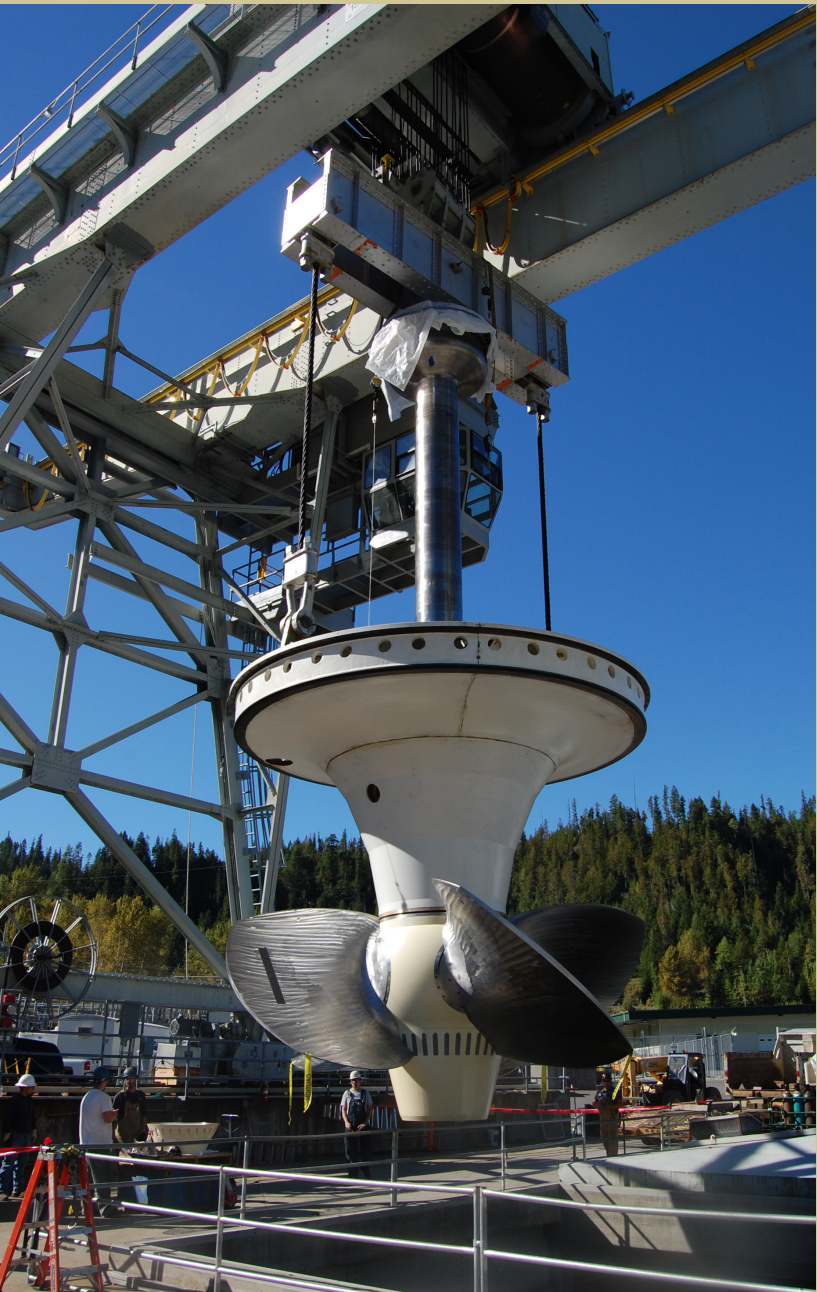




Public Utility District No. 1 of Pend Oreille County



Annual Report
2014

Contents

Manager’s Message	3
Commissioners	5
Production	6
Transmission and Distribution	7
Regulatory Affairs	8
Natural Resources	9
Water Systems	10
Community Network System	11
Energy Resources	12
2014 District Highlights	13
Report of Independent Auditors	14
Management’s Discussion & Analysis	16
Financials	26
Supplemental Information	52
Organizational Information	56



Manager's Message

A Year of Accomplishment

This District is small, yet we operate diverse and challenging utility functions. We are not only a power distribution utility with transmission lines, substations, and distribution lines; we generate power at our Box Canyon Hydroelectric facility. Our staff also operates nine community water systems and a fiber optic broadband wholesale service.

So, what were some of our accomplishments during 2014?

Of primary importance, the District substantially completed the turbine upgrade and plant modernization efforts at the Box Canyon project, successfully refurbishing this hydroelectric project for the benefit of future generations. The District placed the last turbine unit back into service shortly after year end. Some work does remain. Future projects at Box Canyon will involve fish passage and dissolved gas reduction; however, these efforts are more in the nature of bolt on additions. The productive heart of the dam is now rebuilt and faithfully in service.

In 2014, the District completed its Community Network System fiber optic build, financed largely with a \$27 million American Recovery and Reinvestment Act Grant. This wholesale infrastructure extends to every residential and business premise in the southern half of our service territory and is available to private sector providers, who wish to sell Internet and broadband services to the general public. District financial models were predicted on a 30% customer penetration in approximately 5 years; this take ratio was instead attained in the first year of operation. The general public is very pleased with the speed and quality of service and unabashed about letting us know.

During the year, the District completed an interesting environmental project at Sullivan Lake. A pipe installed on the lake bed allows cold water from below to be blended with warm water from the surface, in variable proportions as may be desired, to control the temperature of the outlet creek. The goal is to provide suitable cold water stream habitat for an endangered species of fish, the Bull Trout.

Mother Nature shared a disaster with us in 2014, as two separate summer windstorms hit the area hard, 10 days apart. Pend Oreille County is heavily treed, and the violent microbursts created severe property damage; trees were uprooted throughout entire neighborhoods. The storms created \$1 million in damage to the electric system and another \$250,000 to fiber optic lines. A few customers were without power for up to 3 weeks, and many were out longer for broadband services. Our crews responded in an incredible manner, working long days and late into the night, while eating meals off the tailgates of their trucks. Rather than acting out, the majority of our customers watched that restoration effort and responded in an endearing fashion, thanking our crews for their hard work, and generally conducting themselves with considerable grace during a very difficult and very rare event. We have great customer owners.



John Jordan
General Manager



April Owen, Assistant
General Manager, Distribution &
Finance



Colin Willenbrock, Assistant General
Manager, Production &
General Counsel

A Future of Challenge

A utility needing to reengineer its business processes probably needs a change of leadership. If present leadership manages a utility into a hole, that same leadership is unlikely to be capable of successfully charting a way back to a good corporate health. Here at the District, we believe strongly in continuous improvement, in always striving to find ways to be a better utility, to better serve Pend Oreille County, to be more efficient, more cost-effective, and to improve the customer experience. Our goal is to compound continuous improvements into a brighter future for our utility and the customers we serve.

The successful utility of the future will not be as secure as the utility of the past and cannot be slow to embrace change. Many future industry challenges look the same as those of the past - challenges such as acquiring sufficient power resources, maintaining infrastructure, financing a heavily capital intensive business, and delivering excellence in customer service.

However, many future industry challenges are new and problematic, such as integrating renewable resources into the power mix; preparing for a cost of carbon; enabling distributed generation such as solar panels on a home; avoiding death spirals; developing a smart and secure power grid; complying with ever-increasing environmental regulations and related spending requirements; protecting the utility from cyber attacks; operating in marketplaces where supply and demand are not in balance; and managing through substantial legislative change.

Continuous improvement is a cornerstone for us. To constantly pursue adding value and chasing improvement in times of challenge and change requires far sighted, talented, and innovative staff. No company can be successful without quality employees. The District is extremely fortunate in that our staff is up to the varied challenges of the future. They are engaged and care deeply about serving the communities in which they live. No one here is at rest.

John Jordan
General Manager



Mark Cauchy, Director Regulatory
& Environmental Affairs



Chris Jones, Director, Distribution,
Engineering & Operations



Rhonda Thomas, Director
Information Technology and
Telecommunications

Commissioners

Finding that Perfect Balance

Have you noticed that as we get older, it becomes a little more difficult to keep our balance? It's certainly not like in our younger days, when we were riding bikes, skiing, skateboarding, or just walking on an extremely narrow path. Don't get me wrong, we can still have good balance as we age, we just need to continually work at it.

One of the most difficult tasks of being an elected commissioner of a publicly-owned, not-for-profit utility district is finding that balance between what is best for the utility and what is best for our customers. Granted, they should go hand-in-hand. Most everything that is done at the utility is carried out with the idea of better serving our owners, the rate payers. As with any business, we need to replace older vehicles, remodel buildings, and give raises to our employees as needed. The challenge is keeping that perfect balance, making the necessary improvements, while keeping "Quality Service at Low Cost".

It would be easy not to make improvements and "kick the can" down the road for the next generation to fix. The flip side of that argument is having the District spending too much and then having to raise rates too high. It's a difficult dance, in Pend Oreille County, where we have many retirees and a high rate of unemployment, versus maintaining a quality electric utility in an industry that is heavily regulated with unfunded mandates.

Effective communication is one way to help find that perfect balance. When the utility district openly provides information and listens to the needs and wants of their rate payers, the result is positive for both parties. This is what makes "Public Power" what it is today. No one said it would be easy. As in life, the "right way" is not always the easiest, quickest, or least expensive; it's sometimes the most difficult. But, don't get me wrong, we can keep our balance, we've just got to continually work at it.

Curt Knapp
Commissioner



Curt Knapp
President



Rick Larson
Vice president



Dan Peterson
Secretary



Box Canyon Dam Spillway, June 2014

Production

Work at the Box Canyon Hydroelectric Project continued during 2014. One significant project is the hydraulic gate operations associated with the total dissolved gas (TDG) project at the spillway, for which construction began in June of 2013. Control buildings have been mounted on the downstream sides of the dam abutments, and hydraulic cylinders will be installed early in 2015. The changes will allow passage of water from below, rather than above, the second gate, which will reduce TDG downstream of the dam when spilling water and ultimately improve fish habitat.

The final generator/turbine is scheduled to be operational in March 2015. This will conclude the on-site work with Andritz Hydro, the contractor for the project. The generation and flow capacities will increase. The ability to pass additional flows through the powerhouse will also reduce TDG, thus reducing injury to fish. Powerhouse improvements, the majority of which are related to the major changes incorporated during the upgrade project, continue to be implemented as needed.

The Calispell Creek Power House No. 2 generator and exciter were rebuilt, and plant upgrades in transformers and protection have increased the reliability and safety of the facility. The exciter for Unit No. 1 is being repaired and scheduled to be put into service in March 2015, bringing the site to full generating capacity once again.

Production staff assisted with the Cold Water Pipe Project at Sullivan Lake and will be responsible for operation and maintenance of the project. The Cold Water Pipe Project also included improvements to the structure, operational controls, and security of the Sullivan Lake Dam, which were successfully completed.



Calispell Creek Power House generator being lifted out of the powerhouse.

Transmission and Distribution

The District's electric service area covers all of Pend Oreille County. Three dedicated line crews and one tree trimming crew provide maintenance, construction, line clearing, and outage repair for approximately 8,800 customers in a 1,402 square mile area.

Typically, line crews spend several days working to restore power following snow storms and/or ice events each winter. Summers are typically spent building and making repairs to sections of lines, in preparation for severe winter weather. The summer of 2014 was not typical.

A severe windstorm on July 23, with winds over 70 mph, swept across the southern half of Pend Oreille County, causing major damage to Pend Oreille PUD's electrical and broadband systems. In many areas, large trees fell into the power and fiber optic lines, bringing the lines down, breaking poles, and destroying transformers. The storm, which lasted less than 15 minutes, resulted in 4,000 customers without power and approximately 400 without broadband service.

On August 2nd, with PUD line crews just a few hours from completing repairs related to the July 23 storm, another windstorm occurred. This 45-minute storm caused as much damage, although in a wider area, as the July storm, again leaving approximately 4,000 customers without power.

Repair work following this type of damage requires clean up and rebuilding the sections of line that were destroyed. Following the initial 32-hour push, and another 30-hour push after the second storm, the PUD's line crews, tree trimmers, fiber technicians and splicers, field engineers, and many others worked 17-hour days to restore power and broadband service. With the exception of a few customers who were waiting to have individual service masts repaired, power restoration work was completed on August 11. Broadband service restoration was completed on August 19.

Costs associated with the storm restoration work totaled approximately \$1 million for the electric system and \$250,000 for the Community Network System. Federal funds were not available for reimbursement.

The linemen, CNS technicians, and tree trimming crews were supported by system operators, summer employees, warehouse personnel, mechanics, office personnel, and operations management personnel. Everyone who could pitched in to help restore power and fiber to our customers. From the field personnel, who ate meals delivered by office personnel on the ground or tailgates of their trucks at the work sites, to the customer service representatives and system operators working long hours answering phones, it was a team effort, with a can-do attitude.



Tree Trimmers cut trees off power lines on a garage.



Regulatory Affairs



Construction of the Sullivan Lake Cold Water Release Project

In 2014, the District continued to successfully meet all of its obligations for the Box Canyon Hydroelectric Federal Energy Regulatory Commission (FERC) license. An agreement was reached between the USDA Forest Service and the District, which resolved a long-standing issue regarding erosion control measures on Forest System lands within the Box Canyon Dam reservoir. The agreement is awaiting approval from FERC.

The District completed final design for the Upstream Fish Passage Facility for the Box Canyon Hydroelectric Project. The contract will go out for bid in 2015, with construction scheduled to begin in 2016.

In accordance with a Surrender Order issued by FERC, for the disposition of project facilities for the Sullivan Creek Hydroelectric Project, the District substantially completed construction

of a cold water release facility on Sullivan Lake at the Sullivan Lake Dam. The \$4 million project allows the District to release supplemental water out of the lake for use by the State of Washington under the Columbia River Basin Supply Program, while meeting water quality temperature standards. Under the program, the District is to receive a total of \$14 million over three years for associated water rights. A second payment of \$2.5 million was received in 2014, with the final payment due in 2015.

The District continues discussions with the Kalispel Tribe regarding water quality standards at the District's Calispell Pumping Station, which is a project works under the Box Canyon FERC license. The Environmental Protection Administration (EPA) issued a 401 Certification under the Clean Water Act for the pumping station. The parties are working together to reach an agreement on how the pumping station can best be managed and operated to meet water quality standards.

The District and Kalispel Tribe have also been in discussions over Total Maximum Daily Load (TMDL) for temperature of the Pend Oreille River that was developed by the Washington State Department of Ecology and submitted to EPA for approval. The TMDL will require the District to implement measures that will reduce water temperature in the Box Canyon reservoir, or as an alternative, implement measures that improve temperatures in tributaries to the reservoir.



Box Canyon Dam

Natural Resources

The District continues to implement a variety of components related to its Box Canyon Federal Energy Regulatory Commission (FERC) license. Four major projects will be completed over the next five years, including an upstream trap and haul fishway (operational in 2017) and a total dissolved gas bypass (operational in 2015) at Box Canyon Dam, as well as a downstream fish passage pumping facility at the Calispell Creek Pumping Plant (operational in 2018).

Fish behavior and hydraulic studies at Box Canyon Dam in recent years have led biologists and engineers through the process of selecting the location for the upstream trap and haul fishway. With fishway site selection completed, construction plans have been developed and approved. Efforts will continue on construction permitting, working collaboratively with local, state, and federal regulators, in preparation for the bidding process.

The District's Trout Habitat Restoration Program for tributaries to the Pend Oreille River began in 2009. Stream habitat surveys and enhancement construction projects will continue throughout the life of the program. The first instream construction project occurred on Middle Branch LeClerc Creek in 2011. Work will continue until 164 miles of stream improvements are completed, which will be approximately 25 years. In 2014, projects were completed on Fourth of July and Seco Creeks. Due to remote locations and access issues, much of the stream restoration work must be done without the use of heavy equipment. The photo below shows a log being moved into a stream by hand.



Bald Eagles along the Pend Oreille River



The FERC issued license for Box Canyon Dam also includes components to enhance, create, maintain, and monitor wildlife habitats within the project boundary. The District monitors many different types of wildlife and reports the results to the various agencies that manage the respective species. In general, much of the native wildlife within the project is doing very well. The wildlife management areas and wildlife habitat properties that we are required to manage feature newly created enhancements that are being used by many species.



Metaline Falls Water Treatment Plant

Water Systems

Nine community water systems, which provide quality drinking water to 582 homes and businesses in Pend Oreille County, are managed and operated by the District's Water Department. The staff provides continuous monitoring and testing to assure quality drinking water for its customers, as well as long-range planning for necessary improvements and growth.

During 2014, the Town of Metaline Falls considered acquiring the water system from the District. After performing their due diligence, both parties agreed the District should continue operating the system.

Water system improvement projects are primarily funded by federal and state grants and/or low-interest loans. During 2015, the Sunvale Acres Water System is planning to install 500 feet of new water main lines to replace an older, undersized line.

Also during 2015, the District will be conducting a 5-year cross connection survey, in order to verify current potable and non-potable connections.

In accordance with the Department of Health's Water Use Efficiency Program, the District established water efficiency goals to reduce water usage and leakage. The 2014 water usage efficiency information is as follows:

<u>System</u>	<u>Customers</u>	<u>Gallons Produced</u>	<u>Gallons Sold</u>	<u>Unaccounted for Water</u>
Riverbend	78	2,124,000	2,350,674	-10.7%
Sunvale	66	2,389,500	2,139,860	10.0%
Sandy Shores	70	3,855,420	3,866,340	-0.3%
Metaline Falls	178	23,648,040	16,724,794	29.3%

The negative number in the *Unaccounted for Water* column is due to the size of the master meter in the pumphouse, which does not register flows under 9 gallons per minute, as compared to home water meters, which measure 1/2 gallon or less per minute.



North Fork Dam

Community Network System

The District's Community Network System (CNS or CN System) has provided business class broadband transport and bandwidth for nearly 15 years to Pend Oreille County institutions. A fiber-to-the-premise project, partly funded by grant monies, enabled the District to extend fiber infrastructure to reach over 3,800 homes and businesses in the southern half of Pend Oreille County. In collaboration with the private sector, CNS provides wholesale broadband to multiple retail service providers that use the common infrastructure to compete for residential and business customers. Our rural county now enjoys 100 megabit minimum broadband speeds; speeds that are simply unavailable in most areas, even large cities.

The fiber optic footprint has been expanding over the past four years. At the end of 2014, CNS was enabling service to 1,300 retail customers. In our rural county, many residents were isolated, without basic phone or cell service. The fiber has connected them to the world and changed their lives. CNS facilitates families and businesses moving to our area. The customers using the network are thrilled with the high speeds and appreciate the opportunity to live and work in scenic Pend Oreille County.

The major summer storms that damaged the electric system also caused major damage to the fiber network. Approximately 400 customers were without service at the outage peak. Shortly before the summer storms hit, Central Washington experienced a severe FEMA event. Massive wildfires wiped out forests, homes, and severely damaged emergency communication systems. These emergency communication services were rerouted through Pend Oreille County and to the world via the District's CN System. The first summer storm disabled the District's communication path, also bringing down the Central Washington Emergency Services during the height of their fire-fighting efforts. CNS crews restored the emergency communications within 24 hours, and efficiently repaired all critical circuits. The repair time for heavily damaged areas of the system was extended by the second storm, and it took several weeks to restore the entire system.

Other than outages from these unusual storms, the system has proven to be stable and reliable. Consumer response has been robust and continues to exceed expectations. It has been a major challenge for CNS to respond to the high level of customer demand for service.

We've been saying for years, "Broadband is the next generation utility". Broadband is here to improve the lives of people in Pend Oreille County, much like electricity did many decades ago. Recently, the FCC reclassified broadband service as a utility. The industry is experiencing rapid change, and the District is progressively moving forward with it. CNS will continue to examine future opportunities and improve capabilities for the benefit of both the District and the community it serves.



Patrick Barley, CNS Technician, installing fiber optic electronics.

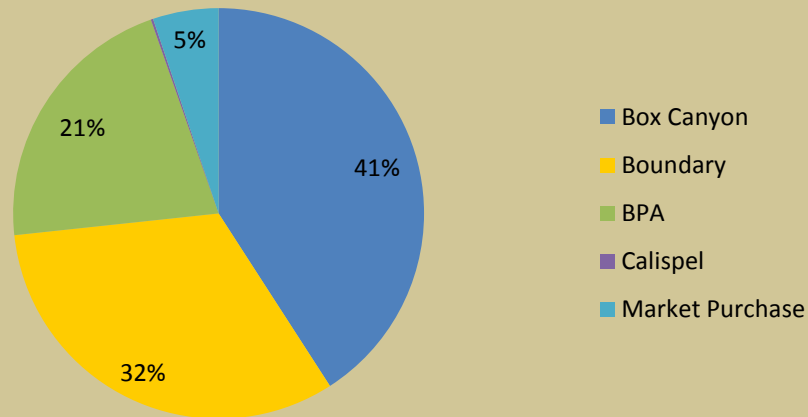


Mike Reed, CNS Technician plowing fiber optic service drop.

Energy Resources

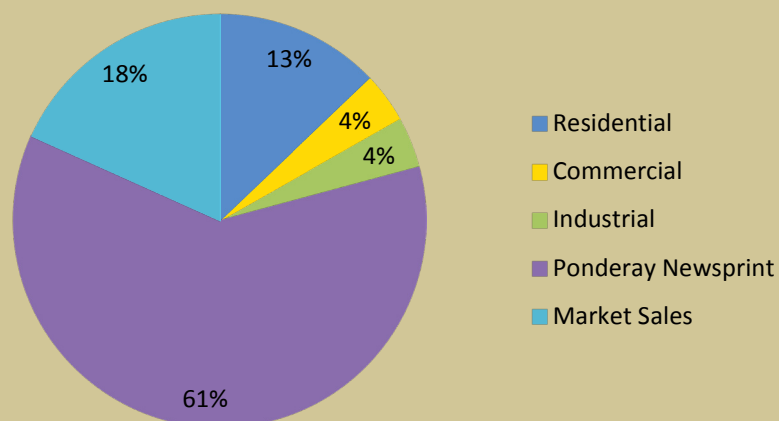
In 2014, the District sold 1,112,183 megawatts (MW) of electricity. Of that total, 41 percent came from Box Canyon Dam and the Calispell Hydro Plant, which are District-owned resources. The remaining electric resources were acquired from Boundary Dam owned by Seattle City Light, and Bonneville Power Administration (BPA).

2014 Energy Resources



Sixty-one percent of the District's area load is created by its largest customer, Ponderay Newsprint Company located in Usk, Washington. Approximately 18 percent is sold into the market as surplus sales. Annual energy consumption by the District's residential, commercial, and other industrial customers was 21 percent.

2014 Area Load



2014 District Highlights

Retail Customers as of December 31, 2014

Electric:	8,883
Water:	582
Fiber end-user connections	1,300

Residential Electric Rates/Usage

Residential Electric Rate:	\$0.0487 per kWh, plus \$24.50 monthly base charge
Ave. Annual Residential Customer Use:	17,976 kWh
Peak Energy Load:	116,186 kw

Water System

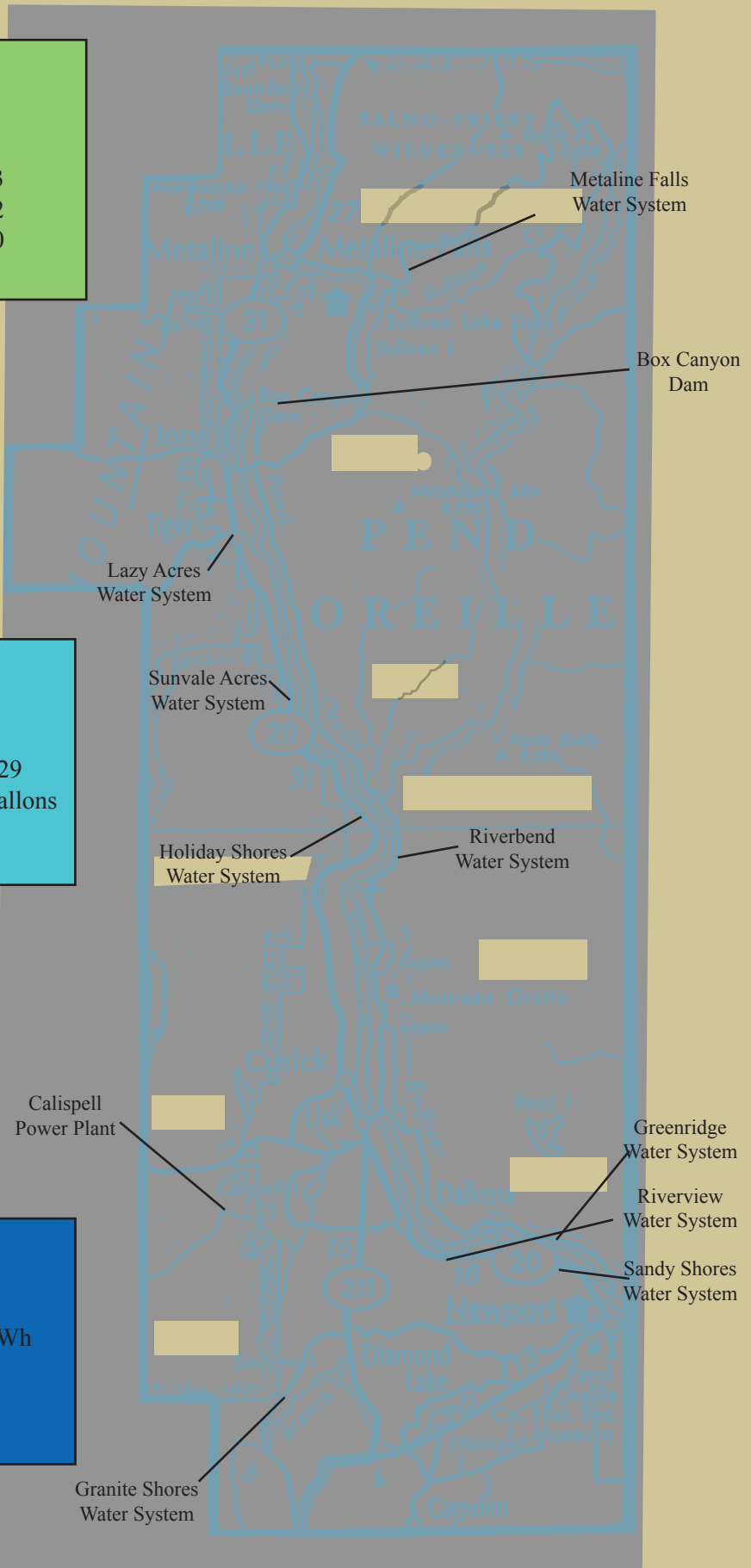
Total Gallons Sold:	26,952,129
Average Annual Water Usage:	46,310 gallons

Generation - Box Canyon

Energy Available:	467,744,075 kWh
Nameplate Capacity:	90 Mw
Mill Rate:	37.21 mills

Generation - Calispell

Energy Available:	2,056,000 kWh
Nameplate Capacity:	.750 Mw
Mill Rate:	38.95 mills



REPORT OF INDEPENDENT AUDITORS

The Commissioners
Public Utility District No. 1
of Pend Oreille County, Washington

Report on Financial Statements

We have audited the accompanying combined financial statements of Public Utility District No. 1 of Pend Oreille County, Washington (the District), which comprise the combined statements of net position as of December 31, 2014 and 2013, the individual statements of net position of the Electric, Box Canyon Production, Water, and Community Network Systems as of December 31, 2014, the related combined statements of revenues, expenses, and changes in net position and of cash flows for the years ended December 31, 2014 and 2013, and the individual statements of revenues, expenses, and changes in net position and of cash flows for the Electric, Box Canyon Production, Water, and Community Network Systems for the years ended December 31, 2014, 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 an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that the audit evidence obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the District as of December 31, 2014 and 2013, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Accounting principles generally accepted in the United States of America require that the accompanying management's discussion and analysis on pages 3 through 12 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental schedules of Electric System - revenue, customer, and energy statistics, Electric System - senior lien parity debt service coverage, and Box Canyon Production System - senior lien parity debt service coverage are not a required part of the basic financial statements, but are supplemental information presented for the purposes of additional analysis. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and, accordingly, we express no opinion on it.



Seattle, Washington
March 9, 2015

MANAGEMENT’S DISCUSSION AND ANALYSIS

The financial management of Public Utility District No. 1 of Pend Oreille County, Washington (the District) offers readers of these financial statements this overview and summary analysis of the financial activities of the District for the years ended December 31, 2014 and 2013. This discussion and analysis is designed to be used in conjunction with the financial statements and notes, which follow this section.

Overview of the Financial Statements

The financial section of the annual report includes the report of independent auditors, management’s discussion and analysis, basic financial statements with accompanying notes, and supplemental information (unaudited).

The financial statements of the District report the self-supporting, proprietary activities of the District funded primarily by the sale of power, water, and telecommunication services. The District reports the business-type activities in a manner similar to private-sector business enterprises, using the accrual basis of accounting, in accordance with accounting principles generally accepted in the United States of America.

The District’s reporting entity consists of four primary component units, or operating systems. The Electric System distributes electricity to residential and other consumers in Pend Oreille County. The Box Canyon Production System produces hydroelectric power from the Box Canyon Hydroelectric Project. The Water System consists of nine individual water distribution subdivisions. The Community Network System supplies wholesale broadband communication services. The financial statements are reported in a combined format, meaning each of the primary component units are reported in a columnar approach, which are combined into a District-wide total.

The combined statements of net position present information on the District’s assets and liabilities and provide information regarding the nature and amount of resource investment (assets), and obligations incurred in the pursuit of such resources. These statements also provide a vehicle for evaluating the capital structure of the District and assessing liquidity and financial flexibility of the District.

The combined statements of revenues, expenses, and changes in net position report revenues and expenses, as well as change in net position for this period. These statements provide a measurement of the District’s operations, help to evaluate the level of cost recovery from charges for products and services, and can be used as a partial determinant of creditworthiness.

The combined statements of cash flows provide information concerning cash receipts and disbursements during the reporting period resulting from operational, financing, and investing activities. This information provides insight into the District’s ability to generate net cash flows and meet obligations as they become due, and is an important indicator of the District’s liquidity and financial strength.

The notes to combined financial statements provide additional information that is essential to a full understanding of the financial statements, as described above, and are an integral part thereof.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**Financial Analysis**

Combined statement of net position information as of December 31, 2014, 2013, and 2012:

	2014	2013	2012
ASSETS			
Current assets	\$ 83,610,453	\$ 99,597,556	\$ 126,547,654
Other assets	11,323,852	5,491,384	4,986,672
Net utility plant	249,750,757	235,885,984	214,802,444
Total assets	344,685,062	340,974,924	346,336,770
DEFERRED OUTFLOWS OF RESOURCES	82,479	127,409	229,218
Total assets and deferred outflows of resources	<u>\$ 344,767,541</u>	<u>\$ 341,102,333</u>	<u>\$ 346,565,988</u>
LIABILITIES			
Current liabilities	\$ 29,070,445	\$ 22,655,882	\$ 33,779,785
Other liabilities	23,823,369	23,490,015	18,123,506
Long-term debt	152,245,743	158,067,248	166,346,219
Total liabilities	205,139,557	204,213,145	218,249,510
NET POSITION			
Invested in capital assets, net of related debt	115,484,383	109,295,771	100,028,720
Restricted	22,207,498	22,034,253	19,405,867
Unrestricted	1,936,103	5,559,164	8,881,891
Total net position	139,627,984	136,889,188	128,316,478
Total liabilities and net position	<u>\$ 344,767,541</u>	<u>\$ 341,102,333</u>	<u>\$ 346,565,988</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Capital Projects

Box Canyon Hydroelectric Project - At the end of 2014, the District was nearly finished upgrading the last of the four turbines at its Box Canyon Hydroelectric Project (Project). Upon final commissioning in February 2015, the name plate capacity of the Project turbines increased from the previous 72 megawatt capacity to 90 megawatts. Although completion of the project was delayed approximately 18 months due to change orders and seasonal working constraints, the upgrade project will be completed very near its \$103 million budget. Plant modernization associated with the upgrade in generating capacity is expected to cost close to the estimated cost of \$25 million. Capital projects required by the license are subject to several variables, including component price fluctuations and changes in engineering specifications. The District is financing these projects with periodic revenue bond issuances, as discussed further in Note 4. Other capital construction associated with the Project's 50-year Federal Energy Regulatory Commission (FERC) license include an upstream fish passage structure, expected to be completed in 2017 at a cost of approximately \$23 million, and downstream fish passage, construction of which is slated for 2020. The District has issued \$144 million in revenue bonds, as discussed in Note 4, to finance these and other related projects. Additional financing is expected to complete upcoming license related projects.

Sullivan Creek Cold Water Pipe Project - The District owns a water storage facility on Sullivan Lake in north Pend Oreille County. As part of the decommissioning of the facility's FERC license, the District constructed a cold water pipe in Sullivan Lake, which is designed to draw cooler water from the bottom of the lake into an outlet creek, creating an attractant for fish in Seattle City Light's Boundary Hydroelectric Project reservoir, located just downstream of the District's Box Canyon Hydro Project. Construction of the pipe occurred in the 4th quarter of 2014, and will be fully operational in early 2015. Seattle City Light agreed to pay half of the \$4.7 million cost of the cold water pipe construction, and all of the cost for the removal of Mill Pond Dam, a storage facility downstream of Sullivan Lake dam, as part of environmental mitigation obligations for Boundary Project's FERC license renewal. Funds from the Washington State Department of Ecology Office of the Columbia River provided funding for the remaining construction costs in exchange for prescribed increased water releases from Sullivan Lake to provide improved water availability for communities along the Columbia River for the next 30 years. The capitalized cost of the cold water pipe is included in the financial statements as Nonutility Plant and accounts for the large increase in Other assets. See Note 8 to the financial statements for further information.

Community Network System ARRA Project - The District's Community Network System is continuing its build-out of a fiber optic project in south Pend Oreille County. In 2010, the District was awarded an American Recovery and Reinvestment Act (ARRA) grant, which provided funding for the District to expand its existing fiber optic infrastructure to approximately 4,000 residential homes and businesses. Grant proceeds provided approximately \$27 million of the \$38 million project cost. The Community Network System has utilized intersystem loans to provide funding to complete the project. As of the end of 2014, 1,300 residential and small business customers were actively using the fiber and internet services through three local internet service providers. An inability of the Community Network System to self-support its own activities could affect Electric System power rates. See Note 9 to the financial statements for further information.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**Capital Projects (continued)**

The District's Current assets decreased by approximately \$16 million, primarily due to construction of capital assets. The District expended \$26.7 million in construction and capital projects in 2014, including \$13 million on the Box Canyon turbines, \$3.5 million for Box Canyon spillway gate modification, \$1.1 for Box Canyon upstream fish passage, \$4.3 million on the Sullivan Lake cold water pipe, and \$0.5 million on the ARRA fiber to the premise project. Both the Box Canyon turbine and upstream fish passage projects have been funded through revenue bond proceeds. No new debt was issued in 2014. Funding to continue the ARRA fiber to the premise project was provided through a refinancing of intersystem debt. Remaining additions to Plant Assets were \$4.3 million and consisted of normal capital purchases, including improvements to the District's electric line system, a large line truck and several smaller vehicles, advancements in technologies, and facility improvements.

Summary of Financial Condition

During 2014, the District's overall financial position improved. Total net position for the District increased \$2.74 million to \$139,627,984 as the District brings several large multi-year construction projects to completion.

Electric System Operating Results

	2014	2013	2012
Electric operating revenues			
Ponderay Newsprint Company	\$ 26,598,450	\$ 30,309,544	\$ 30,387,376
Other retail customers	13,334,603	13,336,214	12,456,448
Sales to other utilities	6,057,541	3,919,890	2,644,550
All other	965,614	1,091,979	681,254
Total operating revenues	46,956,208	48,657,627	46,169,628
Electric operating expenses			
Power costs	30,090,521	30,849,518	28,232,963
All other	15,614,455	14,233,669	14,127,302
Total operating expenses	45,704,976	45,083,187	42,360,265
Net operating revenues	1,251,232	3,574,440	3,809,363
NONOPERATING REVENUES (EXPENSES)	1,283,978	(958,656)	(1,126,131)
CHANGE IN NET POSITION	\$ 2,535,210	\$ 2,615,784	\$ 2,683,232
DEBT SERVICE COVERAGE	1.62x	2.91x	1.68x

MANAGEMENT’S DISCUSSION AND ANALYSIS (continued)

Electric System Operating Results (continued)

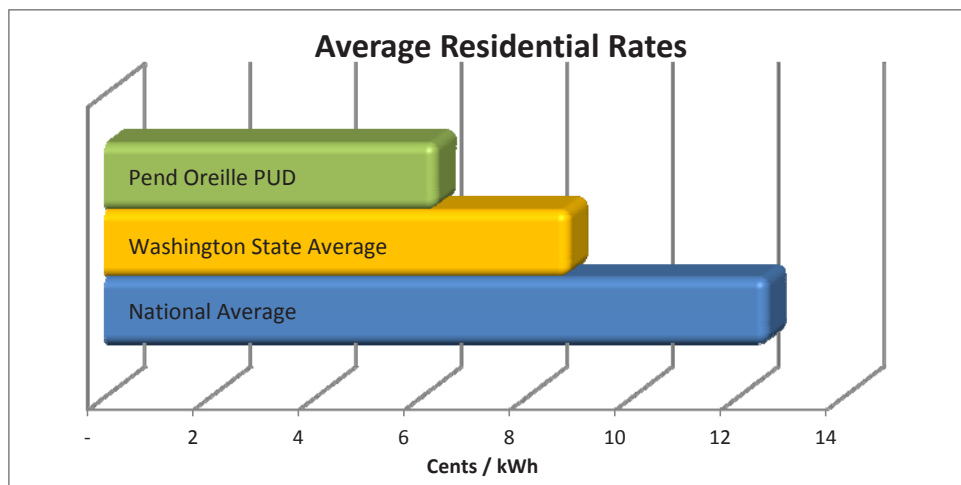
Operating Revenues

Ponderay Newsprint Company is the District’s largest customer, representing 74% of the District’s retail energy usage in 2014 with 675,145 megawatts of consumption, compared to 765,225 and 774,568 megawatts in 2013 and 2012, respectively. Ponderay Newsprint Company’s billing is based on contractually agreed actual cost of service methodology rather than under a rate schedule. Accordingly, their billings increase or decrease in direct relation to the District’s power supply costs. Further, they receive credit for the majority of the District’s wholesale power sales to other utilities; therefore, their billings decrease when sales to other utilities increase, and vice versa.

The District’s second largest customer, Teck, announced in the spring of 2014 that the company would restart its Pend Oreille zinc mine, located in northern Pend Oreille County. The mine had previously operated from 2004 to 2009, but had been in care and maintenance since that time due to unfavorable market conditions. The first shipment of zinc and lead concentrate from the restart left the mine in December 2014.

Remaining other retail customer revenues increased in 2014, mostly due to a mid-year rate increase of approximately 2.3% for all customer classes. Retail customer load for 2014 was 234,191 megawatts, compared to 233,575 and 225,236 megawatts for 2013 and 2012, respectively. The number of District residential energy customers has stayed relatively even over the past three years, with an average of 7,957 residential customers in 2014, 7,912 in 2013, and 7,896 in 2012. The District’s historical growth averaged approximately 2% per year through 2008. The national economic downturn affected local businesses and the District has seen an increased amount of account closures with no replacement.

Despite low growth, the District’s retail rates remain among the lowest in the state and the nation. The following chart shows the District’s retail rate compared to other utilities across the nation. The District’s current blended residential rate is 6.3 cents per kilowatt hour.



MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Electric System Operating Results (continued)

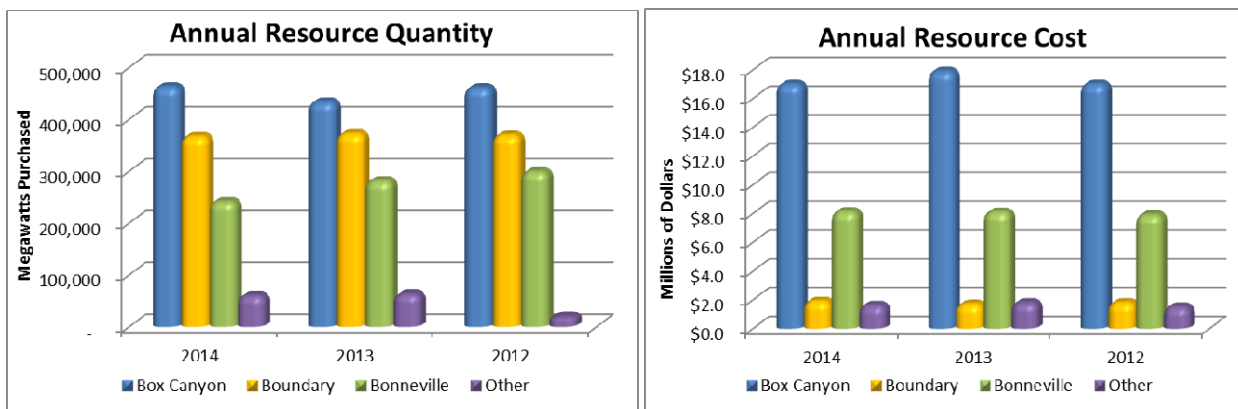
Energy Resources and Power Costs

The District's largest source of power is from the Box Canyon Hydroelectric Project. The cost of power produced from this facility has increased significantly over the last decade, due largely to debt service costs associated with the turbine upgrade project. Once funding is secured for upcoming fish passage construction, costs for the Box Canyon Hydroelectric Project are expected to remain level. Additionally, power generation varies with water flows and capacity has increased from the turbine upgrade work, which both impact the cost of power. The cost of generating Box Canyon power averaged \$37 per megawatt hour in 2014, \$41 in 2013, and \$37 in 2012.

The District receives 48 megawatts of power capacity from the City of Seattle's Boundary Hydroelectric Project. At approximately \$5 per megawatt hour in 2014, power received from the Boundary Hydroelectric Project is the District's most inexpensive power source and a key component of the District's low customer rates.

Power obtained from the Bonneville Power Administration cost \$34 per megawatt hour in 2014, \$29 in 2013, and \$26 in 2012. The District receives an average of 26 megawatts from Bonneville, delivered in monthly block amounts that are shaped to the District's load.

Other energy resources include costs to operate the Calispell Powerhouse, which produces less than 1 megawatt per hour; market power purchases necessary to balance resources to customer load; and power marketed under contract for the Kalispel Tribe.



Other Costs

In July of 2014, an extreme windstorm swept through Pend Oreille County that left more than half of the District's customers without power. Crews were within hours of restoring power to customers when a second extreme wind storm devastated the area, again affecting more than half of the District's customers. District crews worked long hours for nearly three weeks to restore power to customers. Although these storms were extreme and highly unusual, the storms were not declared a FEMA event. Costs related to the storms were more than \$1 million and were funded with District cash reserves.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**Electric System Operating Results (continued)***Debt Service Coverage*

The debt service coverage ratio measures cash flow from operations in comparison to annual debt service. In December 2013, the District defeased bonds set to mature in January 2015, legally removing them as an obligation of the Electric System (see Note 4). The District used accrued bond principal fund cash and a reserve fund to pay off the debt. This resulted in a significant increase in the Electric System's debt service coverage ratio in 2013. Storm costs noted above decreased the District's debt service coverage ratio in 2014, although ended the year well above the District's bond covenant ratio of 1.25.

The District's bonds are currently rated by Moody's Investor Services and Fitch Ratings, which have assigned ratings to the District's bonds of A3 and A-, respectively. Moody's Investor Services improved the District's rating in 2012 by removing the negative outlook they had previously assigned to the District in 2009, citing strong cash balances, positive forecasted debt service coverage rates, and expected successful completion of the ARRA grant. Fitch Ratings' rating of A- (stable) has been consistent for the District since they began analyzing the District in 2005.

Box Canyon Production System Operating Results

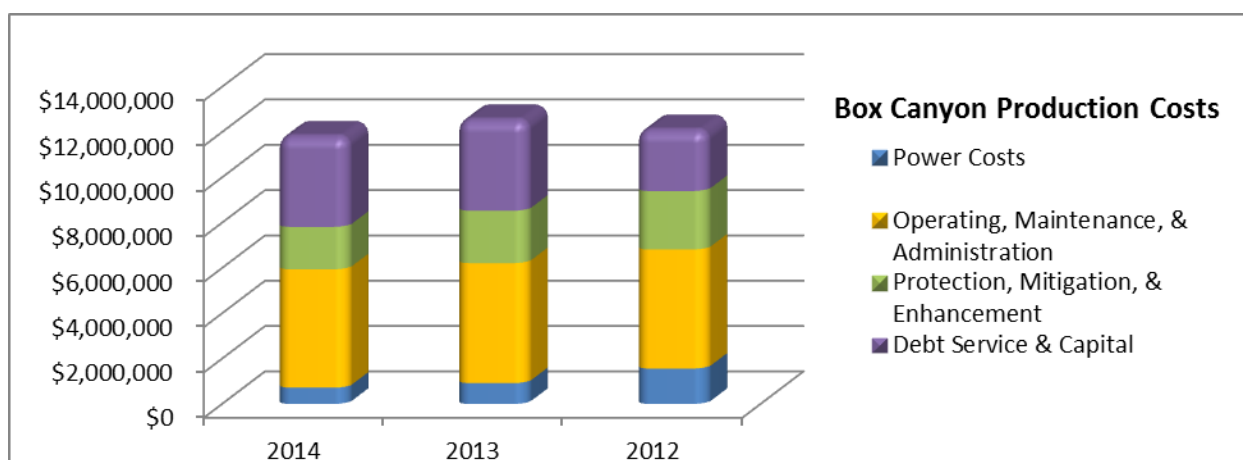
	2014	2013	2012
Production operating revenues			
Sales to Electric System	\$ 17,208,475	\$ 18,097,510	\$ 17,257,548
All other	137,788	59,945	7,097
Total operating revenues	17,346,263	18,157,455	17,264,645
Production operating expenses	10,823,086	11,459,851	11,977,507
Net operating revenues	6,523,177	6,697,604	5,287,138
NONOPERATING EXPENSES	(4,334,010)	(4,421,845)	(4,633,974)
CHANGE IN NET POSITION	\$ 2,189,167	\$ 2,275,759	\$ 653,164
DEBT SERVICE COVERAGE	1.04x	1.05x	1.12x

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Box Canyon Production System Operating Results (continued)

Changes in operating expenses are largely attributable to power purchases made to firm up to contractually required levels of production. Under the Ponderay Newsprint Contracts, if Box Canyon generation is less than 453,330 megawatts during the annual water year, the District will purchase wholesale power to firm generation up to this contractual level. Firm-up power purchases vary with annual Pend Oreille River flows, do not occur in all years, and totaled \$716,646, \$917,434, and \$1,533,458 in 2014, 2013, and 2012, respectively.

Included in operating expenses for the Production System is environmental work being performed as required by FERC license conditions. The type and expense of environmental work will vary from year to year, and in 2014 consisted of cultural studies, historical education, stream rehabilitation projects, recreation and wildlife projects, and water quality programs on the Pend Oreille River. Other costs, such as operations, maintenance, and administrative costs, have been relatively consistent from 2012 to 2014.



Nonoperating expenses include interest expense, net of allowance for funds used during construction (AFUDC), and capitalized interest associated with financing the Box Canyon capital project work.

Because the Box Canyon Hydroelectric System receives revenue from the Electric System sufficient to cover operating costs, including debt service and a component for capital spending, the normal senior lien debt service ratio will be slightly over 1.0x. The ratio will only be significantly above 1.0 during years the District elects to finance significant capital project work through current rates as opposed to debt financing.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**Water System Operating Results**

	2014	2013	2012
Water operating revenues			
Sales to retail customers	\$ 404,763	\$ 407,931	\$ 393,888
All other	15,998	13,152	26,990
Total operating revenues	420,761	421,083	420,878
Water operating expenses	542,619	559,747	560,903
Net operating expenses	(121,858)	(138,664)	(140,025)
NONOPERATING REVENUES	94,319	742,205	51,945
CHANGE IN NET POSITION	\$ (27,539)	\$ 603,541	\$ (88,080)

The District operates nine separate water systems throughout Pend Oreille County. The District is contractually obligated to maintain separate and distinct rates for each water system that reflect the individual system's costs. The majority of the variations in the preceding table are normal variations. Grant revenues of \$100,468, \$749,357, and \$59,968 are included in nonoperating revenue for 2014, 2013, and 2012, respectively, which were used to improve infrastructure.

Community Network System Operating Results

	2014	2013	2012
Community Network operating revenue			
Sales to retail customers	\$ 1,273,072	\$ 733,566	\$ 493,590
Intersystem sales	284,144	303,168	210,480
All other	17,194	63,142	172,478
Total operating revenues	1,574,410	1,099,876	876,548
Operating expenses	3,527,287	964,366	775,250
Net operating revenues (expenses)	(1,952,877)	135,510	101,298
NONOPERATING REVENUES (EXPENSES)	(5,163)	2,942,116	17,370,549
CHANGE IN NET POSITION	\$ (1,958,040)	\$ 3,077,626	\$ 17,471,847

MANAGEMENT’S DISCUSSION AND ANALYSIS (continued)

Community Network System Operating Results (continued)

Prior to the receipt of an ARRA grant to build fiber to the home, the Community Network System sales were made solely to businesses. Revenues for this product in 2014, 2013, and 2012 were \$855,159, \$660,118, and \$491,491, respectively. With the completion of the ARRA grant, standard class services began, adding \$415,813, \$73,448, and \$0 to fiber revenues in 2014, 2013, and 2012 respectively. As of December 31, 2014, the District had approximately 1,300 end users of the District’s fiber, served through three local retail internet service providers. Intersystem sales are services provided for the internal benefit of the District itself. Other revenue includes contributed capital, grant proceeds that reimburse operating expenses, and miscellaneous revenues, which can vary based on new customer service requirements.

Operating expenses include operations and maintenance to maintain the fiber optic line and related equipment, labor, and contracts for control and intertie services. Depreciation is included in operating expenses, which were much higher in 2014 due to the capitalization of ARRA grant assets. The District’s fiber optic line system also experienced significant damage in the 2014 summer extreme wind storms. More than \$300,000 was expended to fix fiber optic lines and connections. The storm also postponed hook-up and extensions for new customers, delaying customer revenue.

Other Significant Matters

A description of currently known facts, decisions, and conditions that are expected to have a significant effect on future financial position or results of operations follows.

Ponderay Newsprint Company - District contracts with Ponderay Newsprint Company expire in 2027. The District is unaware of any plans to cease their operations; however, the condition exists that the District has additional business risk from an unusually high concentration of sales to a single entity. The rate impact from a loss of Ponderay Newsprint Company sales could be significant to the District, cannot be accurately forecasted, and depends upon the interaction of many factors, including but not limited to then-existing cost of production of Box Canyon Project power, cost of acquisition of Bonneville power, and market or resale value of this power.

Contacting the District’s Financial Management

The financial report is designed to provide interested parties with a general overview of the District’s finances and to demonstrate District accountability for the money it receives. For any questions about this report, or additional or clarifying financial information, contact the District’s financial department as set forth on the last page of this Annual Report under Organizational Information—Corporate Office.

April D. Owen, CPA
Assistant General Manager

COMBINED STATEMENTS OF NET POSITION**ASSETS AND DEFERRED OUTFLOWS OF RESOURCES**

	Electric System	Box Canyon Production System	Water System	Community Network System	Combined Total December 31,	
					2014	2013
CURRENT ASSETS						
Cash and cash equivalents	\$ 12,373,302	\$ 10,833,123	\$ -	\$ -	\$ 23,206,425	\$ 21,968,929
Restricted cash and cash equivalents	7,749,057	37,671,694	-	-	45,420,751	72,646,966
Restricted short-term investment	9,929,650	-	-	-	9,929,650	-
Receivables						
Accounts and contracts, net	999,496	-	19,805	153,541	1,172,842	1,227,722
Other	587,911	91,165	375	6,096	685,547	568,790
Unbilled revenue	886,192	-	-	-	886,192	1,031,057
Materials and supplies	1,541,516	-	37,431	244,868	1,823,815	1,788,102
Prepaid expenses and other	414,155	71,076	-	-	485,231	365,990
Due from other systems	370,422	182,687	-	-	-	-
Total current assets	34,851,701	48,849,745	57,611	404,505	83,610,453	99,597,556
NONCURRENT ASSETS						
Contracts and notes receivable	3,768,513	-	-	-	-	-
Nonutility plant	4,822,510	-	-	-	4,822,510	468,384
Licensing costs - regulatory asset	-	6,501,342	-	-	6,501,342	5,023,000
Long-term intersystem investment	-	4,877,464	-	-	-	-
Total noncurrent assets	8,591,023	11,378,806	-	-	11,323,852	5,491,384
UTILITY PLANT						
Land and land rights	3,354,650	784,295	77,304	61,721	4,277,970	4,194,498
Hydroelectric plant and equipment	1,326,376	139,213,675	-	-	140,540,051	113,063,922
Structures, buildings, and equipment	109,098,804	-	8,667,556	42,843,602	160,609,962	155,756,278
Intangible assets	555,902	13,219,176	743	-	13,775,821	13,642,183
Construction work in progress	1,684,439	11,138,279	-	3,015	12,825,733	22,565,216
	116,020,171	164,355,425	8,745,603	42,908,338	332,029,537	309,222,097
Less accumulated depreciation and amortization	53,472,996	19,994,204	2,983,610	5,827,970	82,278,780	73,336,113
Net utility plant	62,547,175	144,361,221	5,761,993	37,080,368	249,750,757	235,885,984
Total assets	105,989,899	204,589,772	5,819,604	37,484,873	344,685,062	340,974,924
DEFERRED OUTFLOWS OF RESOURCES						
Loss on refinancing of debt	82,479	-	-	-	82,479	127,409
Total deferred outflows of resources	82,479	-	-	-	82,479	127,409
Total assets and deferred outflows of resources	\$ 106,072,378	\$ 204,589,772	\$ 5,819,604	\$ 37,484,873	\$ 344,767,541	\$ 341,102,333

COMBINED STATEMENTS OF NET POSITION**LIABILITIES, DEFERRED INFLOWS OF RESOURCES, AND NET POSITION**

	Electric System	Box Canyon Production System	Water System	Community Network System	Combined Total December 31,	
					2014	2013
CURRENT LIABILITIES						
Accounts payable	\$ 4,300,559	\$ 6,973,816	\$ -	\$ 3,572	\$ 11,277,947	\$ 7,885,588
Accrued compensation and benefits	1,965,461	-	-	-	1,965,461	1,939,597
Accrued taxes	773,359	98,981	1,639	1,085	875,064	1,008,515
Customer prepayments and deposits	3,588,133	-	3,732	31,065	3,622,930	965,402
Accrued bond interest	523,222	3,744,466	1,340	-	4,269,028	4,338,599
Current portion of long-term debt	1,978,333	3,570,714	37,590	182,687	5,586,637	4,921,638
Current portion of licensing cost liability and unearned revenues	26,000	1,447,378	-	-	1,473,378	1,596,543
Due to other systems	-	-	111,255	259,167	-	-
Total current liabilities	13,155,067	15,835,355	155,556	477,576	29,070,445	22,655,882
OTHER LIABILITIES						
Unearned revenue	2,660,943	-	-	4,416,196	3,441,961	3,297,366
Licensing costs liability	-	6,501,342	-	-	6,501,342	5,023,000
Contract security liability	10,000,066	3,880,000	-	-	13,880,066	15,169,649
Total other liabilities	12,661,009	10,381,342	-	4,416,196	23,823,369	23,490,015
LONG-TERM DEBT						
Revenue bonds	19,719,142	132,182,895	-	4,877,464	151,902,037	157,672,620
Other long-term debt	133,334	-	210,372	-	343,706	394,628
Due to other systems	-	-	-	133,333	-	-
Total long-term debt	19,852,476	132,182,895	210,372	5,010,797	152,245,743	158,067,248
Total liabilities	45,668,552	158,399,592	365,928	9,904,569	205,139,557	204,213,145
COMMITMENTS AND CONTINGENCIES						
NET POSITION						
Net investment in capital assets	45,421,987	27,482,761	5,514,031	31,872,120	115,484,383	109,295,771
Restricted for						
Sullivan contract obligation	2,664,193	-	-	-	2,664,193	2,466,977
Debt service	4,491,226	15,052,079	-	-	19,543,305	19,567,276
Total restricted	7,155,419	15,052,079	-	-	22,207,498	22,034,253
Unrestricted	7,826,420	3,655,340	(60,355)	(4,291,816)	1,936,103	5,559,164
Total net position	60,403,826	46,190,180	5,453,676	27,580,304	139,627,984	136,889,188
Total liabilities and net position	\$ 106,072,378	\$ 204,589,772	\$ 5,819,604	\$ 37,484,873	\$ 344,767,541	\$ 341,102,333

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

	Electric System	Box Canyon Production System	Water System	Community Network System	Combined Total Years Ended December 31,	
					2014	2013
OPERATING REVENUES						
Sales to retail customers						
Ponderay Newsprint Company	\$ 26,598,450	\$ -	\$ -	\$ -	\$ 26,598,450	\$ 30,309,544
Other retail customers	13,334,603	-	404,763	1,273,072	15,012,438	14,477,711
Sales to other utilities	6,057,541	-	-	-	6,057,541	3,919,890
Intersystem sales	140,458	17,208,475	-	284,144	-	-
Contributed capital	511,575	-	2,856	12,470	526,901	688,022
Grant revenues	-	-	-	-	-	25,729
Other	313,581	137,788	13,142	4,724	237,791	145,674
Total operating revenues	46,956,208	17,346,263	420,761	1,574,410	48,433,121	49,566,570
OPERATING EXPENSES						
Power costs	30,090,521	716,646	-	-	13,598,692	13,669,442
Operations and maintenance	6,432,711	4,582,032	235,504	1,074,563	11,963,098	11,217,071
Administrative and general	3,384,665	2,510,170	64,410	43,317	5,708,228	5,090,532
Taxes	2,189,754	104,537	20,559	7,764	2,322,614	2,519,256
Depreciation and amortization	3,607,325	2,909,701	222,146	2,401,643	9,140,815	6,801,379
Total operating expenses	45,704,976	10,823,086	542,619	3,527,287	42,733,447	39,297,680
Net operating revenues (expenses)	1,251,232	6,523,177	(121,858)	(1,952,877)	5,699,674	10,268,890
NONOPERATING REVENUES (EXPENSES)						
Interest income	18,193	58,721	108	118	66,091	225,154
Interest on debt	(972,853)	(7,382,116)	(6,002)	(5,158)	(8,360,971)	(8,708,251)
Subsidies on debt	-	2,045,040	-	-	2,045,040	2,046,125
AFUDC interest	79,325	949,858	-	-	1,029,183	869,944
Grant revenues	-	-	100,468	-	100,468	3,693,060
Sullivan net revenue	47,907	-	-	-	47,907	95,039
Sullivan contributions in aid of construction	2,113,448	-	-	-	2,113,448	82,805
Other, net	(2,042)	(5,513)	(255)	(123)	(2,044)	(56)
Total nonoperating revenues (expenses)	1,283,978	(4,334,010)	94,319	(5,163)	(2,960,878)	(1,696,180)
CHANGE IN NET POSITION	2,535,210	2,189,167	(27,539)	(1,958,040)	2,738,796	8,572,710
ACCUMULATED NET POSITION						
Beginning of year	57,868,616	44,001,013	5,481,215	29,538,344	136,889,188	128,316,478
End of year	\$ 60,403,826	\$ 46,190,180	\$ 5,453,676	\$ 27,580,304	\$ 139,627,984	\$ 136,889,188

COMBINED STATEMENTS OF CASH FLOWS

	Electric System	Box Canyon Production System	Water System	Community Network System	Combined Total Years Ended December 31,	
					2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES						
Receipts from customers	\$ 49,039,908	\$ -	\$ 416,255	\$ 1,303,367	\$ 50,759,530	\$ 50,949,647
Receipts from other operating revenues	-	387,562	-	-	387,562	(20,547)
Payments to suppliers for goods and services	(18,149,716)	(2,958,155)	(131,070)	(907,208)	(22,146,149)	(32,910,551)
Payments to employees for services	(6,516,228)	(4,072,478)	(164,729)	(536,979)	(11,290,414)	(9,939,541)
Payments to (from) other systems	(16,894,449)	16,689,738	(210,323)	415,034	-	-
Net cash from operating activities	<u>7,479,515</u>	<u>10,046,667</u>	<u>(89,867)</u>	<u>274,214</u>	<u>17,710,529</u>	<u>8,079,008</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES						
Nonoperating asset						
Acquisition and construction of long-term asset, net	(4,274,801)	-	-	-	(4,274,801)	(165,611)
Receipts from Sullivan revenues and contributions in aid	2,172,037	-	-	-	2,172,037	177,844
Intersystem financing	<u>8,317</u>	<u>5,158</u>	<u>(141)</u>	<u>(13,334)</u>	<u>-</u>	<u>-</u>
Net cash from noncapital financing activities	<u>(2,094,447)</u>	<u>5,158</u>	<u>(141)</u>	<u>(13,334)</u>	<u>(2,102,764)</u>	<u>12,233</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES						
Acquisition and construction of capital assets	(3,675,190)	(14,322,978)	(100,772)	(491,091)	(18,590,031)	(23,658,830)
Proceeds from grants	-	-	234,592	-	234,592	7,211,787
Change of deferred revenue	221,306	-	-	(49,588)	171,718	2,416,584
Payments on revenue bonds	(1,360,000)	(3,510,714)	-	(175,535)	(4,870,714)	(7,760,714)
Interest paid on revenue bonds	(1,073,645)	(7,540,619)	-	(5,158)	(8,619,422)	(8,671,669)
Scheduled payments on notes payable	(13,333)	-	(37,590)	-	(50,923)	(50,925)
Interest paid on notes payable	<u>-</u>	<u>-</u>	<u>(6,222)</u>	<u>-</u>	<u>(6,222)</u>	<u>(7,072)</u>
Net cash from capital and related financing activities	<u>(5,900,862)</u>	<u>(25,374,311)</u>	<u>90,008</u>	<u>(721,372)</u>	<u>(31,731,002)</u>	<u>(30,520,839)</u>
CASH FLOWS FROM INVESTING ACTIVITIES						
Purchases of investments	(24,966,018)	-	-	-	(24,966,018)	(23,870,769)
Sales and maturities of investments	24,965,471	175,535	-	-	24,965,471	33,824,544
Loss on investment	-	-	-	-	-	123,635
Interest on investments, contracts, and notes	<u>11,034</u>	<u>53,563</u>	<u>-</u>	<u>118</u>	<u>64,715</u>	<u>204,999</u>
Net cash from investing activities	<u>10,487</u>	<u>229,098</u>	<u>-</u>	<u>118</u>	<u>64,168</u>	<u>10,282,409</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	<u>(505,307)</u>	<u>(15,093,388)</u>	<u>-</u>	<u>(460,374)</u>	<u>(16,059,069)</u>	<u>(12,147,189)</u>
CASH AND CASH EQUIVALENTS						
Beginning of year	<u>30,557,316</u>	<u>63,598,205</u>	<u>-</u>	<u>460,374</u>	<u>94,615,895</u>	<u>106,763,084</u>
End of year	<u>\$ 30,052,009</u>	<u>\$ 48,504,817</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 78,556,826</u>	<u>\$ 94,615,895</u>
SUPPLEMENTAL DISCLOSURE OF NONCASH FINANCING ACTIVITIES						
Accrued capital construction costs	<u>\$ -</u>	<u>\$ 2,569,065</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,569,065</u>	<u>\$ (8,242,853)</u>

COMBINED STATEMENTS OF CASH FLOWS (continued)

	Electric System	Box Canyon Production System	Water System	Community Network System	Combined Total Years Ended December 31,	
					2014	2013
RECONCILIATION OF NET OPERATING REVENUES (EXPENSES) TO CASH FLOWS FROM OPERATING ACTIVITIES						
Net operating revenues (expenses)	\$ 1,251,232	\$ 6,523,177	\$ (121,858)	\$ (1,952,877)	\$ 5,699,674	\$ 10,268,890
Adjustments to reconcile net operating revenues (expenses) to net cash from operating activities						
Depreciation and amortization	3,607,325	2,909,701	222,146	2,401,643	9,140,815	6,801,379
Changes in operating assets and liabilities						
Receivables	(230,715)	34,746	5,694	(5,726)	(196,001)	1,607,928
Unbilled revenue	144,865	-	-	-	144,865	(308,293)
Due to other systems	(77,460)	(5,513)	(168,374)	245,706	(5,641)	-
Materials and supplies	48,431	-	2,578	(33,677)	17,332	(2,410)
Prepaid expenses and other current assets	(96,753)	2,022,552	-	-	1,925,799	2,007,157
Deferred charges	-	(149,165)	-	-	(149,165)	(230,215)
Accounts payable, customer deposits, and prepayments	2,945,374	(1,293,963)	(30,063)	(380,910)	1,240,438	(11,964,891)
Accrued compensation, benefits, and taxes	(112,784)	5,132	10	55	(107,587)	(100,537)
Net cash from operating activities	<u>\$ 7,479,515</u>	<u>\$ 10,046,667</u>	<u>\$ (89,867)</u>	<u>\$ 274,214</u>	<u>\$ 17,710,529</u>	<u>\$ 8,079,008</u>

NOTES TO COMBINED FINANCIAL STATEMENTS

Note 1 - Organization and Significant Accounting Policies

Organization - Public Utility District No. 1 of Pend Oreille County, Washington (the District) is a municipal corporation governed by an elected three-person board of commissioners. The District's reporting entity consists of four primary component units, or operating systems.

The Electric System distributes electricity to residential and other consumers in Pend Oreille County. The Box Canyon Production System produces hydroelectric power from the Box Canyon Hydroelectric Project (the Box Canyon Project). The Water System consists of nine individual water distribution subdivisions. The Community Network System supplies wholesale broadband communication services. The District is required by various financing and contractual arrangements to report separately on each system and maintain each system as a separate entity with separate obligations.

Basis of accounting and presentation - The accounting policies of the District conform to generally accepted accounting principles (GAAP) as applicable to proprietary funds of governments. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The District has applied all applicable GASB pronouncements. Accounting records are maintained in accordance with methods prescribed by the State Auditor under the authority of Revised Code of Washington, Chapter 43.09; the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission (FERC) for the Electric System, Box Canyon Production System, and Community Network System; and the Uniform System of Accounts for Class C Water Utilities prescribed by the National Association of Regulatory Utility Commissioners for the Water System.

System columns presented in the financial statements do not sum to the combined totals due to the elimination of certain intersystem transactions. These transactions relate to intersystem power sales and purchases, loan balances and interest on intersystem loans, and intersystem administrative charges.

A summary of other significant accounting policies used in the preparation of the combined financial statements follows.

New accounting standards - In June 2012, the GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions*. The intent of this statement is to improve information provided by state and local governmental employers about financial support for pensions provided by other entities. This statement is effective for financial statements for periods beginning after June 15, 2014. The District is evaluating the impact of this statement on its combined financial statements.

In November 2013, the GASB issued Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date*, which clarifies accounting treatment and reporting related to the measurement date outlined in Statement No. 68, *Accounting and Financial Reporting for Pensions*. This statement is an amendment to Statement No. 68 and is effective for financial statements for periods after June 15, 2014. The District is evaluating the impact of the statements on its combined financial statements.

NOTES TO COMBINED FINANCIAL STATEMENTS

Note 1 - Organization and Significant Accounting Policies (continued)

Revenue recognition and unbilled revenue - The Electric System, Water System, and Community Network System recognize revenue as earned on a monthly basis based on rates established by the District's board of commissioners and, for the Electric System, in accordance with power sales contracts with Ponderay Newsprint Company (Note 5). The District estimates unbilled revenues for energy delivered to customers between their last respective meter reading date and December 31, and records that amount as unbilled revenue for the current year. The Box Canyon Production System recognizes revenue on a cost-of-service basis from sales to the Electric System.

Allowance for uncollectible accounts - Management reviews accounts receivable on a regular basis to determine whether any receivables will potentially be uncollectible. The allowance for uncollectible accounts includes amounts estimated through an evaluation of specific accounts, based on the best available facts and circumstances of customers who may be unable to meet their financial obligations, and a reserve based on historical experience.

Cash and cash equivalents - For purposes of the combined statements of cash flows, the District considers all highly liquid investments (including restricted assets) with a maturity of three months or less when purchased to be cash equivalents.

Investments - Short-term investments with a maturity of between 3 and 12 months, at date of purchase, are recorded at amortized cost with discount or premium amortized on a straight-line basis over the life of the investments. The District records all other investments at fair value based on quoted market rates, with changes in unrealized gains and losses reported as investment income.

Materials and supplies - Materials and supplies are recorded at average cost.

Utility plant - Utility plant assets are stated at cost, including an allowance for funds used during construction (AFUDC). Betterments and major renewals over \$2,000 are capitalized, whereas maintenance and repairs are charged to operations as incurred. Depreciation is determined by the straight-line method over the estimated useful lives of the related assets, which range from 7 to 50 years. Composite rates are used for asset groups, and, accordingly, no gain or loss is recorded on the disposition of an asset unless it represents a large and unusual retirement.

Contributed capital - Contributions in aid of construction are District-mandated customer connection charges used to fund construction of system properties necessary to extend service to a new customer. The payments are initially recorded as liabilities, and then reclassified to operating revenue (contributed capital) when the associated facilities are constructed or acquired.

Licensing costs liability - The FERC issued the District a 50-year operating license for the Box Canyon Project in July 2005. Certain FERC license conditions require payments to various outside entities for projects and operating costs that will not be directed by, or controlled by, the District. The District has estimated and present valued these payments over the 50-year license and recorded them as a regulatory asset and licensing costs liability. The District has not recorded the future costs of the remaining expenses related to license implementation that will be capitalized or expensed, as may be appropriate, when incurred.

NOTES TO COMBINED FINANCIAL STATEMENTS

Note 1 - Organization and Significant Accounting Policies (continued)

Unamortized bond discounts and premiums - Unamortized bond discounts and premiums are amortized to interest expense, using the effective interest method, over the term of the bonds (Note 4). The excess of costs incurred over the carrying value of bonds refunded on early extinguishment of debt is amortized to expense over the shorter of the remaining life of the old bonds or the life of the new issue and recorded as deferred outflows of resources.

Unearned revenue - In August 2000, the District entered into an agreement with Seattle City Light concerning a cost-sharing arrangement for building fiber optic communications capability in Pend Oreille County. Among other terms and conditions, the District retained ownership of all constructed network assets with a commitment to grant Seattle City Light a 30-year right-of-use for 8 to 12 dark fiber strands along the District's network backbone. Seattle City Light made a one-time, lump-sum payment of \$1,487,650 under the agreement. The District recorded this payment as unearned revenue and is amortizing the balance to Community Network System revenue on a straight-line basis over the 30-year life of the agreement. The unamortized balance was \$781,016 and \$830,604 as of December 31, 2014 and 2013, respectively. Also, the Community Network System unearned revenue includes an Electric System \$4.25 million prepayment for future broadband services. Funds from the Electric System were used by the Community Network System as the matching cash requirement of an American Recovery and Reinvestment Act grant (Note 10). The unamortized balance associated with this payment was \$3,635,180 as of December 31, 2014 and 2013, respectively.

In June 2013, the District signed a Memorandum of Agreement between the District and the State of Washington Department of Ecology Office of Columbia River that will commit the District to release water from Sullivan Lake according to predetermined periods and amounts to allow for improved water access for communities along the Columbia River. In exchange, the Office of Columbia River will pay the District \$14 million in installments over the first 3 years of a 30-year agreement (Note 8). The District received the first payment of \$2.5 million during 2013, with an additional payment of \$2.5 million in 2014. These payments were recorded as unearned revenue, and are recognized as nonoperating revenue in an amount equal to the net cash outflow for Sullivan Project-related activities each year.

Net investment in capital assets - This component of net position consists of capital assets, net of accumulated depreciation; borrowed monies not yet spent, as held in restricted construction and acquisition funds; and outstanding debt balances related to the purchase or construction of capital assets.

Restricted net position - Amounts presented as restricted net position are constrained by provisions imposed by external parties and cannot be used for normal operations. Balances currently classified as restricted include bond principal and interest due for the upcoming year, less unfunded accrued interest; construction and acquisition funds net of the unspent portion of debt proceeds; and bond reserve funds.

NOTES TO COMBINED FINANCIAL STATEMENTS

Note 1 - Organization and Significant Accounting Policies (continued)

Unrestricted net position - Amounts included as unrestricted net position do not meet the definition of either net investment in capital assets or restricted net position, and are used for normal operations.

Compensated absences - Employees accrue personal leave to be used for vacation, sick, and family leave purposes. Annual leave granted each employee varies in accordance with years of service and may be carried forward from year to year, capped at a maximum bank of 1,200 hours for employees hired before April 2011 or 700 hours for employees hired after March 2011. The District records the cost of personal leave as earned, not as taken.

Accounting estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassifications - Certain reclassifications may be made to the prior-year financial statement presentation to conform to the current-year presentation.

Significant risks and uncertainties - The District is subject to certain business risks that could have a material impact on future operations and financial performance. These risks include weather and natural-disaster-related disruptions; collective bargaining labor disputes; changing local and national economic conditions; fish and other Endangered Species Act issues; Environmental Protection Agency regulations; reliability standards issued by the North American Electric Reliability Corporation; federal government regulations or orders concerning the operation, maintenance, licensing, and license surrender of hydroelectric facilities; the financing and completion of significant capital projects including the Box Canyon Project turbine upgrade project; changing federal and state laws, regulations, and requirements; concentration risk in the form of sales to a major customer, Ponderay Newsprint Company, and related potential impact on District power contracts (Note 5); and market and credit risks inherent in buying and selling of power, a commodity with inelastic demand characteristics and minimal storage capability.

NOTES TO COMBINED FINANCIAL STATEMENTS

Note 2 - Cash and Investments

Cash and investments are recorded in accounts as required by the District's bond indentures. Restricted assets represent accounts that are restricted by bond covenants or third-party contractual agreements.

As of December 31, 2014, the District held the following cash and investments:

	Electric System	Box Canyon Production System	Water System	Community Network System	Combined Total Years Ended December 31,	
					2014	2013
Cash and cash equivalents, at cost, which approximate market value						
Cash deposits	\$ 13,644,442	\$ -	\$ -	\$ -	\$ 13,644,442	\$ 23,850,323
Local government investment pool	6,477,917	48,504,817	-	-	54,982,734	70,765,572
Total cash and cash equivalents	20,122,359	48,504,817	-	-	68,627,176	94,615,895
Investments						
U.S. treasuries, short-term, at market	9,929,650	-	-	-	9,929,650	-
Total investments	9,929,650	-	-	-	9,929,650	-
Total cash and investments	\$ 30,052,009	\$ 48,504,817	\$ -	\$ -	\$ 78,556,826	\$ 94,615,895

The table below reconciles the investments listed above to the combined statements of net position:

	Electric System	Box Canyon Production System	Water System	Community Network System	Combined Total Years Ended December 31,	
					2014	2013
Cash and cash equivalents						
Unrestricted assets						
Revenue funds	\$ 12,373,302	\$ 10,833,123	\$ -	\$ -	\$ 23,206,425	\$ 21,968,929
Restricted assets						
Bond principal and interest	2,488,223	7,223,454	-	-	9,711,677	9,572,997
Bond reserve	2,526,225	11,573,091	-	-	14,099,316	14,331,324
Construction and acquisition	-	18,875,149	-	-	18,875,149	36,261,516
Contract obligation	2,664,193	-	-	-	2,664,193	2,466,977
Contract security - money market	70,416	-	-	-	70,416	10,014,152
Restricted funds	7,749,057	37,671,694	-	-	45,420,751	72,646,966
Investments						
Contract security						
Short-term investment	9,929,650	-	-	-	9,929,650	-
Total funds	\$ 30,052,009	\$ 48,504,817	\$ -	\$ -	\$ 78,556,826	\$ 94,615,895

Interest rate risk - The District's investment policy limits investment maturities to less than five years from the date of purchase unless authorized by the General Manager for a specific purpose. During 2014 and 2013, excepting the contract security investment and the 2005 bond reserve account, all investments were in the State Treasurer's Local Government Investment Pool (LGIP), described more fully in the following paragraph.

NOTES TO COMBINED FINANCIAL STATEMENTS

Note 2 - Cash and Investments (continued)

Credit risk - In accordance with the Revised Code of Washington, District bond resolutions, and District internal investment policies, all investments are direct obligations of the U.S. government, deposits in the LGIP, or deposits with financial institutions recognized as qualified public depositories of the state of Washington. U.S. government securities are held by bank trust departments as the District's agent and in the District's name.

The District's cash deposits are covered by the Federal Deposit Insurance Corporation (FDIC) or protected against loss by deposit with financial institutions recognized as qualified public depositories of the state of Washington under the guidelines of the Washington State Public Deposit Protection Commission (PDPC). The District intends to hold time deposits and securities until maturity.

Concentration of credit risk - District policies allow the entire portfolio to be invested in direct U.S. government guaranteed obligations or in the LGIP. No other investment may exceed half of portfolio market value. The LGIP, a 2a7-like pool as defined by GASB Statement No. 31 and the Securities and Exchange Commission, invests in high-quality, short-term investments and is administered by the State Treasurer. The LGIP weighted-average maturity must not exceed 90 days and no single investment may exceed 762 days in maturity. Withdrawals in excess of \$10 million are available on a one-day notice. The LGIP annual report is available on the State Treasurer's website at:
<http://www.tre.wa.gov/lgip/index.shtml>.

Custodial credit risk - The District's deposits are held by public depositories authorized by the PDPC and are not subject to custodial credit risk because state law requires public depositories to fully collateralize their public entity deposits.

Bond principal and interest accounts - For each debt issue, the District is required by bond resolutions to maintain principal and/or sinking fund and interest accounts within the bond funds to provide for the next semi-annual interest and annual principal/sinking fund payments falling due, which are reported as current assets. All bond funds are restricted by bond resolution to the payment of debt service obligations.

Bond reserve funds - District revenue bond resolutions require that reserve accounts be maintained within the bond funds. The 2010 reserve accounts require a deposit equal to 125% of the average annual debt service outstanding on each respective bond. The 2009 and 2012 reserve accounts require deposits equal to the maximum amount of principal and interest falling due in any single bond year. The 2009, 2010, and 2012 deposits are currently held in separate accounts in the LGIP. The 2005 reserve account requirement is 10% of paramount and premium on the 2005 bonds issued. This reserve was invested in a forward supply contract with a private third party, which expired January 1, 2014. Upon expiration, reserve amounts for the 2005 Series B bonds were deposited in the LGIP.

NOTES TO COMBINED FINANCIAL STATEMENTS

Note 2 - Cash and Investments (continued)

Construction and acquisition fund - Proceeds from the 2009, 2010, and 2012 bond issuances were deposited into separate Box Canyon Production System Construction and Acquisition Funds and are restricted to expenditures for the replacement of the Box Canyon Project turbines, plant modernization efforts, and other capital improvements to the Box Canyon Production System.

Contract obligation - The District is obligated through a memorandum of Agreement to release water from Sullivan Lake. In exchange, the District is receiving funds from the Office of Columbia River (Note 8). Monies received are restricted to construction and operations and maintenance activities related to Sullivan Lake and associated facilities.

Contract security - As discussed in Note 5, the Ponderay Newsprint Company has elected to post a \$10 million contract security in lieu of a letter of credit. The contract security is subject to contractual provisions even more stringent than the District's investment policy and, as of December 31, 2014 and 2013, was invested in a bank trust department deposit subject to PDPC protection.

Note 3 - Utility Plant

The following changes occurred in the District's utility plant for the years ended December 31, 2014 and 2013:

	2013 Balance	Additions	Retirements/ Transfers	2014 Balance
Land and land rights	\$ 4,194,498	\$ 83,472	\$ -	\$ 4,277,970
Hydroelectric plant and equipment	113,063,922	27,513,576	(37,447)	140,540,051
Structures, buildings, and equipment	155,756,278	5,274,972	(421,288)	160,609,962
Intangible assets	13,642,183	133,638	-	13,775,821
Construction work in progress	22,565,216	26,993,235	(36,732,718)	12,825,733
	309,222,097	59,998,893	(37,191,453)	332,029,537
Less accumulated depreciation and amortization	73,336,113	9,140,813	(198,146)	82,278,780
Net utility plant	<u>\$ 235,885,984</u>	<u>\$ 50,858,080</u>	<u>\$ (36,993,307)</u>	<u>\$ 249,750,757</u>
	2012 Balance	Additions	Retirements/ Transfers	2013 Balance
Land and land rights	\$ 4,179,012	\$ 15,486	\$ -	\$ 4,194,498
Hydroelectric plant and equipment	92,724,890	-	20,339,032	113,063,922
Structures, buildings, and equipment	115,954,188	335,225	39,466,865	155,756,278
Intangible assets	13,431,970	23,585	186,628	13,642,183
Construction work in progress	56,848,984	27,860,238	(62,144,006)	22,565,216
	283,139,044	28,234,534	(2,151,481)	309,222,097
Less accumulated depreciation and amortization	68,336,600	6,976,605	(1,977,092)	73,336,113
Net utility plant	<u>\$ 214,802,444</u>	<u>\$ 21,257,929</u>	<u>\$ (174,389)</u>	<u>\$ 235,885,984</u>

NOTES TO COMBINED FINANCIAL STATEMENTS

Note 3 - Utility Plant (continued)

The District capitalized to utility plant, as an intangible asset, costs associated with seeking the current Box Canyon Project FERC license, including legal fees for continuing litigation of various license conditions. The District is amortizing the balance of the intangible asset over the 50-year term of the license. Capitalized relicensing costs as of both December 31, 2014 and 2013, were \$12,472,232, with accumulated amortization of \$2,405,094 and \$2,119,273, respectively.

Note 4 - Long-Term Debt

Electric System - In February 2005, the Community Economic Revitalization Board (CERB) awarded the District a \$200,000 loan for construction of communication infrastructure projects. This loan carries no interest, and principal payments are deferred for the first five years. Annual principal payments of \$13,333 began in 2011 and will end in 2026. The loan covenants include a junior lien pledge of Electric System revenues, and, as such, this loan remains as Electric System debt; however, the associated communication infrastructure has been transferred to the Community Network System, which assumed the obligation to reimburse the Electric System for the debt service payments.

In November 2005, the District issued \$13,240,000 Series A (subject to alternative minimum tax) and \$5,430,000 Series B (tax exempt) revenue bonds to refund bonds originally issued in 1996. The Series B bonds consist of \$1,580,000 in series bonds, maturing in annual installments from January 1, 2006, through January 1, 2014, and accruing interest at 3.25% to 4.00%; \$2,420,000 maturing in annual sinking fund installments from January 1, 2015, through January 1, 2017, accruing interest at 4.35%; and \$1,430,000 maturing on January 1, 2018, accruing interest at 5.25%. The District defeased the \$3,055,000 remaining balance of Series A bonds in November 2013. The District deposited cash from the 2005 Bond interest and principal fund and 2005 reserve fund with a defeasance agent, who invested the funds in government obligations and will pay the remaining debt service to bondholders per scheduled maturity dates. Because the Series A bonds are considered legally satisfied through this transaction, the District no longer carries accounting balances related to the Series A bonds. The loss from refinancing of the Series B bonds has an unamortized balance of \$61,100 and \$94,464 as of December 31, 2014 and 2013, respectively, which is amortized using the effective interest method over the remaining life of these bonds. The bonds are recorded in the combined statements of net position net of unamortized premium of \$35,447 and \$45,682 for the Series B bonds as of December 31, 2014 and 2013, respectively.

In November 2010, the District issued \$20,745,000 tax exempt Electric System revenue and refunding bonds. Proceeds from the bonds were used to repay revenue bond anticipation notes for a transmission line build, provide funds for additional Electric System capital work, fund the reserve account, and refund the 1998 Electric System revenue bonds. The net present value of the savings on refunding was approximately \$264,720. The 2010 bonds consist of \$9,710,000 of serial bonds that accrue interest at 4.00% to 5.00%, maturing in annual installments from January 1, 2012, through January 1, 2019, and \$11,035,000 in term bonds maturing in annual sinking fund installments from January 1, 2020, to January 1, 2031. The loss from refinancing has an unamortized balance of \$21,378 and \$32,945 as of December 31, 2014 and 2013, respectively, which is amortized using the effective interest method over the remaining life of these bonds.

NOTES TO COMBINED FINANCIAL STATEMENTS

Note 4 - Long-Term Debt (continued)

The bonds are recorded in the combined statements of net position net of unamortized premium of \$238,695 and \$346,983 as of December 31, 2014 and 2013, respectively.

Box Canyon Production System - In November 2008, the District issued a \$1,340,000 Clean Renewable Energy Tax Credit Bond (CREB) to assist in the financing of the Box Canyon turbine upgrade project. CREB purchasers are eligible for a credit against their federal income tax. The bond carries an interest rate of 1.35% and provides for equal annual principal payments in the amount of \$95,714. The bond matures in December 2021.

In October 2009, the District issued \$21,295,000 Series A (tax exempt) and \$49,015,000 Series B (taxable Build America Bonds - Direct Payment) Box Canyon Production System revenue bonds to provide initial financing for turbine replacement and plant upgrades for the Box Canyon Project. The Series A bonds mature in annual installments from January 1, 2011, through January 1, 2024, and accrue interest at a coupon rate of 5.00%. The true interest cost of the Series A bonds is 4.19%. The Series B bonds are term bonds maturing in annual sinking fund installments from January 1, 2025, through January 1, 2040. Interest rates on the Series B bonds range from 6.85% to 7.35%, but are subject to a subsidy payment from the federal government. This subsidy was 35% of the interest rate at the date of issuance, but was reduced to 32.48% in 2013 as a result of federal sequestration, resulting in a current net interest rate of 4.63% to 4.96%. The bonds are reported in the combined statements of net position net of unamortized premium of \$510,076 and \$645,577 as of December 31, 2014 and 2013, respectively.

In November 2010, the District issued \$34,110,000 tax exempt revenue bonds to partially fund turbine capital improvements and other plant modernizations at Box Canyon Hydroelectric Project. The 2010 bonds consist of term bonds that accrue interest at 5.25% and 5.75% and mature in annual sinking fund installments from January 1, 2030, through January 1, 2041. The bonds are reported in the combined statements of net position net of unamortized discount of \$390,833 and \$400,565 as of December 31, 2014 and 2013, respectively.

In October 2012, the District issued \$38,000,000 taxable new Clean Renewable Energy Bonds - Direct Payment to complete the funding for turbine improvements and other plant modernizations at Box Canyon Hydroelectric Project. The District receives a credit against annual interest payments, payable by the United States Treasury, equal to approximately 70% of the interest due. This credit was also reduced due to federal sequestration during 2013, resulting in a credit of approximately 67%. The 2012 bonds consist of \$26,550,000 in series bonds maturing in annual installments from January 1, 2013, to January 1, 2025, and an \$11,450,000 term bond maturing in annual sinking fund installments from January 1, 2026, to January 1, 2030. Interest rates on the series bonds range from 0.834% to 4.571%, but with the federal subsidy result in rates from 0.000% to 1.817%. The term bond has an interest rate of 5.000%, but net of the federal subsidy is 2.246%. The bonds are reported in the combined statements of net position net of unamortized discount of \$175,637 and \$185,057 as of December 31, 2014 and 2013, respectively.

Water System - In 2000, the Sunvale Subdivision of the Water System received a loan for \$189,607 from the State of Washington Department of Community, Trade, and Economic Development to finance the construction of new wells and distribution line. The fixed interest rate is 2.5% for a term of 20 years. Annual principal payments in the amount of \$9,979 are due through October 2020.

NOTES TO COMBINED FINANCIAL STATEMENTS

Note 4 - Long-Term Debt (continued)

In 2001, the State of Washington Department of Community, Trade, and Economic Development authorized a \$400,070 loan to the Riverbend Subdivision of the Water System to finance system improvements, with a fixed interest rate of 2.5%. Annual principal payments in the amount of \$22,018 are due through October 2020.

In July 2003, the District executed a State of Washington Public Works Board loan agreement for the Granite Shores Subdivision of the Water System enabling a \$70,551 loan to be repaid over 20 years at 1% interest. The loan financed certain system improvements, including drilling a new well. Annual principal repayments of \$3,713 began in October 2005 and will end in October 2023. Subsequently, in March 2006, the District secured an additional loan with the State of Washington Public Works Board for \$35,717 to cover the remaining costs of drilling the new well. The second loan also carries a 1% interest rate. Annual principal payments in the amount of \$1,880 are due through October 2026.

Community Network System - During 2010, the Box Canyon Production System loaned the Community Network System \$2.5 million to provide liquidity for operations while the Community Network System expanded the broadband communications infrastructure. In 2013, this loan was refunded with a new \$5.25 million loan from the Box Canyon Production System. The loan is recorded as an investment by the Box Canyon Production System and accrues interest at the monthly LGIP investment rate net of administrative fees, which was an average of .1027% for the year ended December 31, 2014. Monthly principal payments began on December 31, 2013, and are due through November 30, 2033.

During the years ended December 31, 2014 and 2013, the following changes occurred in the District's long-term debt:

	2013 Balance	Additions	Reductions	2014 Balance*	Due Within One Year*
Revenue bonds, face amount	\$ 162,090,714	\$ -	\$ 4,870,712	\$ 157,220,002	\$ 5,535,713
Unamortized bond premium	1,038,242	-	254,024	784,218	-
Unamortized bond discount	(585,622)	-	(19,152)	(566,470)	-
Other long-term debt	445,552	-	50,922	394,630	50,924
Total debt	<u>\$ 162,988,886</u>	<u>\$ -</u>	<u>\$ 5,156,506</u>	<u>\$ 157,832,380</u>	<u>\$ 5,586,637</u>
	2012 Balance	Additions	Reductions	2013 Balance*	Due Within One Year*
Revenue bonds, face amount	\$ 169,851,430	\$ -	\$ 7,760,716	\$ 162,090,714	\$ 4,870,714
Unamortized bond premium	1,358,737	-	320,495	1,038,242	-
Unamortized bond discount	(603,787)	-	(18,165)	(585,622)	-
Other long-term debt	496,477	-	50,925	445,552	50,924
Total debt	<u>\$ 171,102,857</u>	<u>\$ -</u>	<u>\$ 8,113,971</u>	<u>\$ 162,988,886</u>	<u>\$ 4,921,638</u>

*Intercompany debt transactions have been eliminated for combined presentation.

NOTES TO COMBINED FINANCIAL STATEMENTS**Note 4 - Long-Term Debt (continued)**

Scheduled maturities and interest on long-term debt are as follows:

	Electric System	Box Canyon Production System	Water System	Community Network System	Combined as of 12/31/14*
Principal					
2015	\$ 1,978,333	\$ 3,570,714	\$ 37,590	\$ 182,687	\$ 5,586,637
2016	2,053,333	3,635,714	37,590	190,130	5,726,637
2017	2,153,333	3,705,714	37,591	197,876	5,896,638
2018	2,813,333	3,780,714	37,591	205,938	6,631,638
2019	1,443,333	3,855,714	37,591	214,328	5,336,638
2020 - 2024	3,896,669	20,431,430	56,243	1,209,955	24,384,342
2025 - 2029	4,903,333	23,465,000	3,766	1,477,352	28,372,099
2030 - 2034	2,315,000	27,185,000	-	1,381,885	29,500,000
2035 - 2039	-	34,335,000	-	-	34,335,003
2040 - 2041	-	11,845,000	-	-	11,845,000
	<u>\$ 21,556,667</u>	<u>\$ 135,810,000</u>	<u>\$ 247,962</u>	<u>\$ 5,060,151</u>	<u>\$ 157,614,632</u>
Interest					
2015	\$ 1,005,789	\$ 7,449,075	\$ 5,360	\$ 199,081	\$ 8,460,224
2016	916,748	7,343,597	4,503	191,638	8,264,848
2017	817,596	7,223,851	3,648	183,892	8,045,095
2018	695,038	7,091,861	2,791	175,830	7,789,690
2019	587,500	6,949,440	1,936	167,440	7,538,876
2020 - 2024	2,298,000	32,242,483	1,641	698,882	34,542,124
2025 - 2029	1,213,750	26,560,329	57	431,487	27,774,136
2030 - 2034	117,125	18,942,502	-	113,370	19,059,627
2035 - 2039	-	9,273,166	-	-	9,273,166
2040 - 2041	-	564,048	-	-	564,048
	<u>\$ 7,651,546</u>	<u>\$ 123,640,352</u>	<u>\$ 19,936</u>	<u>\$ 2,161,620</u>	<u>\$ 131,311,834</u>

*Intercompany debt transactions have been eliminated for combined presentation.

Note 5 - Power Purchase Contractual Agreements

Ponderay Newsprint Company - In July 1986, the Electric System entered into power sales contracts with Ponderay Newsprint Company to supply power to a fiber mill and paper plant. The District is obligated to provide all power necessary to operate both the fiber mill and paper plant. Power delivery under these contracts expires in 2027. In 2014, approximately 74% of Electric System retail energy deliveries and 58% of retail energy sale revenues were to Ponderay Newsprint Company.

To fulfill this power commitment, the District delivers power from the Box Canyon Project and acquires power at cost from the Boundary Project as discussed later in this note. Power is also obtained from the Bonneville Power Administration (BPA) and other suppliers under various power purchase contracts. Ponderay Newsprint Company is billed based upon the District's actual cost of service, as contractually defined, rather than under an industrial rate schedule.

NOTES TO COMBINED FINANCIAL STATEMENTS

Note 5 - Power Purchase Contractual Agreements (continued)

The Ponderay Newsprint Company must provide the District \$10 million in security, either in the form of a letter of credit or deposit, which the District may draw upon in the event Ponderay Newsprint Company defaults its obligations under the contracts. Cash deposits are in a District-held trust account and draws may only be made at the District's request. The District believes the \$10 million provides reasonable funds to cover the District's outstanding power purchase commitments and contractual obligations in the event of default by Ponderay Newsprint Company. However, future retail rates of the Electric System may be affected if the District were to no longer provide service to Ponderay Newsprint Company.

The rate impact from a loss of Ponderay Newsprint Company power sales cannot be forecasted accurately; it depends upon the interaction of many factors, including but not limited to existing cost of production of Box Canyon Project power, cost of acquisition of BPA and other power resources, and market or resale value of this power.

Seattle City Light - Boundary Hydroelectric Project - Seattle City Light owns and operates Boundary Hydroelectric Project located in northern Pend Oreille County. In Boundary's previous FERC license, the District was granted a licensed share of the Boundary Project equal to a 48-megawatt capacity. The Boundary Project was issued a new 42-year FERC license on March 20, 2013, in which the District was no longer granted a license share. During 2014, Seattle City Light and the District entered into a new agreement that extends the same operational parameters held under the previous license, including power deliveries capped at a 48-megawatt capacity and delivered at cost. The agreement term corresponds with Boundary's FERC license and expires in 2055.

Bonneville Power Administration - Effective October 1, 2011, the District renewed power purchase contracts with BPA for a 20-year period. At that time, the District received both Shaped Block purchases and Slice of the System purchases. Slice of the System is a product wherein the District accepted 0.18668% of the base federal hydroelectric system, and paid equal costs thereof. Slice of the System output is highly variable, depending on seasonal water flows and generational risks. Shaped Block purchases are predetermined monthly levels of power delivered consistently throughout the month. The amount of power received varies from month to month, depending on the projected load levels and District power resources for each month.

In February 2013, BPA granted the District's request to make an early change to contract provisions and reduce the District's Slice of the System percentage to 0.0%, delivering all power allocation through Shaped Block purchases. In April of 2014, the District received notice from BPA that the District's load levels did not improve sufficiently during the three-year provisional period, and resultantly, BPA retroactively adjusted approximately 3 megawatts of the District's provisional BPA product from Tier 1 to Tier 2 market-based rates back to October of 2013. This resulted in a reduction of power costs due to the low cost of the market-based Tier 2 rate. The District receives an average of 26 megawatts from Tier 1 rates.

The risks and rewards associated with Bonneville purchases pass through to Ponderay Newsprint Company under the terms of the contracts with that customer.

NOTES TO COMBINED FINANCIAL STATEMENTS

Note 5 - Power Purchase Contractual Agreements (continued)

Energy Northwest - The District is a participant in Energy Northwest's (formerly the Washington Public Power Supply System) Nuclear Project Nos. 1 and 3, both of which have terminated. The District purchased from Energy Northwest, and assigned to BPA, 0.087% of the capability of Project No. 1 and 0.078% of Energy Northwest's 70% ownership share of Project No. 3. Under the agreements, the District is unconditionally obligated to pay Energy Northwest its pro rata share of the total costs of the projects, including debt service, even though the projects are terminated. Under the Net Billing Agreements, BPA is responsible for assuming the District's cost obligation. The District's Electric System revenue requirements are not directly affected by the associated costs; revenue requirements are affected indirectly to the extent that the costs of the projects result in increases in BPA's wholesale power rates.

Note 6 - Retirement Benefit Plans

Pension plans - All full-time, as well as certain part-time, District employees participate in the statewide cost sharing, multiple employer Public Employees Retirement System (PERS). The Washington State Department of Retirement Systems (DRS) issues a publicly available financial report that includes financial statements and required supplementary information for PERS. This report may be found on the DRS website, located at www.drs.wa.gov.

PERS provides both retirement and disability benefits, established by state statute, based on compensation and length of service. Plans 1 and 2 are defined benefit programs; Plan 3 is a combination defined benefit/defined contribution program. PERS participants joining the system by September 30, 1977, are Plan 1 members. Participants joining the system subsequently, but on or before August 31, 2002, are Plan 2 members unless they make a decision to transition from Plan 2 to Plan 3. Employees hired after August 31, 2002, will be in Plan 3, unless they make a decision to join Plan 2 within 90 days of hire.

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 employees vest after 5 years of eligible service and are eligible for retirement at any age after 30 years of service, or at the age of 60 with 5 years of service, or at the age of 55 with 25 years of service. The annual pension is 2% of the average final compensation (greatest compensation during any 24 consecutive eligible months) per year of service, capped at 60%. 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% annually.

Plan 2 employees vest after 5 years of eligible service and may retire at the age of 65 with 5 years of service, or at age 55 with 20 years of service. The retirement benefit is based on 2% of average final compensation, per year of service, based on any eligible consecutive 60-month period. Actuarially calculated early retirement penalties apply to retirements prior to the age of 65. With 30 years of service credit, no penalty is calculated if age of retirement is 62 or older, and the penalty is capped at 3% per year if retirement age is between 55 and 62. There is no cap on years of service credit and a cost-of-living allowance is granted, capped at 3% annually.

NOTES TO COMBINED FINANCIAL STATEMENTS**Note 6 - Retirement Benefit Plans (continued)**

Plan 3 is a dual benefit structure. Plan 3 members may retire at the age of 65, if vested. Vesting occurs after 10 years of service, or 5 years of service with at least 1 year after age 44, or 5 years of service in Plan 2 prior to June 1, 2003. Plan 3 members may also retire at age 55 with 10 years of service; however, early retirement penalty rules similar to Plan 2 apply on the defined benefit component. Participant contributions finance a defined contribution component. Employer contributions finance a defined benefit component operating similar to Plan 2, but with the retirement benefit based on 1% of average final compensation per year of service.

Each biennium, the State Pension Funding Council adopts employer contribution rates for all three plans and employee contribution rates for Plan 2. Plan 1 employee contribution rates are set at 6% by state statute and do not vary. Plan 3 employee contribution rates vary from 5% to 15% and are individually set by each employee. The contribution rates following represent both District and employees' full liabilities under PERS.

	2014	2013	2012
Employee contribution %			
Plan 1	6.00%	6.00%	6.00%
Plan 2	4.92%	4.64% - 4.92%	4.64% - 5.00%
Plan 3	5.00% - 7.00%	5.00% - 15.00%	5.00% - 15.00%
Employer contribution %			
Plan 1	9.21%	7.21% - 9.21%	7.08% - 7.25%
Plan 2	9.21%	7.21% - 9.21%	7.08% - 7.25%
Plan 3	9.21%	7.21% - 9.21%	7.08% - 7.25%
Contribution dollars			
Employee	\$ 460,081	\$ 403,996	\$ 401,781
Employer	853,590	688,211	614,712
	<u>\$ 1,313,671</u>	<u>\$ 1,092,207</u>	<u>\$ 1,016,493</u>
PERS covered payroll	<u>\$ 9,268,077</u>	<u>\$ 8,342,466</u>	<u>\$ 8,552,316</u>

Savings plans - In addition to PERS, the District maintains a deferred compensation plan, as well as two defined contribution plans, in accordance with the Internal Revenue Code Sections 457 and 401(a), respectively. All District employees are eligible to participate in the 457 plan and one of the two available 401(a) plans. The 401(a) plans provide for an employer match of 50% of eligible employee deferral of employee straight-time wages, capped at a 2% employer match on a 4% employee deferral.

Employer contributions for 2014 and 2013 were \$149,551 and \$148,046, respectively. All plan assets have been placed into trust for the exclusive benefit of plan participants and their beneficiaries and are, therefore, not reflected in the combined statements of net position.

NOTES TO COMBINED FINANCIAL STATEMENTS

Note 6 - Retirement Benefit Plans (continued)

The District maintains a Health Reimbursement Arrangement for employees. Non-bargaining-unit employees receive 3.5% of employee base wage paid into individual employer-sponsored medical savings accounts to pay for eligible medical expenses, tax-free, whether incurred while employed or after retirement. Bargaining unit employees are eligible for up to 1.0% of the employee's base wage and an additional 1.0% if they participate in District-sponsored wellness programs.

Other post-employment benefits - The District provides reimbursement for health care insurance premiums for retired employees. Retiring employees who chose to continue medical coverage under the District's plan did so primarily at their own cost, but were eligible to receive between \$10 and \$4 per year of service, per month, toward postemployment medical premiums if they retired prior to December 31, 2014. Effective January 1, 2015, medical insurance is no longer offered for retirees under the District's plan, and the subsidy will be replaced by a contribution to the employee's Health Reimbursement Arrangement account, the amount of which is based on essentially the same formula as the subsidy. The estimated liability for this benefit as of December 31, 2014 and 2013, is \$65,910 and \$73,413, respectively. The District has elected to finance this plan under a pay-as-you-go method, disbursing \$178 for the year ended December 31, 2014. No funds were issued during the year ended December 31, 2013. There is no past service cost to be realized in future years; all related past service costs have been fully accrued.

Note 7 - Self-Insurance

Public Utility Risk Management Services - The District, along with 16 other public utility districts and one joint operating agency, is a member of the Public Utility Risk Management Services (PURMS) self-insurance fund. The program provides members with various liability, property, and health insurance coverages in three separate pools.

The District is a participant in the liability pool, which maintains a base self-insured retention level of \$1 million, funded reserves ranging from \$2.5 million to \$3 million, and individual member deductibles of \$250. The liability pool provides the District with shared excess coverage of \$60 million general liability, \$10 million professional liability, and \$35 million directors and officers liability.

The District is also a participant in the property pool, which maintains a self-insured retention level of \$250,000, funded reserves ranging from \$500,000 to \$750,000, and varying deductibles of \$250 on most property and \$75,000 on the Box Canyon, Sullivan, and Calispell Hydroelectric Projects. The property pool provides the District with \$200 million shared excess coverage, attaching at the self-insured retention level for all property risks excepting flood and earthquake, which attach at 2% of total insured value. Any gap between the self-insured level and excess insurance is funded half by the property pool and half by the affected member.

NOTES TO COMBINED FINANCIAL STATEMENTS**Note 7 - Self-Insurance (continued)**

As a member, the District is subject to assessments based on claims submitted by all members. The following assessments were charged during the years ended December 31:

	Liability		Property	
	2014	2013	2014	2013
Electric System	\$ 181,455	\$ 131,211	\$ 45,817	\$ 35,686
Box Canyon Production System	66,113	48,748	194,379	138,971
Water System	3,371	5,853	3,842	2,952
Community Network System	14,337	9,920	750	539
	<u>\$ 265,276</u>	<u>\$ 195,732</u>	<u>\$ 244,788</u>	<u>\$ 178,148</u>

Central Washington Public Utilities - The District, with six other public utility districts, is a member of the Central Washington Public Utilities Unified Insurance Program and Trust, which is a self-insurance program providing medical, dental, life insurance, disability insurance, and similar benefits to member employees and families. Formed by a Declaration of Trust and an Interlocal Agreement under RCW Chapter 39.34, the trust is administered by a board of trustees consisting of an appointed trustee from each of the seven member districts. Further information may be obtained by contacting the District's financial department as set forth on the last page of this Annual Report under Organizational Information—Corporate Office.

Note 8 - Commitments and Contingencies

Box Canyon Project license - The Federal Energy Regulatory Commission 50-year license for the District's Box Canyon Project expires on July 1, 2055. The license contains several conditions, including environmental studies and projects initiated by state and federal agencies and the Kalispel Tribe of Indians. All projects and studies are related to Box Canyon Dam and its reservoir and include the protection, mitigation, and enhancement of fish, wildlife, recreation, erosion, and cultural preservation. Required capital projects include replacement of Box Canyon Dam turbines, alteration of spillway gates for total dissolved gas abatement, fish entrapment vessels, and fish passage facilities. Costs for these projects will be capitalized at the time of completion. District-directed projects that are noncapital in nature, which are expensed as incurred, include improvement of wildlife and fish habitat, water quality monitoring, erosion mitigation, and environmental studies. The license also requires payments to agencies that are used at the discretion of the receiving party. These payments are primarily intended for recreation, but the District has no control over the final disposition of the funds. These costs have been estimated over the life of the license and recorded as a regulatory asset and licensing costs liability (Note 1).

NOTES TO COMBINED FINANCIAL STATEMENTS

Note 8 - Commitments and Contingencies (continued)

The Box Canyon turbine replacement consists of the purchase and installation of new four-blade Kaplan-style turbines, generator rewinds, upgrades or replacement of auxiliary equipment related directly to each turbine, and plant modernization for the upgrade in electrical capacity. Approximately \$117.0 million in construction funds have been expended on the project through 2014, with approximately \$19.0 million in borrowed funds left to complete the project. The fourth and final turbine replacement began in December 2013, and began final commissioning in December 2014.

The District is currently in construction to modify Box Canyon's spillway gates to mitigate total dissolved gas. This \$6.8 million project will reduce the height from which water spills over the gates, lessening the amount of plunge and resultant air trapped in the water downstream of the Project, which improves fish habitat. The District is also currently engineering upstream fish passage for the Box Canyon Project and expects to start construction on that \$15.4 million project in the summer of 2016. Downstream fish passage is expected to start in 2017 and is projected at \$16.7 million, although engineering has not yet occurred for this project. Engineering modifications and change orders could significantly affect the total cost of these projects. The District will issue bonds to complete the funding for these projects once the total cost is better known.

The license includes language authorizing the District to use lands in the Kalispel Indian Reservation. Under a contract signed in 2007, payment to the Kalispel Tribe for use of their lands is based on costs to produce power at Box Canyon Dam. The Kalispel Tribe receives their payment in electrical energy, the amount of which is based upon a formula using Box Canyon Dam production costs. The Kalispel Tribe chooses on an annual basis, in advance of the calendar year, to use the energy, require the District to sell the energy to a third party on the Kalispel Tribe's behalf at market prices, or require the District to purchase the power at cost of production. For 2014 and 2013, the Kalispel Tribe chose to have the District purchase the power at generation cost. Power sales on the Kalispel Tribe's behalf totaled \$215,028 and \$214,966 in 2014 and 2013, respectively.

Sullivan Creek Project - The Electric System's Sullivan Creek Project consists of two dams, an abandoned conduit, a forebay, and an empty powerhouse. Using the project for energy generation is not currently thought to be economically feasible within the in-stream flow operating criteria imposed by the Washington State Department of Ecology and the United States Forest Service (USFS); therefore, the project is used solely for water storage.

NOTES TO COMBINED FINANCIAL STATEMENTS

Note 8 - Commitments and Contingencies (continued)

The Sullivan Creek Project's 50-year FERC license expired in September 2008. In 2010, the District concluded a negotiated license surrender process with several agencies, including USFS, Department of Ecology, Washington State Department of Fish and Wildlife, United States Fish and Wildlife, several other organizations, and local citizens. The resultant settlement agreement outlines continued operation of the Sullivan Dam as a water storage facility. The agreement also outlines various environmental projects to protect and enhance fish and wildlife habitat. Through an Interlocal Agreement between Seattle City Light and the District, Seattle City Light has agreed to pay the full cost to remove the Mill Pond Dam and perform other restoration and environmental work as part of the relicensing conditions for Boundary Dam. Seattle City Light also agreed to pay half of the cost of construction of a cold water pipe, which will draft cooler water from the bottom of Sullivan Lake in an effort to lower the water temperature of an outlet creek. Once the terms and conditions of the negotiated agreement are approved by FERC, which is expected in 2015, the District will become eligible to receive a 30-year USFS permit to continue to operate Sullivan Dam as a water storage facility.

Concurrent with the license surrender process, the District applied to the Department of Ecology to sell certain Sullivan-related water rights to the state of Washington through the Department of Ecology Office of Columbia River, Columbia River Water Management Program. The parties have executed an agreement committing \$14 million in funding to be received in exchange for the release of water from Sullivan Lake at designated times and amounts over the expected USFS permit 30-year life. The District received the first of three payments in the amount of \$2.5 million in September 2013 and the second \$2.5 million payment in August 2014. The final payment is expected in 2015, with the majority of the money disbursed after completion of the cold water pipe, which is also expected in 2015. Proceeds are expected to finance Sullivan Creek Project capital and operating, maintenance, and environmental expenditures for the entirety of the USFS 30-year license term. The proceeds are recorded as unearned revenue and will amortize in an amount equal to the net cash outflow for Sullivan Project-related activities each year. The monies are restricted to use for Sullivan Creek Project-related expenditures.

Because there is no operating value for the District in owning the Sullivan Project assets, the District reports the net revenues and expenses as nonoperating. Asset values, including construction costs for the cold water pipe, are recorded net of accumulated depreciation as nonutility plant. The District reports no remaining license surrender liability. Although considered unlikely, the District retains risk that the associated parties will fail to perform their agreed-upon obligations and the District will incur a considerable liability associated with the license surrender.

Rental agreement - In 1997, the District entered into a rental agreement with the Pend Oreille County Port District for use of their railroad right-of-way related to a 115-kilovolt transmission line project. Under this agreement, the District agreed to pay a consumer price index-adjusted \$125,000 per year, for a 20-year period commencing January 1, 1997, subject to termination by the District with a year's notice. The District paid \$190,202 and \$187,465 under the terms of this agreement for 2014 and 2013, respectively.

NOTES TO COMBINED FINANCIAL STATEMENTS

Note 8 - Commitments and Contingencies (continued)

NoaNet - The District guaranteed certain NoaNet debt obligations and participates in assessments (Note 9).

Other contingencies - The District is subject to various claims, possible legal actions, and other matters arising out of the normal course of business. When it is possible to make a reasonable estimate of the District's liability with respect to probable claims, an appropriate provision is made. Although the ultimate outcome of litigation against the District cannot be determined, management intends to continually defend all claims against the District and believes the District is adequately reserved for all known events.

Note 9 - Broadband Services

Community Network System - The District owns a fiber optic backbone extending from Spokane north past Metaline Falls and includes fiber into all District substations. The District built this system primarily for Electric System operation and control, but allowed others to use the system and thereby help local businesses, as well as develop revenues to offset infrastructure costs.

With the acceptance of the ARRA grant (Note 10), the District expanded its broadband services to the residents of Pend Oreille County, changing the scope of the utility services offered by the Community Network System. The Community Network System operates in accordance with state wholesale laws, which authorize the District to build infrastructure and enable open-access use of that infrastructure to internet service providers and entities authorized to provide retail telecommunications services within the state of Washington, who may then, in turn, provide retail services to customers.

Construction associated with the ARRA grant is primarily complete, with over 1,100 residents receiving internet service through local retail service providers. Although customer count is initially better than projected, the Community Network System is subject to cost pressures and risks associated with a start-up business. Actual costs for the ARRA grant project exceeded the original grant estimated cost by approximately \$4 million. Forecasts predict that the Community Network System will be cash flow positive in 2015, but customer count, unexpected increases in operational cost, and increases in capital cost projections could greatly affect the Community Network System's cash flow.

Northwest Open Access Network - The District, along with nine other Washington public utility districts and Energy Northwest, is a member of Northwest Open Access Network (NoaNet), a Washington nonprofit mutual corporation. NoaNet uses a high-speed fiber optic transmission system, largely located within Washington State, to provide ethernet and other advanced telecommunications services on a wholesale basis to its members and retail telecommunications companies. NoaNet has first right-of-refusal to lease four strands, designated as public purpose, from fiber optic lines the BPA owns on transmission lines.

NOTES TO COMBINED FINANCIAL STATEMENTS

Note 9 - Broadband Services (continued)

NoaNet members have guaranteed a \$27 million revenue bond issuance, which accrues interest at rates varying from 5.05% to 7.09% and matures in annual and sinking fund installments through December 2016. The District's 3.91% guarantee share of the \$5,510,000 outstanding as of December 31, 2014, is \$215,441, with a maximum exposure of \$269,301 in the event other members fail to honor their guarantees.

In August 2009, NoaNet established a \$1.5 million variable rate, junior lien, nonrevolving line of credit that had a balance outstanding of \$166,667 as of December 31, 2013, which was repaid in full during the 2014 year.

In October 2012, NoaNet established a \$5 million variable rate, junior lien, nonrevolving line of credit that had a balance outstanding of \$5 million as of December 31, 2013. In September of 2014, NoaNet established a \$1 million variable rate, junior lien, nonrevolving line of credit. An additional draw in the amount of \$1 million was taken bringing the total balance to \$2 million. These lines of credit were refinanced through a \$13 million variable rate, junior lien, nonrevolving line of credit established in December 2014, which had a balance outstanding of \$5,771,729 as of December 31, 2014.

In 2014, NoaNet reported a net operating loss of \$3,220,771, \$318,554 of nonoperating expense, \$7,414 in interest income, and \$1,924,694 of grant revenue for a total decrease in net position of \$1,607,217.

The District's Electric System reports no investment or liability account balance reflecting NoaNet membership.

A NoaNet annual report may be obtained by writing to Northwest Open Access Network, 3511 Norfolk Court, Olympia, WA 98501. NoaNet's website is available at www.noanet.net.

Note 10 - Grants

The District reports most grant revenue as nonoperating. Occasionally, grant proceeds are received in reimbursement for operating expenses. In such cases, the grant revenue is classified as operating.

Box Canyon Production System

United States Department of Agriculture, Forest Service - The District has an ongoing program to address milfoil in the Pend Oreille River as a requirement of its Box Canyon Project FERC license. In 2011, the U.S. Forest Service awarded the District a \$47,500 grant to aid the milfoil work. Although no funds were recorded in 2014, \$7,847 was recorded as grant revenue in 2013; the District has until December 15, 2015, to use the remainder of the grant.

NOTES TO COMBINED FINANCIAL STATEMENTS

Note 10 - Grants (continued)

Water System

Washington State Department of Health - In 2012, the Washington State Department of Health awarded a \$900,000 Jobs Now Act Grant to replace approximately 7,000 feet of water transmission main line and related support structures for the Metaline Falls water system. The project was completed in early 2014 and the District realized \$100,468 and \$749,357 in costs and associated revenue during 2014 and 2013, respectively.

Community Network System

American Recovery and Reinvestment Act - In 2010, the National Telecommunications and Information Administration awarded the District a grant through the Broadband Telecommunications Opportunity Program to expand the District's broadband communication infrastructure to bring fiber optic connectivity to residential and business customers in Pend Oreille County. The grant provided \$27,257,838 for construction costs and required a District match of \$4,842,792 in cash and \$1,971,667 of pre-existing infrastructure as an in-kind contribution. This fiber-to-the-premise project encompassed approximately 600 miles of the District's 1,100 miles of electric distribution lines. Project costs through the required completion date of September 30, 2013, totaled \$38.2 million. As of December 31, 2013, the District had submitted for and received all grant funding available under the grant. Remaining costs of the project were funded through District monies.

Northwest Open Access System (NoaNet)

American Recovery and Reinvestment Act - In 2010, the National Telecommunications and Information Administration awarded NoaNet, a related party entity discussed in Note 9, two grants through the Broadband Telecommunications Opportunity Program. As part of the related project work, NoaNet built approximately 70 miles of fiber optics within Pend Oreille County. In 2013, the District paid \$333,786 toward the project, receiving in exchange a second fiber optic pathway exiting the county, managed by NoaNet, and the right of use for 36 strands of the 48-strand fiber optic cable deployed within Pend Oreille County. Concurrently, the District granted NoaNet a right of use on the District's fiber optic cable extending from Pend Oreille County to Spokane, Washington.

Public Utility District
No. 1 of
Pend Oreille County Washington

Supplemental Information
(Unaudited)

Disclosure Under U.S. Securities and
Exchange Commission
Rule 15c2-12

ELECTRIC SYSTEM - REVENUE, CUSTOMER, AND ENERGY STATISTICS (Unaudited)

	For the Years Ended December 31,				
	2014	2013	2012	2011	2010
Average number of customers					
Residential	7,957	7,912	7,896	7,921	7,922
Commercial	841	836	838	836	825
Industrial	8	8	8	8	8
Other	77	62	38	37	36
Total District customers	8,883	8,818	8,780	8,802	8,791
Sales for resale	2	2	2	7	3
Total	8,885	8,820	8,782	8,809	8,794
Revenues from sale of energy (000s)					
Residential	\$ 8,963	\$ 9,052	\$ 8,461	\$ 8,392	\$ 7,142
Commercial	2,391	2,434	2,297	2,242	1,917
Industrial	28,541	32,122	32,048	28,466	29,435
Other	39	38	38	35	32
Total District customers	39,934	43,646	42,844	39,135	38,526
Intersystem sales	140	142	153	161	712
Sales for resale	6,057	3,920	2,645	4,674	4,028
Total energy sales	46,131	47,708	45,642	43,970	43,266
Other operating revenues	825	950	528	558	664
Total	\$ 46,956	\$ 48,658	\$ 46,170	\$ 44,528	\$ 43,930
Energy (MWh)					
Residential	143,037	143,077	138,253	149,656	133,607
Commercial	43,806	47,340	46,462	48,462	43,952
Industrial	719,194	808,082	814,788	793,722	805,936
Other	299	301	301	308	311
Total District customers	906,336	998,800	999,804	992,148	983,806
Intersystem sales	3,229	3,534	4,063	5,130	22,863
Sales for resale	202,618	131,358	131,968	202,317	136,344
Total sales	1,112,183	1,133,692	1,135,835	1,199,595	1,143,013
Peak demand (MW)	162	153	149	159	152
Energy requirements (MWh)					
Ponderay Newsprint Company	675,145	765,225	774,568	755,387	772,666
All other retail customers	237,420	237,109	229,299	241,891	234,003
Total retail sales	912,565	1,002,334	1,003,867	997,278	1,006,669
Sales for resale	202,618	131,358	131,968	202,317	136,344
Total sales	1,115,183	1,133,692	1,135,835	1,199,595	1,143,013
Electric System losses	16,345	16,790	12,177	10,332	849
Total energy requirements	1,131,528	1,150,482	1,148,012	1,209,927	1,143,862
Energy resources (MWh)					
Box Canyon Project	462,530	433,381	460,771	451,790	453,621
Boundary Project	366,993	372,221	369,284	366,025	369,573
Bonneville and other sources	302,005	344,880	317,957	392,112	320,668
Total energy resources	1,131,528	1,150,482	1,148,012	1,209,927	1,143,862

ELECTRIC SYSTEM - SENIOR LIEN PARITY DEBT SERVICE COVERAGE (Unaudited)

	For the Years Ended December 31,				
	2014	2013	2012	2011	2010
Operating revenues (000s)					
Energy sales	\$ 46,131	\$ 47,708	\$ 45,642	\$ 43,970	\$ 43,266
Other	825	950	528	558	664
Total operating revenues	46,956	48,658	46,170	44,528	43,930
Operating expenses (1)					
Power costs	30,090	30,849	28,233	27,685	28,416
Operations and maintenance	6,433	5,287	5,115	4,548	4,646
Administrative and general	3,385	3,066	3,309	3,484	3,214
Taxes	2,190	2,394	2,320	2,016	1,907
Total operating expenses	42,098	41,596	38,977	37,733	38,183
Investment income (2)	18	110	126	122	117
Net revenue available for debt service	4,876	7,172	7,319	6,917	5,864
Senior lien debt service	3,011	2,461	4,359	4,234	3,160
Net revenue available for capital	\$ 1,865	\$ 4,711	\$ 2,960	\$ 2,683	\$ 2,704
Debt service coverage ratio (3)	1.62x	2.91x	1.68x	1.63x	1.86x

- (1) Total operating expenses exclude depreciation for purposes of determining parity debt service coverage ratios.
- (2) Investment income varies depending on many factors, including unrealized gains and losses on long-term investments.
- (3) Debt service coverage ratio on senior lien debt service.

BOX CANYON PRODUCTION SYSTEM
SENIOR LIEN PARITY DEBT SERVICE COVERAGE (Unaudited)

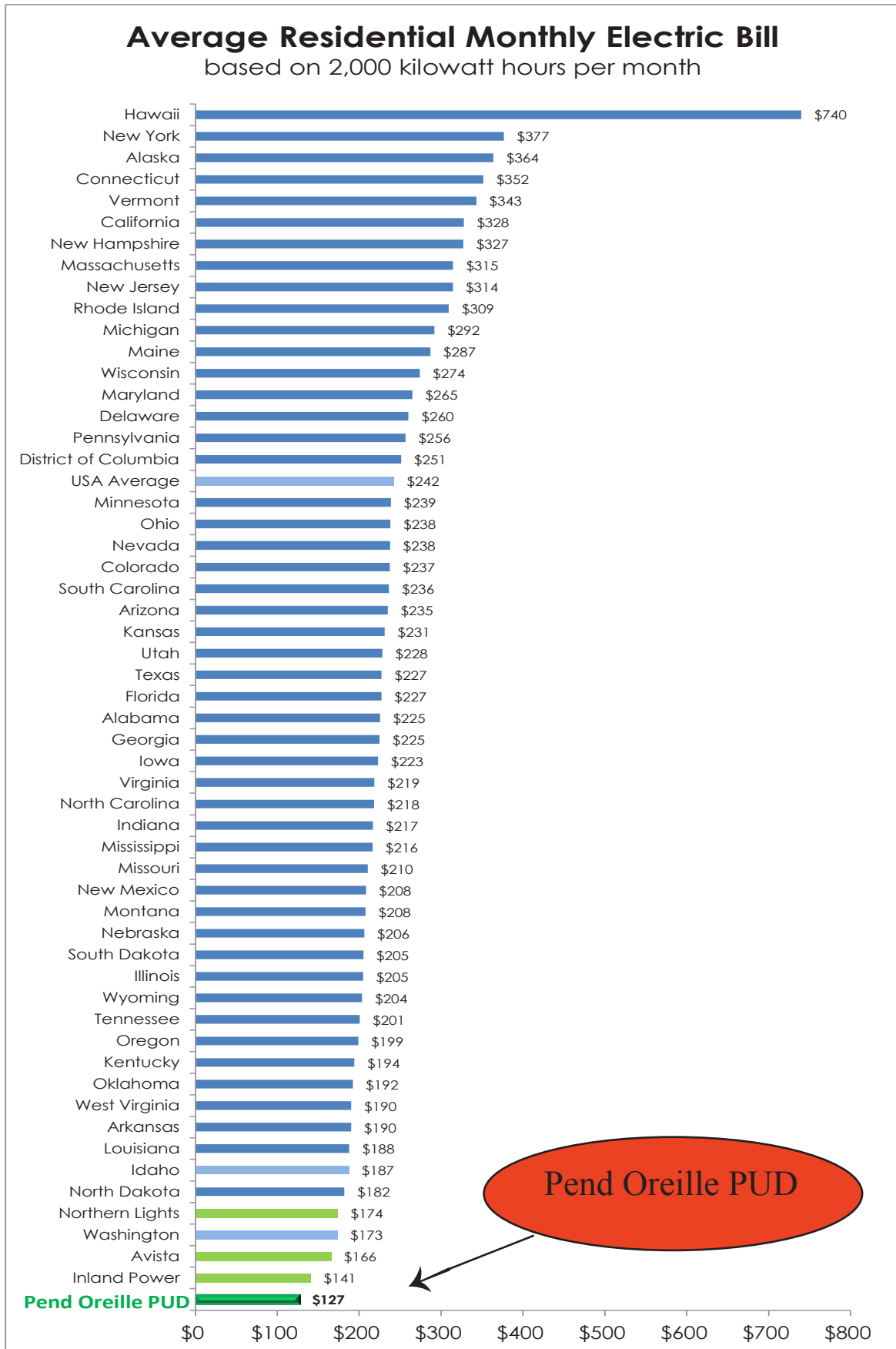
	For the Years Ended December 31,				
	2014	2013	2012	2011	2010
Operating revenues (000s)					
Energy sales					
Electric System	\$ 16,993	\$ 17,883	\$ 17,068	\$ 14,690	\$ 15,597
Tribal use of lands	215	215	190	158	293
All other (1)	138	59	7	1,448	2
Total operating revenues	17,346	18,157	17,265	16,296	15,892
Operating expenses (2)					
Power costs	717	917	1,533	896	2,463
Operations and maintenance	4,582	5,365	5,651	5,600	6,172
Administrative and general	2,510	2,249	2,174	2,192	2,089
Taxes	105	99	105	103	104
Total operating expenses	7,914	8,630	9,463	8,791	10,828
Investment income	59	125	126	141	162
Other nonoperating (3)	2,045	2,049	1,431	1,225	1,225
Net revenue available for debt service (4)	11,536	11,701	9,359	8,871	6,451
Senior lien debt service (5)	11,069	11,095	8,386	7,565	5,986
Junior lien debt service	-	-	-	-	-
Net revenue available for capital	\$ 467	\$ 606	\$ 973	\$ 1,306	\$ 465
Debt service coverage ratio (6)	1.04x	1.05x	1.12x	1.17x	1.08x

- (1) "All Other" includes miscellaneous revenue such as logging activities on project properties. The 2011 balance includes a negotiated settlement from a contractor associated with the turbine upgrade project.
- (2) Excludes depreciation for purposes of determining senior lien debt service coverage.
- (3) Internal Revenue Service interest reimbursement for 2009 Series B, Taxable Build America Bonds, and 2012 Taxable Clean Renewable Energy Bonds - Direct Payment.
- (4) The District controls net revenue available by adjusting the power sales transfer price to the Electric System based on Box Canyon Production System cash flow requirements for debt service and capital investment. 2010 and subsequent net revenue reflect the funding associated with higher debt service requirements.
- (5) Senior lien debt service includes the 2008 line of credit, the 2008 CREB bonds, the 2009 bonds, the 2010 bonds, and 2012 CREB bonds.
- (6) Debt service coverage ratio on senior lien debt service.

ORGANIZATIONAL INFORMATION

Date of organization	November 1936
Nature of business	A municipal corporation supplying public utility services in Pend Oreille County, Washington
Board of Commissioners	
President	Curt J. Knapp
Vice President	Richard A. Larson
Secretary	Daniel L. Peterson
Key District Management	
General Manager	John D. Jordan
Assistant General Manager, Distribution	April D. Owen
Assistant General Manager, Production/Legal Counsel	F. Colin Willenbrock
Auditor/Customer Service Manager	Elaine Averyt
Treasurer	Sarah L. Holderman
Director, Regulatory and Environmental Affairs	Mark J. Cauchy
Director, Information Technology	Rhonda Thomas
Director, Distribution, Engineering, and Operations	Christopher Jones
Systems	
Electrical power distribution	Electric System
Hydroelectric power generation at Box Canyon Project	Box Canyon Production System
Water distribution in residential subdivisions and the town and vicinity of Metaline Falls	Water System
Wholesale broadband communications services	Community Network System
Corporate Office	P.O. Box 190 130 N. Washington Newport, Washington 99156 (509) 447-3137 Telephone (509) 447-5824 Facsimile www.popud.org
Paying Agent and Registrar Information	The Bank of New York 101 Barclay Street State of Washington Fiscal Agencies Dept. 7E New York, New York 10286

Electric Rates Among the Lowest in the Nation



Source: U.S. Energy Information Administration

District Staff

Jethro Allen, Journeyman Lineman
Elaine Averyt, Auditor, Customer Services Manager
Patrick Barley, CNS Technician
Jerry Beacham, Power Supply Operator
Brian Benham, IT Support Specialist
Paul Boxleitner, Human Resources Manager
Mike Boyle, IT Supervisor
Gary Brathovde, Meter Reader
Pat Buckley, Natural Resources Manager
Mark Cauchy, Director, Regulatory & Envir. Affairs
Chris Chaney, System Operator
J.L. Chantry, Journeyman Lineman
Mike Chantry, IT Support Analyst
Ray Chantry, Meter Reader
Rod Clark, Journeyman Lineman
Mark Cleveland, Power Production Manager
Steve Cona, Water System Operator
Keith Cordes, Line Construction Superintendent
Brandon Corkill, Journeyman Lineman
Josh Cox, System Operator
Brenda Cruse, Meter Reader II
Lisa Curry, Customer Service Representative
Steve Davis, Line Foreman
Roby Douglas, System Operator
Eileen Dugger, Contracts & Public Info. Administrator
Shawn Ellsworth, Journeyman Lineman
Jane Emrick, Admin. Assistant, Production
Lisa Enyeart, Hydro Maintenance
Kevin Fisher, Warehouseman
Chuck Frandrup, Engineering Manager
Robert Fritz, CNS Operations Supervisor
Kim Gentle, Power & Risk Manager
Bronson Gerstenberger, Journeyman Tree Trimmer
Rusty Gill, Water System Operator
Shawn Gumenberg, Technician/Electrician I
Stan Haney, Hydro Mechanic Foreman
Brian Hansen, Network Support Specialist
Jacob Hanson, Power Supply Operator/Tech/Elec
Sarah Holderman, Treasurer
Dan Hoogheem, Distribution Field Engineer
Rick Hughes, Line Foreman
Ben Huntley, Serviceman
Bonnie Jennings, Customer Service Representative
Jason Johnson, Plant Engineer, Box Canyon
Chris Jones, Director, Distribution, Engineering & Operations
John Jordan, General Manager
Scott Jungblom, Resource Biologist
Bill Kershul, Project Mgr. Operations
Paul Kiss, Line Foreman
Bryant Kramer, Senior System Operator
Brodie Larson, Sr. Power Supply Operator
Karl Laska, Power Supply Operator
Anna Layser, Payroll/Personnel Analyst
Rob Linton, Hydro Mechanic

Dale Maki, Mechanic
Brian Marsengill, Substation & Apparatus Tech II
David Mason, Power Supply Operator
Syd Maurer, Natural Resources Field Technician
Dale Mendenhall, Hydro Maintenance
Brenda Miller, Compliance Coordinator
Jeff Miller, Technician/Electrician II
Mike Mondich, Technician/Electrician II
Michael Mumford, Meter Reader
Scott Nagle, Network Administrator
David Nichols, Electrical Project Engineer
Lenny Nichols, Lead Warehouseman
Dario Nila, CNS System Specialist
Joe Onley, GIS Engineer
Dave Osborne, Lead Mechanic
April Owen, Assist. Gen. Mgr., Distribution & Finance
Christy Parry, Utility Data Analyst
Sandra Pea, Compliance Manager
Mike Peterson, Natural Resources Field Technician
John Petrich, Lead Technician/Electrician
Tommy Petrie, Wildlife Habitat Specialist
James Reed, Journeyman Lineman
Michael Reed, CNS Technician I
Autumn Rice, Administrative Secretary/CSR
Keith Saxe, Hydro Mechanic
Kelly Scherf, Sr. Accountant
Rod Schoener, Journeyman Tree Trimmer Foreman
Dennis Schult, Natural Resources, MS Hydrology
Mark "Bubba" Scott, Water Systems Manager
Dick Shaw, Journeyman Tree Trimmer
John Shukle, Journeyman Lineman
Laura Smith, Customer Service Representative
Spencer Smith, Journeyman Lineman
Teresa Smith, Power Marketer/Scheduler
Amy Smock, Admin. Assistant, Engineering & Operations
Todd Swegle, Drafting Technician
Cecil Taylor, Safety & Environmental Coordinator
Larry Taylor, Hydro Mechanic
Rhonda Thomas, Director, Information Technology & Telecommunications
Nancy Thompson, Administrative Assistant, Reg. Affairs
Dale Weathers, Distribution Field Engineer
Dean Welter, System Operator
Colin Willenbrock, Assist. Gen. Mgr., Production & Legal Counsel
Tanner Williams, Journeyman Lineman
Karen Willner, Assistant to the General Manager
Janice York, Customer Service Representative
Fred Zakar, System Operator
Dick Zimmerman, Power Supply Operator





Public Utility District No. 1
of Pend Oreille County
P.O. Box 190
Newport, WA 99156
(509) 447-3137
www.popud.org