time and qualifying part-time employees participate in one of the following statewide retirement systems administered by the Washington State Department of Retirement Systems, under cost-sharing multiple-employer public employee defined benefit and defined contribution retirement plans. The Department of Retirement Systems (DRS), a department within the primary government of the State of Washington, issues a publicly available comprehensive annual financial report (CAFR) that includes financial statements and required supplementary information for each plan. The DRS CAFR may be obtained by writing to: Department of Retirement Systems, Communications Unit, P.O. Box 48380, Olympia, WA 98504-8380. The following disclosures are made pursuant to GASB Statement No. 27, *Accounting for Pensions by State and Local Government Employers* and GASB Statement No. 50, *Pension Disclosures – An amendment of GASB Statements No. 25 and No. 27*.

Plan description – PERS is a cost-sharing multiple-employer retirement system comprised of three separate plans for membership purposes: Plans 1 and 2 are defined benefit plans and Plan 3 is a combination defined benefit/defined contribution plan. PERS participants who joined the system by September 30, 1977 are Plan 1 members. Those who joined on or after October 1, 1977 and by August 31, 2003 are Plan 2 members unless they exercise an option to transfer their membership to Plan 3.

PERS participants joining the system after September 1, 2003 have the option of choosing membership in either PERS Plan 2 or PERS Plan 3. The option must be exercised within 90 days of employment. An employee is reported in Plan 2 until a choice is made. Employees who fail to choose within 90 days default to PERS Plan 3. PERS defined benefit retirement benefits are financed from a combination of investment earnings and employer and employee contributions. PERS retirement benefit provisions are established in state statute and may be amended only by the State Legislature.

Plan 1 retirement benefits are vested after an employee completes five years of eligible service. Plan 1 members are eligible for retirement at any age after 30 years of service, or at the age of 60 with five years of service, or at the age of 55 with 25 years of service. The annual pension is 2 percent of the average final compensation per year of service, capped at 60 percent. The average final compensation is based on the greatest compensation during any 24 eligible consecutive compensation months. If qualified, after reaching the age of 66 a cost-of-living allowance is granted based on years of service credit and is capped at 3 percent annually.

Plan 2 retirement benefits are vested after an employee completes five years of eligible service. Plan 2 members may retire at the age of 65 with five years of service, or at the age of 55 with 20 years of service with a reduced benefit, with an allowance of 2 percent of the average final compensation per year of service. The average final compensation is based on the greatest compensation during any eligible consecutive 60-month period.

PUBLIC UTILITY DISTRICT NO. 1 OF LEWIS COUNTY

NOTES TO FINANCIAL STATEMENTS

Note 5 – Pension, Deferred Compensation Plan, and Post-Retirement Benefits (continued)

Plan 2 members who have 30 or more years of service credit and are at least 55 years old can retire under one of two provisions, if hired prior to May 1, 2013:

- With a benefit that is reduced by 3 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.

Plan 2 members hired on or after May 1, 2013 have the option to retire early by accepting a reduction of 5 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. There is no cap on years of service credit; and a cost-of-living allowance is granted (indexed to the Seattle Consumer Price Index), capped at 3 percent annually.

Plan 3 has a dual benefit structure. Employer contributions finance a defined benefit component and employee contributions finance a defined contribution component. The defined benefit portion provides a benefit calculated at 1 percent of the average final compensation per year of service. The average final compensation is based on the greatest compensation during any eligible consecutive 60-month period. Plan 3 members are vested in the defined benefit portion of their plan after ten years of service; or after five years of service, if twelve months of that service are earned after age 44; or after five years of service credit years earned in PERS Plan 2 by June 1, 2003. Plan 3 members are immediately vested in the defined contribution portion of their plan.

Vested Plan 3 members are eligible for normal retirement at age 65, or they may retire early with the following conditions and benefits:

- If they have at least ten service credit years and are 55 years old, the benefit is reduced by an early retirement factor that varies with age, for each year before age 65.
- If they have 30 service credit years and are at least 55 years old, and were hired before May 1, 2013, they have the choice of a benefit that is reduced by 3 percent for each year before age 65; or a benefit with a smaller (or no) reduction factor (depending on age) that imposes stricter return-to-work rules.
- If they have 30 service credit years, are at least 55 years old, and were hired after May 1, 2013, they have the option to retire early by accepting a reduction of 5 percent for each year before age 65.

There is no cap on years of service credit, and Plan 3 provides the same cost-of-living allowance as Plan 2. The defined contribution portion can be distributed in accordance with an option selected by the member, either as a lump sum or pursuant to other options authorized by the Employee Retirement Benefits Board.

PUBLIC UTILITY DISTRICT NO. 1 OF LEWIS COUNTY
NOTES TO FINANCIAL STATEMENTS

Note 5 – Pension, Deferred Compensation Plan, and Post-Retirement Benefits (continued)

Funding policy – Each biennium, the state Pension Funding Council adopts Plan 1 employer contribution rates, Plan 2 employer and employee contribution rates, and Plan 3 employer contribution rates. Employee contribution rates for Plan 1 are established by statute at 6 percent and do not vary from year to year. The employer and employee contribution rates for Plan 2 and the employer contribution rate for Plans 1 and 3 are developed by the Office of the State Actuary to fully fund Plan 2 and the defined benefit portion of Plan 3. All employers are required to contribute at the level established by the Legislature. PERS Plan 3 defined contribution is a non-contributing plan for employers. Employees who participate in the defined contribution portion of PERS Plan 3 do not contribute to the defined benefit portion of PERS Plan 3. The Employee Retirement Benefits Board sets Plan 3 employee contribution rates. Six rate options are available ranging from 5 to 15 percent; two of the options are graduated rates dependent on the employee’s age. The methods used to determine the contribution requirements are established under state statute in accordance with chapters 41.40 and 41.45 RCW.

The required contribution rates expressed as a percentage of current-year covered payroll, as of December 31, 2014, were as follows:

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

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

** Plan 3 defined benefit portion only.

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

The District’s required contributions for the years ended December 31, 2014, 2013, and 2012 were \$796,542, \$698,444, and \$555,902, respectively.

Deferred compensation plan – The District maintains a deferred compensation plan (Internal Revenue Code Section 457) for all eligible employees. The plan is entirely funded by voluntary employee contributions. The District has entered into a contractual relationship with the State of Washington Deferred Compensation Program placing all plan assets into trust for the exclusive benefit of participants and their beneficiaries.

Post Retirement Benefits Plan Other than Pensions Plan (OPEB) description – The District provides post-retirement health care benefits for retired employees until age 65. Prior to April 1, 2008, these benefits paid for 97% of the medical premiums of retirees through age 65. Effective April 1, 2008 the District pays 95% of the medical premiums of retirees up to the age of 65. Spouses and dependents of retirees’ benefits are not paid under the plan but can access the plan on a self-pay basis. Employees that retire with disability retirement under Washington State PERS may continue their health insurance coverage through the District with the same coverage provisions as other retirees. Currently, 11 retirees and 99 active employees are covered under the plan.

PUBLIC UTILITY DISTRICT NO. 1 OF LEWIS COUNTY
NOTES TO FINANCIAL STATEMENTS

Note 5 – Pension, Deferred Compensation Plan, and Post-Retirement Benefits (continued)

Funding policy – The contribution requirements of plan participants are established by the District and may be amended from time to time. It is the District’s intent to expense the actuarially determined OPEB cost annually.

Annual OPEB cost – The District’s annual OPEB cost is calculated based on the annual required contribution of the employer (ARC). The ARC is an amount actuarially determined, based on the entry age normal method, determined in accordance with the guidance of GASB Statement 45.

The ARC represents level funding, that if paid on an ongoing basis, is projected to cover normal costs each year and amortize any unfunded actuarial accrued liabilities over a period not to exceed thirty years. The District’s estimated contributions for 2014 of \$137,595 were less than the current year ARC of \$166,182 and therefore, as of December 31, 2014, the District had an OPEB obligation of \$508,771. The District’s estimated contributions for 2013 of \$138,011 were less than the annual ARC of \$223,365 and therefore, as of December 31, 2013, the District had an OPEB obligation of \$480,184.

Other actuarial assumptions include a rate of return on investments of present and future assets of 3.0%. The health care benefit rate is assumed to increase 9.0% in 2015, and then decreasing to 5.0% annually over 8 years and remaining at 5.0% thereafter. Dental premiums are assumed to increase by 3.0% in all future years.

The District’s annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for 2014, 2013 and 2012 were as follows:

<u>Fiscal Year Ending</u>	<u>Annual OPEB Cost</u>	<u>Percentage of Annual OPEB Cost Funded</u>	<u>Net OPEB Obligation</u>
December 31, 2014	\$ 166,182	82.8%	\$ 508,771
December 31, 2013	223,365	61.8%	480,184
December 31, 2012	231,855	54.0%	394,831

Funding status and funding progress – As of January 1, 2014, the most recent actuarial valuation date, the plan was not funded (0%). The actuarial accrued liability for benefits was \$2.2 million, and the actuarial value of assets was zero, resulting in an unfunded actuarial accrued liability (UAAL) of \$2.2 million.

PUBLIC UTILITY DISTRICT NO. 1 OF LEWIS COUNTY
NOTES TO FINANCIAL STATEMENTS

Note 5 – Pension, Deferred Compensation Plan, and Post-Retirement Benefits (continued)

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

Actuarial Valuation Date	Actuarial Value of Assets	Entry Age Normal AAL (b)	UAAL (b – a)	Funded Ratio (a / b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b – a) / c)
January 1, 2014	-	\$ 2,227,272	\$ 2,227,272	0%	\$ 8,857,441	25%
January 1, 2013	-	2,895,484	2,895,484	0%	8,314,762	35%
January 1, 2012	-	2,814,327	2,814,327	0%	8,168,761	34%

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

Note 6 – Purchased Power Contracts

Bonneville Power Administration (BPA) – The District obtains power from BPA under a long-term power purchase agreement. BPA supplies the District’s power under a 20-year Block and Slice Power Sale Agreement, which was signed on November 24, 2008, commenced on October 1, 2011, and extends through September 30, 2028. This contract provides federal power in the form of two products: Block and Slice. The monthly Block purchase amounts are fixed hourly values each month, but are shaped somewhat to closer align with the District’s monthly power requirements. The non-Slice allocation or Block portion is 0.59662% for fiscal year 2014. The Slice product provides the District 0.96216% of the output of the federal system for fiscal year 2014.

BPA is required by federal law to recover all of its costs through the rates it charges its customers. BPA makes various filings with FERC to confirm that rates are sufficient to cover costs. Under BPA’s adopted power and transmission rate provisions, its rates are subject to revision in order to enable BPA to recover its actual costs of service.

PUBLIC UTILITY DISTRICT NO. 1 OF LEWIS COUNTY

NOTES TO FINANCIAL STATEMENTS

Note 6 – Purchased Power Contracts (continued)

Beginning October 1, 2011, BPA changed its rate-making methodology to a tiered rate approach. Each public utility (preference) customer received a High Water Mark (HWM) based on either its 2010 load or average 2007-2008 loads that defined its right to buy power at a Tier 1 rate. The Tier 1 rate is based on the cost of the existing federal system. Both Block and Slice and non-Slice (Load Following) customers' HWMs are translated into "Tier 1 Cost Allocators" (TOCAs) which, when multiplied by the estimated costs of the federal system, determine their power costs. The District's TOCA for fiscal year 2015 and 2014 is 1.53257% and 1.55878%, respectively. There is an additional monthly load shaping charge (or credit) for the Block product, determined by the shape of customers' loads compared to the actual shape of the Federal Columbia River Power System (FCRPS). If preference customers want to buy more BPA power beyond their HWM, it will be sold at a BPA Tier 2 rate set to fully recover BPA's cost of securing additional resources to serve that customer's load. The customer also has the option of serving some or all of their above-HWM load with non-federal resources. The District elected not to purchase any Tier 2 products from BPA during the first purchase period, October 2011 through September 2014, or during the second purchase period, October 2014 through September 2019. The District has surplus energy, on average, over this time period.

The rate provisions for the Block product include a Cost Recovery Adjustment Clause (CRAC) and a Dividend Distribution Clause (DDC). Either may be triggered if certain thresholds are met. The CRAC allows BPA to raise rates to collect sufficient funds to pay costs. The DDC results in dollars being returned to customers, in the form of future power rate decreases, if excess dollars are collected.

Pursuant to the Slice product rate provisions, the District is subject to additional charges or credits from BPA if BPA's actual costs deviate from budgeted amounts. The Slice product is not subject to the CRAC or DDC; but rather, the District pays its share of cost increases or receives its share of cost decreases through an annual Slice true-up mechanism.

The District also entered into a long term contract with BPA for transmission service, which provides adequate BPA Firm transmission capacity to meet the District's annual system peak load. The transmission contract extends through September 30, 2031.

Energy Northwest – The District is a member of Energy Northwest and a participant in Nuclear Project Nos. 1 and 3 (terminated projects), Columbia Generating Station, the Packwood Lake Hydroelectric Project, and the Nine Canyon Wind Project.

Energy Northwest is a municipal corporation and a joint operating agency of the State of Washington. It has the authority to acquire, construct, and operate plants and facilities for the generation and transmission of electric power and energy.

The membership of Energy Northwest consists of twenty-three public utility districts, including the District, and five cities, all located in the State of Washington.

PUBLIC UTILITY DISTRICT NO. 1 OF LEWIS COUNTY
NOTES TO FINANCIAL STATEMENTS

Note 6 – Purchased Power Contracts (continued)

The District entered into “Net Billing Agreements” with Energy Northwest and the BPA. Under terms of these agreements, the District purchased a maximum of 1.276% of the capacity of Energy Northwest Nuclear Projects (WNP) 1, 2.274% of WNP 2 (now Columbia Generating Station) and 1.103% of Energy Northwest’s 70% ownership share of WNP 3. The District in turn sold this capability to BPA. Under the “Net Billing Agreements,” BPA is unconditionally obligated to pay the District, and the District is unconditionally obligated to pay Energy Northwest the pro rata share of the total annual costs of each project, including debt service on revenue bonds issued to finance the projects, whether or not the projects are completed, operable or operating and notwithstanding the suspension, reduction or curtailment of the projects’ outputs. WNP 2 commenced commercial operation in December 1984. On November 19, 1984, the District withdrew its membership in Energy Northwest and participated in Energy Northwest Projects as a non-member for nearly 25 years. On April 27, 2009, the District approved a resolution to make application to become a member of the Energy Northwest and Energy Northwest Board approved the District’s membership on July 23, 2009.

Packwood Lake Hydroelectric Project – The District is a 14.25% participant in Energy Northwest’s 27 MW Packwood Project (the “Project”), located in the Cascade Mountains south of Mount Rainier. The Project’s fifty-year license has expired and the Project has satisfied all of the requirements for relicensing with the Federal Energy Regulatory Commission and is waiting for final issuance. The participants’ original Packwood Agreements with Energy Northwest obligated the 12 participants to pay annual costs and receive excess revenues. Energy Northwest recognizes revenues equal to expenses for each period. No net income or loss is recognized, and no equity is accumulated. Accordingly, no investment for the joint venture is reflected on the District’s statement of net position. The participants entered into new Power Sales Contracts with Energy Northwest effective October 1, 2011. The terms are similar to the original 1962 agreements, wherein the participants are obligated for a percentage of the Project costs. However, seven of the participants, including the District, began taking their share of the energy, and four participants with very small shares assigned theirs to Clallam PUD under separate bilateral contracts.

In addition the District and Energy Northwest have entered into a power transmission service agreement. The agreement, in exchange for providing transmission services to wheel Packwood Power from the Project to the BPA transmission system, provides for the District to receive monthly payments adjusted periodically for actual costs. Revenue amounted to \$496,508 for the years ended 2014 and 2013, respectively.

Burton Creek Hydroelectric Project – The Burton Creek Hydroelectric Project is located near the east Lewis County town of Packwood. The project is a 560 KWh small hydro owned and operated by a private party. The District previously purchased the output of the Burton Creek Project under a power purchase agreement executed September 29, 2003, at the price of the District’s average BPA priority firm monthly energy and demand rates.

PUBLIC UTILITY DISTRICT NO. 1 OF LEWIS COUNTY

NOTES TO FINANCIAL STATEMENTS

Note 6 – Purchased Power Contracts (continued)

The power purchase agreement extended from year to year unless terminated by either party with six months advance notice. Following the 2011 seasonal shutdown, Burton Creek Hydroelectric failed to resume sale and delivery of power. The District terminated the agreement on July 1, 2012 due to default of the sale and delivery obligation.

Not soon after the District terminated the above agreement, an individual notified the District that he had purchased the distressed FERC license for Burton Creek and had approximately one year to repair the facility and move certain Burton Creek components off Federal land and back onto private property. After the project received Qualifying Facility status, the District contracted to purchase the output of the Burton Creek Project effective October 1, 2013. The contract continues through December 31, 2018, unless otherwise terminated per terms in the agreement. Purchase prices are locked in each fall for the ensuing calendar year based on forward Northwest prices.

Renewable Power Supply – The citizens of Washington State passed Initiative 937 in November, 2006, now codified in the Revised Code of Washington Chapter 19.285 as the Energy Independence Act. This Act mandates renewable energy and conservation targets for the State’s electric utilities with more than 25,000 customers. The District complied with its requirements for the annual renewable energy compliance period ended December 31, 2012 and its two-year conservation compliance period ended December 31, 2011. BPA operated wind projects that are part of the FCRPS, as well as Nine Canyon Wind and White Creek Wind contracts will assist in providing the renewable energy the District will need in order to comply with the Act’s energy targets in the future. At this time the District can meet its I-937 yearly compliance targets with these aforementioned plants using the 3-year REC shaping allowed in the Act. After 2020, the District will meet any new higher REC requirements using either tradable RECs or through purchase agreements from renewable resources.

Nine Canyon Wind Project (Phase I and III) – Located near the city of Kennewick, WA, Nine Canyon Wind Project is owned by Energy Northwest. The District has signed a Power Purchase Agreement for 2% of the output of Phase I. The District’s 2% share represents approximately 1 MW of capacity and based upon a 30% load factor, approximately 2,600 MWh of energy production annually. The District has also signed a Power Purchase Agreement for 15.7% of the output of Phase III. The District’s 15.7% share represents approximately 5 MW of capacity and based upon a 30% load factor, approximately 13,100 MWh of energy production annually.

White Creek Wind Project – On June 20, 2008, the District executed agreements with Klickitat County PUD for the acquisition of a 10% share of the output of the 205 megawatt White Creek Wind Project near Goldendale, Washington for the purchase price of \$36.85 million. The White Creek Wind Project agreements include but are not limited to the Energy Marketing Agreement. On June 16, 2008, the District issued bonds to finance a portion of the White Creek Wind Project purchase (see Note 13).

PUBLIC UTILITY DISTRICT NO. 1 OF LEWIS COUNTY
NOTES TO FINANCIAL STATEMENTS

Note 6 – Purchased Power Contracts (continued)

The prepaid power agreements are amortized using the straight line method over the 20 year contract period and had amortization in 2014 and 2013 totaling \$1,889,538. The District’s 10% share represents approximately 20.5 MW of capacity and based upon a 32% load factor, approximately 57,500 MWh of energy production annually.

Power management – In 2011, the District entered into a power management services agreement with The Energy Authority Inc. (TEA) to provide certain power scheduling, purchasing, sales and related services to assist in the short term management of the District’s power supply. Power purchases and sales are managed by the District in accordance with adopted risk management policies.

Note 7 – Derivative Instruments

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

	Changes in Fair Value		Fair Value at December 31, 2014		Notional
	Classification	Amount	Classification	Amount	
Cash Flow Hedges:					
Financial Swap Forward	Deferred Inflow	\$ 219,565	Derivative Asset	\$ 219,565	MWH
Financial Swap Forward	Deferred Outflow	94,037	Derivative Liability	94,037	MWH

The fair values of the financial swap contracts were based on the futures price curve for the Mid-Columbia Intercontinental Exchange for electricity. The financial swaps were entered into between November 30, 2011 and November 2, 2012, with maturity dates through June 2014.

Objective & 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 expected long and short positions as determined by projected load and resource balance positions. 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 locking in a forward price. Surplus power is generally sold forward at a fixed-price, either physically or financially, when the probability of surplus is high.

Deficit Power Resources – The District hedges projected power resource deficits in future periods by purchasing power. Power is generally purchased to cover projected deficits at a fixed price, either physically or financially, when the probability of the deficit position is high.

PUBLIC UTILITY DISTRICT NO. 1 OF LEWIS COUNTY

NOTES TO FINANCIAL STATEMENTS

Note 7 – Derivative Instruments (continued)

Derivatives authorized under the Risk Management Policy by the District include:

- Physical power forward purchases and sales
- Monthly and daily power physical calls and puts
- Power and natural gas fixed for floating swaps
- Monthly financial Asian power call and put options
- Financial daily power put and call options
- Monthly power swaptions

There is no associated debt for these instruments at December 31, 2014.

Credit risk – The District is a member of The Energy Authority, Inc. (TEA). The District adheres to the credit policies and credit limits agreed to by TEA and the District. TEA’s policy addresses guidelines for setting credit limits and monitors credit exposure on a real time basis on behalf of the District. TEA’s management determines the credit quality of the District’s counterparties based upon various credit evaluation factors, including collateral requirements under certain circumstances.

All physical commodity transactions (for hourly and/or daily) for the District are traded by TEA as principle (on behalf of the District) and rely on TEA’s credit limits. All forward physical/financial commodity transactions are entered into only with counterparties approved by the District’s Risk Management Committee for creditworthiness. As of December 31, 2014, the District had 11 counterparties. The maximum credit extended to any one counterparty is \$1.75 million.

The District entered into master enabling agreements with various counterparties, which enable hedging transactions. Such agreements include the International Swap Dealers Association Agreements (ISDA) for financial transactions. All of the enabling agreements have provisions addressing credit exposure and provide for various remedies to assure financial performance, including the ability to call on additional collateral as conditions warrant, generally as determined by the exposed party. The District also uses netting provisions in the agreement to diffuse a portion of the risk.

Transactions under the ISDA agreements are used to financially hedge monthly long or short positions to reduce the risk of an underlying physical position by using Risk Management Committee approved financial instruments.

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. At December 31, 2014, there are no derivative transactions outstanding that carry basis risk. As applicable, all power related transactions are to be settled on the relevant Mid-Columbia Intercontinental Exchange index and all gas transactions are to be settled on the relevant Sumas/Huntingdon index.

PUBLIC UTILITY DISTRICT NO. 1 OF LEWIS COUNTY
NOTES TO FINANCIAL STATEMENTS

Note 7 – Derivative Instruments (continued)

Termination risk – As of December 31, 2014 no termination events have occurred and there are no outstanding transactions with material termination risk. None of the outstanding transactions have early termination provisions except in the event of default by either counterparty. Events of default are generally related to (i) failure to make payments when due, (ii) failure to provide and maintain suitable credit assurances as required, (iii) bankruptcy or other evidence of insolvency, or (iv) failure to perform under any material provision of the agreement. Failure to provide or receive energy or natural gas under physical commodity transactions does not generally fall under the events of default provisions, unless the non-performing party fails to pay the resulting liquidated damages as they come due.

Note 8 – District Hydroelectric Projects

Cowlitz Falls Project – The Cowlitz Falls Project is located on the upper Cowlitz River in eastern Lewis County, Washington upstream from two existing hydroelectric projects, Mayfield and Mossyrock, owned by the City of Tacoma. The Project includes a concrete gravity dam and powerhouse, a reservoir covering about 610 acres extending approximately 10 miles up the Cowlitz River and 1.5 miles of the Cispus River, and 5.2 miles of overland transmission line to the District’s Glenoma Substation.

The powerhouse contains two Kaplan turbine generating units with net installed capacity of 35 MW each at a rated head of 87.5 feet. Average annual energy generation is estimated at 261 million kilowatt hours. Project operation depends upon the “run of the river” to produce the maximum amount of electric energy, instead of extensively regulating the reservoir behind the dam to maximize the Project’s firm or dependable capacity.

In June 1986, the District was granted a license by FERC to proceed with the development and construction of the Cowlitz Falls Project. On May 23, 1991 the District and BPA executed an Amendatory Power Purchase Contract. Construction of the Project began in July 1991 and the Project began commercial operation on June 29, 1994.

Revenues for the Cowlitz Falls System are recognized on the basis of the Amendatory Power Purchase Contract between the District and BPA. Through this contract, BPA receives all output from the Cowlitz Falls Project in exchange for payment of all operation and maintenance costs and debt service on Cowlitz Falls revenue bonds (see Note 12). The District receives monthly operation and maintenance payments from BPA based upon an annual budget of operating and capital project expenditures. Certain operation and maintenance costs are subject to incentive or reimbursement provisions if actual expenses are less or more than certain budgeted amounts. The District did not receive any incentive payments for the year ended December 31, 2014. Debt service payments are made by BPA directly to the Bond transfer agent for payment of scheduled bond interest and principal.

PUBLIC UTILITY DISTRICT NO. 1 OF LEWIS COUNTY

NOTES TO FINANCIAL STATEMENTS

Note 8 – District Hydroelectric Projects (continued)

The District records the Cowlitz Falls System activity reflecting the cost reimbursement basis of the Amendatory Power Purchase Contract with BPA. As a result, revenues and costs offset one another with no resulting net income or loss. The Cowlitz Falls System consists of essentially two activities, plant construction and related debt service, and operations and maintenance. For related debt service, revenue is recognized primarily for BPA debt service payments. Expenses consist of interest on the outstanding revenue bonds, depreciation, and amortization of bond costs. For operations and maintenance, revenue is recognized primarily for BPA operation and maintenance advances, and interest income on unspent advances. Expenses consist of operation and maintenance costs, including plant renewals and replacements, and taxes.

As part of the contract, the District (Electric System) provides power transmission services to BPA over facilities of both the City of Tacoma (Tacoma) and the District. The terms and conditions for the use of the Tacoma facilities are governed by an agreement between Tacoma and the District. Costs are passed to BPA as part of the District's contract with BPA. Revenue amounted to \$940,975 for the years ended 2014 and 2013, respectively.

Mill Creek Hydroelectric Project – The Mill Creek Hydroelectric Project is located on Mill Creek, a tributary to the Cowlitz River, near Salkum, Washington and the Cowlitz Salmon Hatchery. The project includes a six foot high concrete diversion structure, 1,500 feet of 42 inch concrete cylinder pipe and a concrete block powerhouse downstream. The powerhouse contains two Francis turbine induction generating units with net installed capacity of 300 KW each at an average head of 96 feet.

Note 9 – Conservation Programs

The District has participated in BPA programs over the past several years to more aggressively seek out and acquire energy efficiency savings. On March 3, 2004, the District signed a Purchase of Conservation Agreement with BPA for the purpose of offering conservation under a program known as "Conservation as Part of Augmentation" (ConAug). On July 10, 2006, the District signed a Conservation Acquisition Agreement (CAA) with BPA for purpose of offering conservation to commercial and industrial customers. On September 22, 2009 the District executed the "Energy Conservation Agreement" (ECA) with BPA to continue efforts begun under the ConAug and CAA agreements. The District continues to offer commercial and industrial energy efficiency measures through the ECA program.

In 2009, the District completed a Conservation Potential Assessment (CPA) as part of the requirements under the Energy Independence Act adopted with passage of Initiative 937. The CPA developed 20 year and 10 year conservation plans with a defined target equaling 20% of the corresponding 10 year potential starting in 2010. Every two years the District must update the CPA with new information and establish a new target for the subsequent two year period. The CPA for the 2012-2013 biennium set the energy savings target for this period at 1.73 aMW, or approximately 7,577 MWh for each year. Through the conservation programs described above and indirect savings acquired through the activities of NEEA, the District was able to exceed the 2013-2014 target.

PUBLIC UTILITY DISTRICT NO. 1 OF LEWIS COUNTY
NOTES TO FINANCIAL STATEMENTS

Note 10 – Fiber Optic Activity

The District’s fiber optic based communication system consists of approximately 60 miles of overhead ADSS fiber optic cable, primarily following the District’s transmission routes. The District is constructing the system to support its Electric System with communication between its offices and various substations located throughout Lewis County.

The District has also leased portions of excess dark fibers to telecommunication companies, BPA, non-profit, and governmental agencies. Expansion of the system may occur where it best meets the District’s communication needs.

Selected financial data is reported as follows:

	2014	2013
Telecommunication services		
Operating revenues		
Dark fiber leases	\$ 294,988	\$ 286,456
Total operating revenues	294,988	286,456
Operating expenses		
Operating expenses	414	3,060
Maintenance expense	6,081	5,903
Depreciation expense	78,266	76,824
Total operating expenses	84,761	85,787
Net operating revenue	\$ 210,227	\$ 200,669
Capital investment		
Net telecommunication plant	\$ 1,286,576	\$ 1,300,969

PUBLIC UTILITY DISTRICT NO. 1 OF LEWIS COUNTY

NOTES TO FINANCIAL STATEMENTS

Note 11 – PURMS Self-Insurance Agreement

The District and eighteen other PUD's participate in a joint self-insurance pool in affiliation with Public Utility Risk Management Services (PURMS).

Liability risk pool – PURMS provides liability insurance coverage for its members participating in the Liability Risk Pool (Liability Pool) and to a limited extent for the benefit of their employees under an agreement entitled "PURMS Joint Self-Insurance Agreement" (amended and restated as of November 10, 2011, "SIA"). Under SIA, the Liability Pool had a self-insured retention of \$1,000,000 per occurrence, which was the Coverage Limit in effect for 2014, and in effect as of December 31, 2014.

The Liability Pool is funded through assessments of its participating members. Assessments are levied at the beginning of each calendar year to replenish the Liability Pool to its designated risk pool balance, and at any time during the year that either (a) the actual risk pool balance becomes \$500,000 less than the designated risk pool balance or (b) the risk pool balance is depleted to the amount of 70% funding level established by the actuarial report for the liability pool. For calendar year 2014, the designated risk pool balance was \$3,000,000.

At all times, PURMS also maintains excess liability insurance for its members in the Liability Pool. For the year 2014, the amount of such excess insurance was \$35,000,000.

As of December 31, 2014, there were 5 known incidents and/or unresolved liability claims pending against one or more members or former members of PURMS' Liability Pool. The total dollar value of the risk posed by these claims to such members and to the Liability Pool itself is unknown. Accordingly, no provision has been included in the accompanying financial statements.

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

The Property Pool is funded to the amount of its Designated Property Pool Balance, which in 2014 was \$750,000. The Property Pool's operations are financed through assessments of its Members in accordance with the terms of the Property General Assessment Formula. A Property Assessment is issued automatically at the beginning of each calendar year to replenish the Property Pool to its Designated Balance. Property Assessment are also issued at any time during the year that the Actual Property Pool Balance drops below \$500,000 or is depleted to the amount of the 70% funding level established by the annual actuarial report for the Property Pool.

PUBLIC UTILITY DISTRICT NO. 1 OF LEWIS COUNTY
NOTES TO FINANCIAL STATEMENTS

Note 11 – PURMS Self-Insurance Agreement (continued)

The Property Pool also provides its members with automatic extended property coverage. This coverage extends property coverage for property losses that exceed the Property Pool’s \$250,000 property coverage limit if those losses are also subject to increased retentions under the excess property insurance. Under the excess property insurance retentions in effect for 2014, the maximum exposure to the Property Pool from a property loss that exceeded \$250,000, and that was subject to an increased retention, was \$250,000, less the applicable deductible, or a maximum of \$250,000 more than the property coverage limit.

At all times, PURMS also maintains excess property insurance for its members in the Property Risk Pool. For the year 2014, the amount of such excess insurance was \$200,000,000.

Note 12 – Cowlitz Falls Hydroelectric Project Revenue Bonds

In July 2013, the Board issued \$87,995,000 in Cowlitz Falls Hydroelectric Project Revenue Refunding Bonds to refund the series 2003 bond issues, with an average interest rate of 4.79%. The balance of the refunding included proceeds from premium on issue of \$12,278,112. Underwriting fees and other issuance costs totaled \$925,151. The loss on refunding was \$5,284,305 and is being charged to operations through the year 2024 using the effective interest method.

The 2013 Bonds are special limited obligations of the District secured by a lien and charge on the Cowlitz Falls revenues and bond insurance. Pursuant to a Power Purchase Contract and Payment Agreement all Project output has been sold to BPA. BPA is obligated to pay all operation and maintenance costs including debt service on the Bonds, whether or not the Dam is operating or operable (see Note 8).

	2014	2013
2013 Revenue Bonds to refund 2003 revenue bonds due April 1, 2032	\$ 85,055,000	\$ 87,995,000
Less current maturities	3,000,000	2,940,000
Long-term portion of revenue bonds	\$ 82,055,000	\$ 85,055,000

PUBLIC UTILITY DISTRICT NO. 1 OF LEWIS COUNTY
NOTES TO FINANCIAL STATEMENTS

Note 12 – Cowlitz Falls Hydroelectric Project Revenue Bonds (continued)

Scheduled debt service deposits for principal, interest and principal maturities are as follows:

	Sinking Funds			Principal Maturities
	Principal	Interest	Total	
2015	\$ 3,000,000	\$ 4,299,412	\$ 7,299,412	\$ 3,000,000
2016	3,150,000	4,149,413	7,299,413	3,150,000
2017	3,310,000	3,991,912	7,301,912	3,310,000
2018	3,475,000	3,826,413	7,301,413	3,475,000
2019	3,650,000	3,652,662	7,302,662	3,650,000
2020 – 2024	21,160,000	15,338,063	36,498,063	21,160,000
2025 – 2029	27,205,000	9,291,788	36,496,788	27,205,000
2030 – 2032	20,105,000	1,798,969	21,903,969	20,105,000
	<u>\$ 85,055,000</u>	<u>\$ 46,348,632</u>	<u>\$ 131,403,632</u>	<u>\$ 85,055,000</u>

Note 13 – Electric System Revenue Bonds, Series 2008

In June, 2008 the District issued two series of revenue bonds in the aggregate amount of \$36,690,000 to finance capital improvements to the Electric System and acquire the right to energy and other attributes from the White Creek Wind Project (see Note 6). The bonds consist of two series, Series 2008A, in the principal amount of \$19,415,000 with an interest rate of 5.00%, and Series 2008B (Taxable) in the principal amount of \$17,275,000 with interest rates ranging from 3.64% to 5.32%.

These bonds are subject to covenants which specify the order of application of gross revenue requirements and which require the District to: pay costs of maintenance and operations; costs associated with the generation, conservation, transformation, transmission or distributions of power and energy acquired or purchased or constructed by the District; and to make all payments required to be made into the Bond Account. Other covenants also apply. The 2008 Series bonds were issued with a premium of \$1,146,751 and had underwriting fees and other issuance costs of \$982,888, both of which are amortized on the effective interest method over the life of the bonds.

PUBLIC UTILITY DISTRICT NO. 1 OF LEWIS COUNTY
NOTES TO FINANCIAL STATEMENTS

Note 13 – Electric System Revenue Bonds, Series 2008 (continued)

Scheduled debt service deposits for principal and interest and principal maturities are as follows:

	Series 2008 A			Principal Maturities
	Principal	Interest	Total	
2015	\$ -	\$ 970,750	\$ 970,750	\$ -
2016	-	970,750	970,750	-
2017	-	970,750	970,750	-
2018	-	970,750	970,750	-
2019	1,760,000	970,750	2,730,750	1,760,000
2020 – 2023	7,970,000	2,957,500	10,927,500	7,970,000
2024 – 2027	9,685,000	1,240,250	10,925,250	9,685,000
	\$ 19,415,000	\$ 9,051,500	\$ 28,466,500	\$ 19,415,000

	Series 2008 B			Principal Maturities
	Principal	Interest	Total	
2015	\$ 1,850,000	\$ 475,954	\$ 2,325,954	\$ 1,850,000
2016	1,945,000	382,159	2,327,159	1,945,000
2017	5,275,000	280,630	5,555,630	5,275,000
	\$ 9,070,000	\$ 1,138,743	\$ 10,208,743	\$ 9,070,000

A reconciliation of the Series 2008 bond issuance and the Statement of Net Position is as follows:

Series 2008 A	\$ 19,415,000
Series 2008 B	9,070,000
Total	28,485,000
Less current maturities	(1,850,000)
Long-term portion of 2008 Series Bonds	\$ 26,635,000

The District issued \$9,499,000 in Revenue Bonds in June 1992 for financing a portion of the District's Capital Improvement Program and conservation efforts. The Program made capital improvements and completed conservation efforts of \$13 million over a two year period. On November 29, 1994, the District deposited \$9,480,300 in an irrevocable trust with an escrow agent to provide for all future debt service payments on the 1992 Series bonds.

PUBLIC UTILITY DISTRICT NO. 1 OF LEWIS COUNTY

NOTES TO FINANCIAL STATEMENTS

Note 13 – Electric System Revenue Bonds, Series 2008 (continued)

These refunded bonds constitute a contingent liability of the District only to the extent that cash and investments presently in the control of the refunding trustees are not sufficient to meet debt service requirements, and are therefore excluded from the financial statements because the likelihood of additional funding requirements is considered remote.

Note 14 – Line of Credit

On October 18, 2011, the District and West Coast Bank (now Columbia Bank) entered into a Loan Commitment for a Revolving Line of Credit (LOC) with an available commitment of \$5 million bearing an interest rate of 3.25%. The District may either draw on the LOC or request that Columbia Bank issue a letter of credit. The District may use the proceeds of any draws on the LOC to fund short-term cash flow needs caused by variable power supply costs. The initial term of the Loan Commitment expired on October 18, 2013. The LOC was extended for up to an additional 38 months expiring on December 1, 2016. As of December 31, 2014, the District has not drawn on the LOC nor requested the issuance of any letters of credit.

Note 15 – Endangered Species Listing of Salmon and Steelhead/American Rivers Intent to Sue

The National Marine Fisheries Service (NMFS) has listed the lower Columbia Chinook salmon and steelhead trout as threatened under the Endangered Species Act (ESA). The Cowlitz River is a tributary of the lower Columbia River and the Cowlitz Falls Project operates on the upper Cowlitz River.

On January 14, 2000, American Rivers, Trout Unlimited, Friends of the Cowlitz, CPR Fish and the Cowlitz Indian Tribe filed a Notice of Intent to Sue for Violations of the ESA. The Notice claims the FERC, BPA, and District are violating the ESA by continued operation of the Cowlitz Falls Project. American Rivers indicates that unless BPA and FERC initiated consultation under Section 7 of the ESA with NMFS regarding the impact of the Project on listed species, and unless immediate action is taken to bring the Project into compliance, they will file suit against BPA, FERC, and the District.

As a result of the Cowlitz Falls Project operation and the ESA anadromous fish listings, the District (as the non-Federal representative to FERC) initiated consultation with the FERC and NMFS to evaluate possible ESA impacts of the Project. As part of the consultation the District completed a draft Biological Assessment (BA) of the Cowlitz Falls Project benefits, impacts, and operation in March 2002 and submitted it to the FERC. The FERC accepted the draft BA, finalized it and submitted it to NMFS in July 2002.

PUBLIC UTILITY DISTRICT NO. 1 OF LEWIS COUNTY
NOTES TO FINANCIAL STATEMENTS

**Note 15 – Endangered Species Listing of Salmon and Steelhead/American Rivers Intent to Sue
(continued)**

In June 2009, the NMFS issued a Biological Opinion (BiOp) for the Project which allows limited “Take” of the threatened species. The BiOp was submitted to the FERC for inclusion as a Project License amendment which includes studies and mitigation measures to reduce impacts to the species at the Project. As of this time the FERC has not acted on the BiOp. In the interim, the District has evaluated and/or implemented many of the reasonable and prudent measures for protection of the species at the Project. On April 9, 2013, NMFS updated the BiOp’s Incidental Take Statement and study schedule.

On June 20, 2014, Tacoma Power, BPA and the District signed the “Northshore Project Easement Agreement” whereby BPA signed over ownership of the Cowlitz Falls Fish Facility (CFFF) and the Stress Relief Ponds (located at the downstream salmon hatchery). The District agreed to provide access and easement areas to Tacoma Power so that a new fish collection facility could be combined with the existing CFFF. Tacoma Power’s goal is to improve fish collection efficiencies to 95%.

As stated in Note 8, BPA pays all operation and maintenance costs of the Cowlitz Falls Project. As such, the above matters are not expected to impact the District’s financial position.

Note 16 – Subsequent Event

On May 12, 2015, the Board of Commissioners passed Resolution No. 2685 revising certain rate schedules effective June 1, 2015. The basic charge was increased by \$0.20 per day and the kilowatt hour charge was increased by 2%.

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

Board of Commissioners
Public Utility District No. 1 of Lewis County
Chehalis, Washington

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, which comprise the statement of net position as of December 31, 2014, and the related combined and separate statements of revenues, expenses and changes in net position and cash flows for the year then ended, and the combined statement of net position as of December 31, 2013, 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 of the Public Utility District No. 1 of Lewis County's Electric System and Cowlitz Falls System (the District), which collectively comprise the Public Utility District No. 1 of Lewis County's financial statements, and have issued our report thereon dated May 29, 2015.

Internal Control Over Financial Reporting

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

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or 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.

**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)**

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 and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether District's financial statements are free of 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 result 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.

Moss Adams LLP

Portland, Oregon
May 29, 2015