



Public Utility District No. 1 of Pend Oreille County



Annual Report
2013

Contents



Distribution Line Upgrade



Stream Survey Work



Box Canyon Dam

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Manager's Message

Quality Service at Low Cost

This District does not strive for flashy. The above Mission Statement is well known by all our employees and many of our customers. Importantly, it does not reference “Best in Class” or “World Class.” We try to avoid the leading edge, while we watch and learn from others. Our goal is to be solid, to continue providing power and other services to our customer owners at reasonably low cost. Not at the lowest possible cost, but at a good value that still allows sufficient cash flow for this District to be a quality utility. This does not mean the District is sleepy or that our employees are without challenge.

This small utility owns the Box Canyon Hydroelectric Project and is wrapping up a \$110 million multi-year effort to refurbish the facility’s four turbines. The cost of this effort has come in at our expectations, with very little change since we opened up the first unit and could clearly identify what work needed to be done. In late 2013, we completed the third unit upgrade. Parts are largely manufactured for the fourth and final unit; disassembly is now underway. Our employees have done a great job, working long hours managing a difficult and challenging project to expectations.

In 2013, the District’s Community Network System completed a major fiber optic to-the-premise effort utilizing a \$27 million federal grant. The bad news is a 12% project overrun, meaning the District-required investment came in at \$9 million rather than the hoped for \$5 million. The good news is the system is working nicely and community reception is exceeding expectations. The majority of the premise owners touched by the project gave permission for the District to place fiber optic to their business or home. Of these potential customers, about 30% signed up for 100 megabit Internet service in the first six months. Unless you live in a rural area, it is difficult to understand what a system like this means to a community, to our schools, to our health care systems, to economic development, and to our kids. Community reception to this project has been very appreciative and overwhelmingly positive.

When you are small, large projects come at an opportunity cost. The District does not have enough human resources or money to do all desired improvements concurrently. We must be patient, plan prudently, complete our major projects successfully, and then move onto seizing other opportunities.

Without the right people, reaching success is unlikely. The District has very talented employees, but many are nearing retirement. We have planned well for their departure. It would be very difficult for me to fully express the faith I have developed in our next generation of leaders here at the District. Our utility’s future is in very good hands.



John Jordan
General Manager



April Owen, Assistant
General Manager



Colin Willenbrock, General Counsel,
Government Affairs Officer



Mark Cauchy, Director Regulatory
& Environmental Affairs

The District hires regionally from throughout the Pacific Northwest and seeks the very best and most talented. It is surprising how often the best and most talented turns out to be a person who grew up locally and wants to return to our county to raise their family where they were raised. Our ability to attract and keep talent speaks well of our small corner of the world, of our quality of life here in Pend Oreille County, and of our District's reputation regionally.

This District may be small, but we have talented people pursuing significant achievements.

As a public utility, these achievements accrue to the benefit of our local residents, who are also our owners. This District does not strive for flashy; still, we could not be more proud of who we are, what we are doing, and who we serve.

John Jordan
General Manager



Charlie O'Hare, Chief
Operating Officer



Rhonda Thomas, Director
Information Technology

Commissioners

“All Politics is Local”

This famous phrase was the title of Massachusetts Congressman Tip O’Neill’s 1993 book about the world of politics and campaigning. A former U.S. House Speaker from the east coast is worlds away from Public Utility District Commissioners elected in Pend Oreille County, but the principle he emphasized fits everywhere.

We three Commissioners together have been “locals” for over 111 years! Our experience enables us to provide practical oversight and strategic direction for the District. We take seriously our responsibility to represent the public’s interest in the PUD and to protect and enhance the benefits it brings them.

Recent PUD hiring suggests a similar phrase, “all talent is local.” Of course, many of our great employees have come from other places. But recently, several of “the best and brightest” have turned out to also be locally grown. As our General Manager noted, these young professionals want to return here to raise their own families. They now combine the skills they have sharpened elsewhere with their local roots in community service and common sense. They join other equally talented PUD employees with similar backgrounds who have been hired in the past.

The District, like the industry at large, continues to face the challenge of many baby boomer workers retiring soon. But we share John Jordan’s observation that our future is already in some very good hands of the next generation.

We continue to be “the little utility that does big things.” This report demonstrates how we have done. Thanks to the hard working staff at every level of our organization, we believe the people of Pend Oreille County were well served in 2013. Let us know what you think.

Dan Peterson
Secretary, Board of Commissioners



Curt Knapp
President



Rick Larson
Vice president



Dan Peterson
Secretary



Turbine Assembly Installation

Production

Upgrade work for the third of four turbine-generator units at Box Canyon Dam was completed in 2013. Contract crews began upgrade work on the fourth unit late in the year. This unit is scheduled to be completed and on-line in the fall of 2014.

In accordance with the District's Total Dissolved Gas Abatement Plan, contract work began on a Hydraulic Cylinder Gate Hoist Project, the purpose of which is to reduce total dissolved gas in spillway discharge. When complete, the work will allow raising the top and middle gate leaves together, allowing water to flow underneath, instead of over the middle gate leaf. This gate configuration will produce a skimming flow as water enters the tailwater from a lower elevation, thus reducing the amount of air trapped in the tailwater that occurs from water plunge, and ultimately improving water quality for fish habitat. The project is scheduled for completion in 2015.

The Calispell Creek Pumping Station's motor control center replacement platform was completed in 2013. The structure is scheduled to be installed in 2014. The pumps/motors and controls will be installed by PUD staff when work loads permit. A high level of reliability is required of this pumping station, as it is vitally important to the District's ability to meet the Federal Energy Regulatory Commission's operational requirements of the Box Canyon Hydroelectric Project.

Major maintenance and upgrade work performed in 2013 included the completion of the turbine-generator cooling water piping replacement, generator switchgear upgrades, and unit relay and protection upgrades. In addition, jib cranes were added to the spillway crane, the powerhouse crane track beds were repaired, and new crane trucks are on site ready for installation in 2014, and the Box Canyon emergency generator controls were upgraded, allowing remote start capacity and remote metering.

The Calispell Creek Power Plant's generator unit #1 was put back on-line after transformers, switchgear, and protection was upgraded and replaced. Unit #2 repairs are scheduled for 2014.

Emergency repairs were completed on the Trimble Creek pump. A replacement pump/motor and column have been ordered and are scheduled for installation in the summer of 2014.

Transmission and Distribution

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

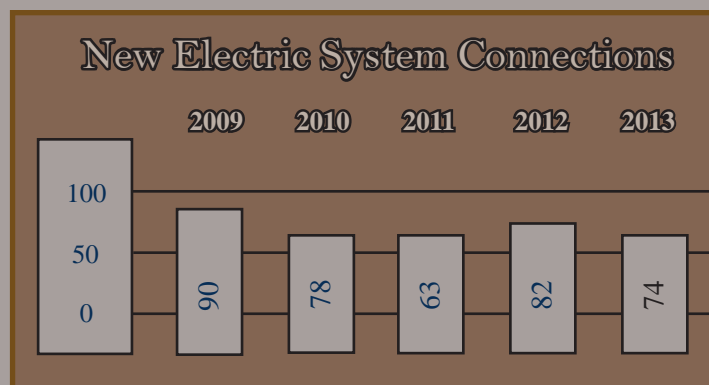
The Operations Department completed a number of large capital projects in 2013. These included total rehabilitation of two major overhead river crossings and the construction of several miles of new three-phase power lines in the north end of the county. These projects were a continuation of the work completed in 2012 to supply the Northwest Open Access Network with a 15-mile route for fiber optic cable. These improvements have greatly increased the reliability of power to the communities on the east side of the Pend Oreille River.

District line crews also began the rehabilitation of the Deer Valley Substation. Even though this substation is the smallest of the District's seven substations, it remains a vital part of the electric system for the south portion of the county. Crews completed fence and ground work, replaced underground conduit, vaults, and primary conductor, and replaced the overhead structures needed for the substation getaways.

The District also continued with its Pole Testing and Treatment Program. During 2013, approximately 2,000 poles were tested, and over 80, which were found to be either defective or a potential threat to our employees or the public, were replaced by the District's line crew. This program continues to be a benefit to the District, improving the safety and reliability of its distribution system.



Line Construction on Cooks Mt.





Sullivan Lake

Regulatory Affairs

After years of study and consultation, the Upstream Fish Passage Facility site location and design criteria at the Box Canyon Hydroelectric Project was approved by federal, state, and local agencies in 2013. The approval allows the design of the \$20 million upstream fishway to begin. Located on a rock outcropping next to the Box Canyon powerhouse, the upstream fish passage facility will attract and house fish until evaluated by District staff. After evaluation and tagging, target species will be relocated upstream.

The District received a Surrender Order (Order) for the Disposition of Project Facilities for the Sullivan Creek Hydroelectric Project (Project) from the Federal Energy Regulatory Commission (FERC) on March 20, 2013. The Project consists of Sullivan Lake Dam and the smaller Mill Pond Dam, located just

downstream, both of which are both used as storage facilities. The Order requires the District to remove Mill Pond Dam, continue the operation of the Sullivan Lake Dam, and construct a Cold Water Release Facility at Sullivan Lake. The final design and construction bid documents were completed for the Cold Water Release Facility during 2013, and construction is expected to be completed in early 2015. The District also received its first payment of \$2.5 million from the State of Washington for the sale of water from Sullivan Lake, which is part of the agreement to continue operation of the Sullivan Lake Dam. The District will receive two additional payments totaling \$11.5 million following completion of the Cold Water Release Facility.

Removal of the Mill Pond Dam will take place over the next 5 years. Seattle City Light, through an agreement with the District, will be responsible for the dam removal project.

Two outstanding legal matters remain in abeyance awaiting resolution relating to the 401 certification under the Clean Water Act at the Calispell Pumping Station which is a project works under the Box Canyon Hydroproject FERC License and the Total Maximum Daily Load (TMDL) for temperature of the Pend Oreille River that was developed by the WA State Department of Ecology and submitted to EPA for approval. The TMDL-Temperature will require the District to implement measures that will reduce temperature in the Box Canyon Project Reservoir, or as an alternative, implement measures that improve temperatures in tributaries to the reservoir.

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 at Box Canyon Dam (operational in 2016), a total dissolved gas bypass at Box Canyon Dam (operational in 2015), a downstream fish passage pumping facility at the Calispell Creek Pumping Plant (operational in 2017), and an upstream fish passage 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 up to the 60% design level. Efforts will continue on final design development and construction permitting, working collaboratively with local, state, and federal, regulators to start construction early in 2015.

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, which will be approximately 25 years. The first instream construction project occurred on Middle Branch LeClerc Creek in 2011, with work continuing until 164 miles of stream improvements are completed. In 2013, projects were completed on North Fork Calispell Creek, White Man Creek, and the upper section of Middle Branch LeClerc Creek.

The FERC issued license for Box Canyon Dam also includes components to enhance, create, maintain, and monitor wildlife habitats within the project boundary. We also monitor many different types of wildlife within the project boundary and report 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, and many of the wildlife areas and their newly created enhancements are being used by many species.



Stream Enhancement Work

Water Systems

Nine community water systems, which provide quality drinking water to 584 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.

Water system improvement projects are primarily funded by federal and state grants and/or low-interest loans. The Metaline Falls Water System, which is the oldest and largest of the District's water systems, has been a priority for improvement efforts for several years. In 2014, the District will complete a \$900,000 Department of Health grant for additional improvements which consisted primarily of the replacement of approximately 7,000 feet of transmission lines.



Metaline Falls Water Filtration Plant

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 2013 water usage efficiency information is as follows:

System	Customers	Gallons Produced	Gallons Sold	Unaccounted for Water
Riverbend	77	2,616,196	2,519,386	3.7%
Sunvale	63	2,560,200	2,442,160	4.6%
Sandy Shores	71	3,866,800	4,152,470	-7.4%
Metaline Falls	162	20,415,748	16,373,621	19.8%

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.

Community Network System

The District sells broadband on a wholesale basis. While the District owns the infrastructure, private sector Retail Service Providers (RSP's) provide actual services to the customers. The District's Community Network System (CN System or CNS) sells connectivity to the RSP, who in turn sells Internet and other services to the retail customer.

For the past three years, the District has been greatly expanding its fiber optic footprint in the southern half of Pend Oreille County. Construction of the American Recovery and Reinvestment Act Fiber-to-the-Premise Project wrapped up in 2013. We are now enjoying stories of the changes fiber has made in the lives of our community including members of the workforce who can now live and work in Pend Oreille County, entrepreneurs with the opportunity to establish a home business, and families that are able to bridge the miles using the Internet to communicate through voice and video. This project was not done to make a profit, but rather to provide a service to the community. The success stories are heartwarming and reaffirm that the challenge of bringing fiber optic to the county, to enrich the lives of the people we serve, was the right thing to do.

The project encompassed installation of 388 miles of overhead and 185 miles of underground backbone and distribution cables. The District also installed slightly more than 20 miles of service drop cables (the distance from the street to the home or business premise), both overhead and underground. By year end, we had completed fiber installation to 3,350 premises. Of this number, 1,014 customers requested service through our RSP's, and we had connected 768 of these customers by year end. These customer connections are continuing into 2014.

Deployment of Internet services has gone well, with minimal issues and very few service outages. The CN System network has proven to be both stable and reliable. The District is receiving almost no customer complaints; those that have been received tend to relate to premise landscaping issues, not reliability or Internet service quality. Customers are very impressed with the 100 megabit broadband connectivity speed, which is fully available both upstream and down. Internet Protocol Television (IPTV) is being tested at several homes with the goal of having it available for our RSP's to market early in 2014.

The Community Network System has provided business class broadband transport and bandwidth for more than a decade and now provides a last mile network infrastructure for residential customers that offers services rarely seen in other rural communities.

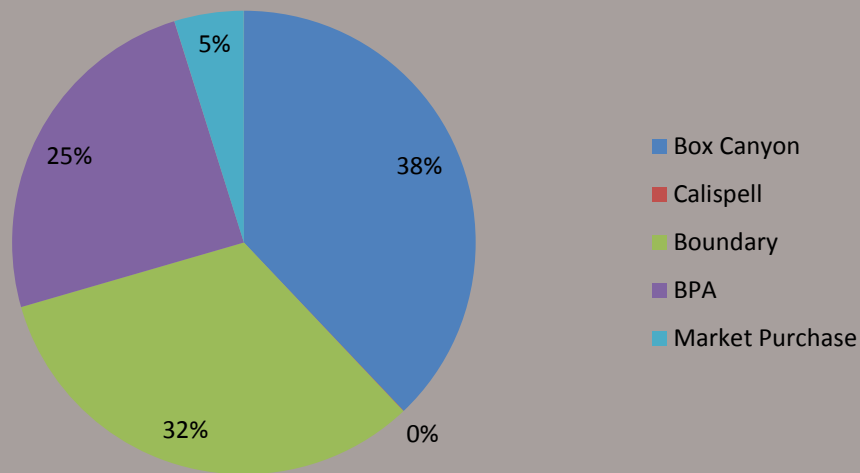


Fiber Optic Installation

Energy Resources

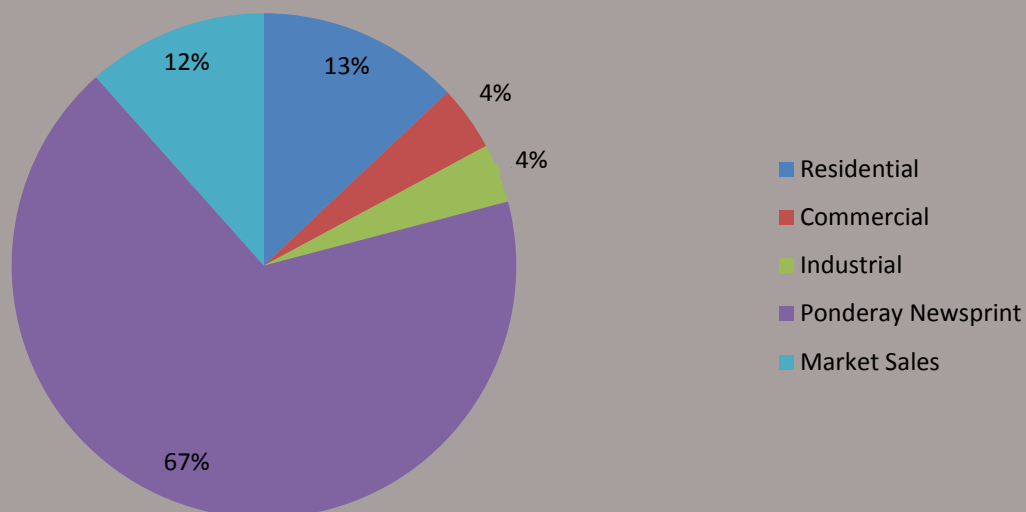
In 2013, the District sold 1,148,012 megawatts (MW) of electricity. Of that total, 38 percent came from Box Canyon Dam and the Calispell Hydro Plant, which are District-owned resources. The remaining electric resources were acquired from Boundary Dam owned by Seattle City Light, and Bonneville Power Administration (BPA).

2013 Energy Resources



Sixty-seven percent of the District's area load is created by its largest customer, Ponderay Newsprint Company, which carries a paper machine and fiber mill load, located in Usk, Washington. Approximately 12 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.

2013 Area Load



2013 District Highlights

Electric System

Number of Electric Customers:	8,818
Residential Electric Rate:	\$0.0472 per kWh, plus \$24.50 monthly base charge
Average Annual Residential Customer Use:	18,084 kWh
Average Energy Load:	116,186 kw
Peak Energy Load:	153,480 kw



Water System

Number of Water Customers:	584
Number of Individual Systems:	9
Total Gallons Sold:	37,213,648
Average Annual Water Usage:	63,722 gallons



Box Canyon Hydroelectric Project

Energy Available:	438,547,280 kWh
Nameplate Capacity:	69.5 Mw
Mill Rate:	41.27 mills
Location:	Pend Oreille River Mile 34.41, near Ione



Calispell Hydroelectric Project

Energy Available:	369,000 kWh
Nameplate Capacity:	.750 Mw
Mill Rate:	169.15 mills
Location:	Approximately 15 miles northwest of Newport, in the Calispell Valley



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, 2013 and 2012, the individual statements of net position of the Electric, Box Canyon Production, Water, and Community Network Systems as of December 31, 2013, the related combined statements of revenues, expenses, and changes in net position and of cash flows for the years ended December 31, 2013 and 2012, 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, 2013, 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, 2013 and 2012, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

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.

A handwritten signature in dark ink, appearing to read "Moss Adams LLP", with a stylized flourish at the end.

Seattle, Washington
March 7, 2014

MANAGEMENT'S DISCUSSION AND ANALYSIS

The financial management of the 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, 2013 and 2012. 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.

Summary of Financial Condition

During 2013, the District's overall financial position improved. Total net position for the District increased \$8.57 million to \$136,889,188 as the District prepares to bring several large multi-year construction projects to completion.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Capital Projects

Box Canyon Hydroelectric Project - The District is upgrading the four turbines at its Box Canyon Hydroelectric Project (Project) as defined in the Project's 50-year Federal Energy Regulatory Commission (FERC) license, issued in 2005. The District completed construction on the third of four units in December 2013, and anticipates completing the final unit in late 2014. Each new turbine and associated generator output capacity is projected at 22.5 megawatts, an increase of 4.5 megawatts per turbine, and is currently estimated at \$100 million to complete. 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.

Community Network System ARRA Project - The District's Community Network System is completing 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 residential homes and businesses. Grant proceeds were approximately \$27 million, or 80% of the original \$34 million project estimate. At the grant's closing date of September 30, 2013, the total project cost had grown to approximately \$38 million. The Community Network System has utilized intersystem loans to provide cash for matching funds and to complete the project. The initial customer participation for the project has been 25%, which was above expectations, and the Community Network System has experienced growth in its legacy commercial product, both of which have improved the Community Network System's future revenue projections over original estimates. 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.

Sullivan Creek Cold Water Pipe Project - The District owns a water storage facility on Sullivan Lake in north Pend Oreille County. Upon the expiration of the facility's FERC license in 2008, the District engaged in a decommissioning process with several agencies. As a result of negotiations, the District will construct a cold water pipe in Sullivan Lake, which will 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 Project. Seattle City Light agreed to pay half of the \$4.5 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.

Concurrent with the construction of the cold water pipe process, the District signed an agreement with the Washington State Department of Ecology Office of Columbia River to release increased volumes of water from Sullivan Lake during the spring and summer to enable better water usage for communities along the Columbia River. The Office of Columbia River has obligated to pay \$14 million upfront for these releases of water, which are expected to continue over the next 30 years.

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

Combined statement of net position information as of December 31, 2013, 2012, and 2011:

	2013	2012	2011
ASSETS			
Current assets	\$ 99,597,556	\$ 126,547,654	\$ 109,794,123
Other assets	5,491,384	4,986,672	2,346,321
Net utility plant	235,885,984	214,802,444	170,134,593
Total assets	340,974,924	346,336,770	282,275,037
DEFERRED OUTFLOWS OF RESOURCES	127,409	229,218	4,950,917
Total assets and deferred outflows of resources	<u>\$ 341,102,333</u>	<u>\$ 346,565,988</u>	<u>\$ 287,225,954</u>
LIABILITIES			
Current liabilities	\$ 22,655,882	\$ 33,779,785	\$ 28,218,395
Other liabilities	23,490,015	18,123,506	17,757,169
Long-term debt	158,067,248	166,346,219	133,654,075
Total liabilities	204,213,145	218,249,510	179,629,639
NET POSITION			
Invested in capital assets, net of related debt	109,295,771	100,028,720	72,161,063
Restricted	22,034,253	19,405,867	16,867,675
Unrestricted	5,559,164	8,881,891	18,567,577
Total net position	136,889,188	128,316,478	107,596,315
Total net position, liabilities, and deferred inflows of resources	<u>\$ 341,102,333</u>	<u>\$ 346,565,988</u>	<u>\$ 287,225,954</u>

The District expended \$11 million for Box Canyon turbine project upgrades in 2013, and over \$21 million in 2012. As each turbine is replaced, the District has retired the original turbine at a cost of approximately \$1.5 million, offsetting the net increase in net utility plant. \$20.4 million was spent on the Community Network System ARRA project in 2012, and \$7.7 million was spent in 2013 to complete the project. \$749,357 was spent on a Washington State Department of Health grant project for the District's Metaline Falls Water System in 2013. Total funds spent on the project over the two-year period ending in 2013 totaled \$809,325, representing a fairly significant 10% growth in gross utility plant for the Water System. Gross utility plant growth in the Electric System was \$3.5 million and \$3.9 million for 2013 and 2012, respectively, representing fairly normal annual construction expenditures for the Electric System.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

The District issued \$38 million in revenue bonds in October 2012 to help fund the Box Canyon turbine upgrade project. Approximately \$20 million of those funds were spent in 2013, accounting for much of the fluctuation in the District's current asset balances from 2011 to 2013. The ARRA Project was funded primarily through grant funds that were distributed on a reimbursement basis.

The District received \$2.5 million in September 2013 as the first of three payments from the Office of Columbia River to satisfy their obligation to pay for water releases from the District's Sullivan Project (see Note 8). This payment was recorded as unearned revenue and will amortize in amount equal to the net cash outflow for Sullivan Project related activities each year. Further payments are expected to be received in the next two years (see Note 1).

Electric System Operating Results

	2013	2012	2011
Electric operating revenues			
Ponderay Newsprint Company	\$ 30,309,544	\$ 30,387,376	\$ 26,944,338
Other retail customers	13,336,214	12,456,448	12,190,672
Sales to other utilities	3,919,890	2,644,550	4,673,926
All other	1,091,979	681,254	719,469
Total operating revenues	48,657,627	46,169,628	44,528,405
Electric operating expenses			
Power costs	30,849,518	28,232,963	27,684,535
All other	14,233,669	14,127,302	13,340,121
Total operating expenses	45,083,187	42,360,265	41,024,656
Net operating revenues	3,574,440	3,809,363	3,503,749
NONOPERATING EXPENSES	(958,656)	(1,126,131)	(1,092,080)
CHANGE IN NET POSITION	\$ 2,615,784	\$ 2,683,232	\$ 2,411,669
DEBT SERVICE COVERAGE	2.97x	1.68x	1.63x

Operating Revenues

Ponderay Newsprint Company is the District's largest customer, representing 76% of the District's retail energy usage in 2013 with 765,225 megawatts of consumption, compared to 774,568 and 755,387 megawatts in 2012 and 2011, 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.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Other retail customer revenues, which represent all retail energy customers other than Ponderay Newsprint Company, increased in 2013, mostly due to a mid-year rate increase of approximately 1.95% for all customer classes. Retail customer load for 2013 was 233,575 megawatts, compared to 225,236 and 236,761 megawatts for 2012 and 2011, respectively. The number of District residential energy customers has stayed relatively even over the past three years, with an average of 7,912 residential customers in 2013, 7,896 in 2012, and 7,921 in 2011. The District's historical growth averaged approximately 2% per year through 2008. The national economic downturn affected local businesses, including a large mining operation, and the District has seen an increased amount of account closures with no replacement. Total residential growth over the last 5-year period has been 1.2%.

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 increases compared to other utilities across the nation. The District's current blended residential rate is 6.3 cents per kilowatt.



Energy Resources and Power Costs

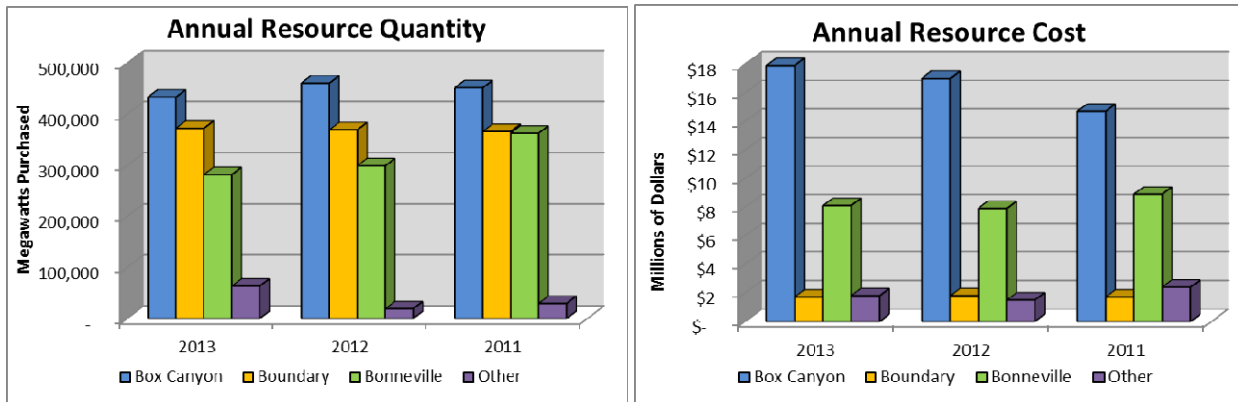
The cost of power from the Box Canyon Hydroelectric Project increased in recent years as a result of debt service associated with turbine upgrades and plant modernization efforts, as well as FERC license compliance obligations. Additionally, power generation varies with water flows and capacity increases as the turbine upgrade work continues. The cost of generating Box Canyon power averaged \$41 per megawatt hour in 2013, \$37 in 2012, and \$32 in 2011.

The District receives 48 megawatts of power capacity from the City of Seattle's Boundary Hydroelectric Project. At less than \$5 per megawatt hour in 2013, 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 \$29 per megawatt hour in 2013, \$26 in 2012, and \$25 in 2011. The District receives an average of 29 megawatts from Bonneville, delivered in monthly block amounts that vary month to month based on the District's expected energy needs.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

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

All other operating expenses include operations and maintenance, administrative and general, taxes, and depreciation, the balances of which increase slightly, reflecting normal fluctuations and higher depreciation expense.

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 and 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.

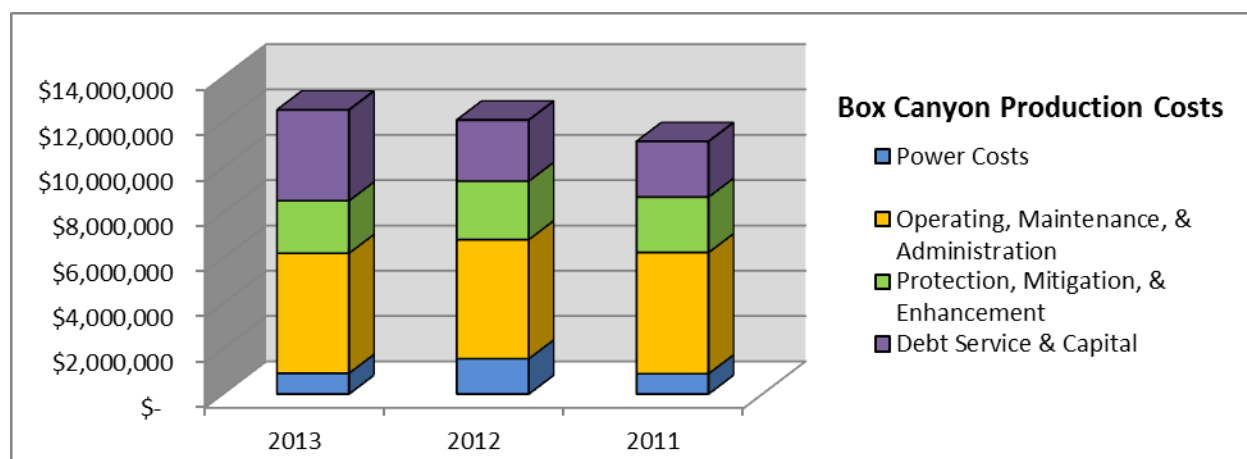
The District's bonds are currently rated by Moody's Investor Services and Fitch Ratings, which have assigned ratings to the District's bonds of A3 and A-, respectively. Moody's Investor Services improved the District's rating in 2012 by removing the negative outlook they had previously assigned to the 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.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**Box Canyon Production System Operating Results**

	2013	2012	2011
Production operating revenues			
Sales to Electric System	\$ 18,097,510	\$ 17,257,548	\$ 14,847,710
All other	59,945	7,097	1,448,319
Total operating revenues	18,157,455	17,264,645	16,296,029
Production operating expenses	11,459,851	11,977,507	11,032,364
Net operating revenues	6,697,604	5,287,138	5,263,665
NONOPERATING EXPENSES	(4,421,845)	(4,633,974)	(3,754,638)
CHANGE IN NET POSITION	\$ 2,275,759	\$ 653,164	\$ 1,509,027
DEBT SERVICE COVERAGE	1.05x	1.12x	1.17x

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. Thus, firm-up power purchases vary with annual Pend Oreille River flows, do not occur in all years, and totaled \$917,434, \$1,533,458, and \$896,159 in 2013, 2012, and 2011, 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 2013 consisted of cultural studies, stream rehabilitation work, and fish studies done in the Pend Oreille River. Other costs, such as operations, maintenance, and administrative costs, have been relatively consistent from 2011 to 2013.



MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

The increase in nonoperating expenses relates to increased interest expense, net of allowance for funds used during construction (AFUDC), and capitalized interest associated with financing the Box Canyon capital project work.

As 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.

Water System Operating Results

	2013	2012	2011
Water operating revenues			
Sales to retail customers	\$ 407,931	\$ 393,888	\$ 398,397
All other	13,152	26,990	11,614
Total operating revenues	421,083	420,878	410,011
Water operating expenses	559,747	560,903	537,566
Net operating expenses	(138,664)	(140,025)	(127,555)
NONOPERATING REVENUES	742,205	51,945	1,031,791
CHANGE IN NET POSITION	<u>\$ 603,541</u>	<u>\$ (88,080)</u>	<u>\$ 904,236</u>

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 \$749,357, \$59,968, and \$1,041,145 are included in nonoperating revenue for 2013, 2012, and 2011, respectively, which were used to improve infrastructure.

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

	2013	2012	2011
Community Network operating revenue			
Sales to retail customers	\$ 733,566	\$ 493,590	\$ 444,460
Intersystem sales	303,168	210,480	218,264
All other	63,142	172,478	42,728
Total operating revenues	1,099,876	876,548	705,452
Operating expenses	964,366	775,250	754,840
Net operating revenues (expenses)	135,510	101,298	(49,388)
NONOPERATING REVENUES	2,942,116	17,370,549	6,225,900
CHANGE IN NET POSITION	\$ 3,077,626	\$ 17,471,847	\$ 6,176,512

Prior to the receipt of an ARRA grant to build fiber to the home, the Community Network System sales were made to businesses rather than residential consumers. Sales in 2012 and 2011 were exclusively made under this business product. Revenues for this product in 2013 were \$660,118. With the completion of the ARRA grant, residential services began, adding \$73,448 to revenue in 2013. 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.

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.

MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

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. If you have questions about this report, or require 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,	
					2013	2012
CURRENT ASSETS						
Cash and cash equivalents	\$ 13,395,986	\$ 8,112,569	\$ -	\$ 460,374	\$ 21,968,929	\$ 26,775,853
Restricted cash and cash equivalents	17,161,330	55,485,636	-	-	72,646,966	79,987,231
Restricted short-term investment	-	-	-	-	-	10,060,868
Receivables						
Accounts and contracts, net	1,070,901	-	25,499	131,322	1,227,722	2,455,755
Other	285,791	125,911	134,499	22,589	568,790	4,415,561
Unbilled revenue	1,031,057	-	-	-	1,031,057	722,764
Materials and supplies	1,589,947	-	40,009	158,146	1,788,102	1,783,711
Prepaid expenses and other	317,402	48,588	-	-	365,990	345,911
Due from other systems	292,962	175,535	-	-	-	-
Total current assets	35,145,376	63,948,239	200,007	772,431	99,597,556	126,547,654
NONCURRENT ASSETS						
Contracts and notes receivable	3,781,847	-	-	-	-	-
Nonutility plant	468,384	-	-	-	468,384	290,541
Licensing costs - regulatory asset	-	5,023,000	-	-	5,023,000	4,696,131
Long-term intersystem investment	-	5,060,151	-	-	-	-
Total noncurrent assets	4,250,231	10,083,151	-	-	5,491,384	4,986,672
UTILITY PLANT						
Land and land rights	3,271,177	784,295	77,305	61,721	4,194,498	4,179,012
Hydroelectric plant and equipment	1,326,376	111,737,546	-	-	113,063,922	92,724,890
Structures, building, and equipment	105,617,758	-	7,766,857	42,371,663	155,756,278	115,954,188
Intangible assets	422,265	13,219,176	742	-	13,642,183	13,431,970
Construction work in progress	1,871,639	19,858,730	799,927	34,920	22,565,216	56,848,984
	112,509,215	145,599,747	8,644,831	42,468,304	309,222,097	283,139,044
Less accumulated depreciation and amortization	50,029,903	17,120,401	2,761,465	3,424,344	73,336,113	68,336,600
Net utility plant	62,479,312	128,479,346	5,883,366	39,043,960	235,885,984	214,802,444
Total assets	101,874,919	202,510,736	6,083,373	39,816,391	340,974,924	346,336,770
DEFERRED OUTFLOWS OF RESOURCES						
Loss on refinancing of debt	127,409	-	-	-	127,409	229,218
Total deferred outflows of resources	127,409	-	-	-	127,409	229,218
Total assets and deferred outflows of resources	\$ 102,002,328	\$ 202,510,736	\$ 6,083,373	\$ 39,816,391	\$ 341,102,333	\$ 346,565,988

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,	
					2013	2012
CURRENT LIABILITIES						
Accounts payable	\$ 3,978,774	\$ 3,473,542	\$ 29,963	\$ 403,309	\$ 7,885,588	\$ 19,200,912
Accrued compensation and benefits	1,939,597	-	-	-	1,939,597	2,027,140
Accrued taxes	912,007	93,849	1,629	1,030	1,008,515	1,021,509
Customer prepayments and deposits	949,333	-	3,831	12,238	965,402	837,704
Accrued bond interest	550,422	3,786,623	1,554	-	4,338,599	4,109,124
Current portion of long-term debt	1,373,333	3,510,714	37,591	175,535	4,921,638	4,756,638
Current portion of licensing cost liability	-	1,596,543	-	-	1,596,543	1,826,758
Due to other systems	-	-	279,629	13,333	-	-
Total current liabilities	9,703,466	12,461,271	354,197	605,445	22,655,882	33,779,785
OTHER LIABILITIES						
Unearned revenue	2,466,762	-	-	4,465,784	3,297,366	880,193
Licensing costs liability	-	5,023,000	-	-	5,023,000	4,696,131
Contract security liability	10,014,152	5,155,497	-	-	15,169,649	12,547,182
Total other liabilities	12,480,914	10,178,497	-	4,465,784	23,490,015	18,123,506
LONG-TERM DEBT						
Revenue bonds	21,802,665	135,869,955	-	5,060,151	157,672,620	165,900,666
Other long-term debt	146,667	-	247,961	-	394,628	445,553
Due to other systems	-	-	-	146,667	-	-
Total long-term debt	21,949,332	135,869,955	247,961	5,206,818	158,067,248	166,346,219
Total liabilities	44,133,712	158,509,723	602,158	10,278,047	204,213,145	218,249,510
COMMITMENTS AND CONTINGENCIES						
NET POSITION						
Net investment in capital assets	39,440,471	25,360,193	5,597,814	33,661,607	109,295,771	100,028,720
Restricted for						
Sullivan contract obligation	2,466,977	-	-	-	2,466,977	-
Debt service	4,129,779	15,437,497	-	-	19,567,276	19,405,867
Total restricted	6,596,756	15,437,497	-	-	22,034,253	19,405,867
Unrestricted	11,831,389	3,203,323	(116,599)	(4,123,263)	5,559,164	8,881,891
Total net position	57,868,616	44,001,013	5,481,215	29,538,344	136,889,188	128,316,478
Total liabilities and net position	\$ 102,002,328	\$ 202,510,736	\$ 6,083,373	\$ 39,816,391	\$ 341,102,333	\$ 346,565,988

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,	
					2013	2012
OPERATING REVENUES						
Sales to retail customers						
Ponderay Newsprint Company	\$ 30,309,544	\$ -	\$ -	\$ -	\$ 30,309,544	\$ 30,387,376
Other retail customers	13,336,214	-	407,931	733,566	14,477,711	13,343,926
Sales to other utilities	3,919,890	-	-	-	3,919,890	2,644,550
Intersystem sales	141,513	18,097,510	-	303,168	-	-
Contributed capital	644,963	-	477	42,582	688,022	329,350
Grant revenues	-	7,847	-	17,882	25,729	177,451
Other	305,503	52,098	12,675	2,678	145,674	108,113
Total operating revenue	48,657,627	18,157,455	421,083	1,099,876	49,566,570	46,990,766
OPERATING EXPENSES						
Power costs	30,849,518	917,434	-	-	13,669,442	12,508,368
Operations and maintenance	5,286,827	5,364,862	267,432	651,831	11,217,071	11,148,985
Administrative and general	3,065,641	2,248,467	48,553	45,951	5,090,532	5,439,959
Taxes	2,393,987	99,185	20,629	5,455	2,519,256	2,449,057
Depreciation and amortization	3,487,214	2,829,903	223,133	261,129	6,801,379	6,386,623
Total operating expenses	45,083,187	11,459,851	559,747	964,366	39,297,680	37,932,992
Net operating revenues (expenses)	3,574,440	6,697,604	(138,664)	135,510	10,268,890	9,057,774
NONOPERATING REVENUES (EXPENSES)						
Interest income	109,809	125,088	137	2,170	225,154	239,139
Interest on debt	(1,254,861)	(7,445,973)	(6,858)	(559)	(8,708,251)	(8,027,336)
AFUDC interest	12,233	857,711	-	-	869,944	527,276
Grant revenues	-	-	749,357	2,943,703	3,693,060	17,430,475
Sullivan net revenue	177,844	-	-	-	177,844	53,106
Other, net	(3,681)	2,041,329	(431)	(3,198)	2,046,069	1,439,729
Total nonoperating revenues (expenses)	(958,656)	(4,421,845)	742,205	2,942,116	(1,696,180)	11,662,389
CHANGE IN NET POSITION	2,615,784	2,275,759	603,541	3,077,626	8,572,710	20,720,163
ACCUMULATED NET POSITION						
Beginning of year	55,252,832	41,725,254	4,877,674	26,460,718	128,316,478	107,596,315
End of year	\$ 57,868,616	\$ 44,001,013	\$ 5,481,215	\$ 29,538,344	\$ 136,889,188	\$ 128,316,478

COMBINED STATEMENTS OF CASH FLOWS

	Electric System	Box Canyon Production System	Water System	Community Network System	Combined Total Years Ended December 31,	
					2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES						
Receipts from customers	\$ 49,868,634	\$ -	\$ 411,286	\$ 669,727	\$ 50,949,647	\$ 44,122,118
Receipts from other operating revenues	22,040	(60,469)	-	17,882	(20,547)	211,202
Payments to suppliers for goods and services	(20,419,183)	(12,046,875)	(128,921)	(315,572)	(32,910,551)	(25,593,358)
Payments to employees for services	(5,447,471)	(4,037,275)	(176,970)	(277,825)	(9,939,541)	(9,575,063)
Payments to (from) other systems	(18,004,687)	17,822,677	(14,255)	196,265	-	-
Net cash from operating activities	6,019,333	1,678,058	91,140	290,477	8,079,008	9,164,899
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES						
Nonoperating asset						
Acquisition and construction of long-term asset, net	(165,611)	-	-	-	(165,611)	(48,637)
Receipts from revenues	177,844	-	-	-	177,844	161,710
Payments for goods and services	-	-	-	-	-	(108,604)
Economic development fund						
Awarded to grant applicants	-	-	-	-	-	(20,961)
Intersystem financing	1,382,759	1,995,313	(294)	(3,377,778)	-	-
Net cash from noncapital financing activities	1,394,992	1,995,313	(294)	(3,377,778)	12,233	(16,492)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES						
Acquisition and construction of capital assets	(3,104,581)	(11,655,621)	(750,971)	(8,147,657)	(23,658,830)	(35,858,944)
Proceeds from grants	-	-	704,789	6,506,998	7,211,787	15,716,876
Change of deferred revenue	2,466,172	-	-	(49,588)	2,416,584	(49,588)
Proceeds from issuance of revenue bonds	-	-	-	5,250,000	-	38,000,000
Cost of issuance of long-term debt	-	-	-	-	-	(517,015)
Payments on revenue bonds	(6,025,000)	(1,735,714)	-	(14,314)	(7,760,714)	(3,955,714)
Interest paid on revenue bonds	(1,461,500)	(7,210,169)	-	-	(8,671,669)	(7,751,069)
Scheduled payments on notes payable	(13,333)	-	(37,592)	-	(50,925)	(50,924)
Interest paid on notes payable	-	-	(7,072)	-	(7,072)	(7,927)
Net cash from capital and related financing activities	(8,138,242)	(20,601,504)	(90,846)	3,545,439	(30,520,839)	5,525,695
CASH FLOWS FROM INVESTING ACTIVITIES						
Purchases of investments	(23,870,769)	(5,250,000)	-	-	(23,870,769)	(13,865,746)
Sales and maturities of investments	33,824,544	14,314	-	-	33,824,544	8,904,000
Loss on investment	123,635	-	-	-	123,635	1,736
Interest on investments, contracts, and notes	80,783	121,980	-	2,236	204,999	186,399
Net cash from investing activities	10,158,193	(5,113,706)	-	2,236	10,282,409	(4,773,611)
NET CHANGE IN CASH AND CASH EQUIVALENTS	9,434,276	(22,041,839)	-	460,374	(12,147,189)	9,900,491
CASH AND CASH EQUIVALENTS						
Beginning of year	21,123,040	85,640,044	-	-	106,763,084	96,862,593
End of year	\$ 30,557,316	\$ 63,598,205	\$ -	\$ 460,374	\$ 94,615,895	\$ 106,763,084
SUPPLEMENTAL DISCLOSURE OF NONCASH FINANCING ACTIVITIES						
Accrued capital construction costs	\$ -	\$ (8,242,853)	\$ -	\$ -	\$ (8,242,853)	\$ 3,240,298

See accompanying notes.

COMBINED STATEMENTS OF CASH FLOWS (continued)

	Electric System	Box Canyon Production System	Water System	Community Network System	Combined Total Years Ended December 31,	
					2013	2012
RECONCILIATION OF NET OPERATING REVENUES (EXPENSES) TO CASH FLOWS FROM OPERATING ACTIVITIES						
Net operating revenues (expenses)	\$ 3,574,440	\$ 6,697,604	\$ (138,664)	\$ 135,510	\$ 10,268,890	\$ 9,057,774
Adjustments to reconcile net operating revenues (expenses) to net cash from operating activities						
Depreciation and amortization	3,487,214	2,829,903	223,133	263,110	6,803,360	6,386,623
Changes in operating assets and liabilities						
Receivables	1,835,538	(120,414)	1,903	(109,099)	1,607,928	(1,555,327)
Unbilled revenue	(308,293)	-	-	-	(308,293)	185,283
Due to other systems	(4,948)	-	4,948	-	-	-
Materials and supplies	(5,985)	-	917	677	(4,391)	(269,282)
Prepaid expenses and other current assets	(45,941)	2,053,098	-	-	2,007,157	2,022,700
Deferred charges	-	(230,215)	-	-	(230,215)	(123,596)
Accounts payable, customer deposits, and prepayments	(2,418,156)	(9,545,831)	(1,100)	196	(11,964,891)	(6,918,894)
Accrued compensation, benefits, and taxes	(94,536)	(6,087)	3	83	(100,537)	379,618
Net cash from operating activities	<u>\$ 6,019,333</u>	<u>\$ 1,678,058</u>	<u>\$ 91,140</u>	<u>\$ 290,477</u>	<u>\$ 8,079,008</u>	<u>\$ 9,164,899</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 November 2010, the GASB issued Statement No. 61, *The Financial Reporting Entity: Omnibus,—an Amendment of GASB Statements No. 14 and No. 34*. This statement modifies certain requirements and criteria for inclusion of component units in the financial reporting entity. GASB Statement No. 61 is effective for financial statements for periods beginning after June 15, 2012. The District currently has no component units to report, and, therefore, the statement has no reporting impact for the District.

NOTES TO COMBINED FINANCIAL STATEMENTS

Note 1 - Organization and Significant Accounting Policies (continued)

In March 2012, the GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*. This statement provides guidance for reclassifying certain items as deferred outflows of resources or deferred inflows of resources. The statement further requires reclassification of certain items previously recorded as assets and liabilities to be presented as expenses or revenues. The statement is effective for financial statements for periods beginning after December 15, 2012, with the effect of the accounting change to be applied retrospectively by restating previously reported amounts. The District chose to implement this statement early and adopted this new pronouncement as of December 31, 2012. Amounts shown on the combined statements of net position are reported in accordance with GASB Statement No. 65.

In March 2012, the GASB issued Statement No. 66, *Technical Corrections—2012, an amendment of GASB Statements No. 10 and No. 62*, improving the accounting for operating leases, servicing fees, and purchase of a loan or group of loans. This statement is effective for financial statements for periods beginning after December 15, 2012. The District does not engage in material operating leases, servicing fees, or loan purchases, and, therefore, this statement had no reporting impact on the District.

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 April 2013, the GASB issued Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*. This Statement is effective for financial statements for periods beginning after June 15, 2013. Some governments extend financial guarantees for the obligations of another governments or other entities without receiving equal value in exchange. The District does not engage in this activity, and, accordingly, this statement is not applicable to the District.

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 has the same effective date. The District is evaluating the impact of the statements on its combined financial statements.

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.

NOTES TO COMBINED FINANCIAL STATEMENTS

Note 1 - Organization and Significant Accounting Policies (continued)

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.

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.

NOTES TO COMBINED FINANCIAL STATEMENTS

Note 1 - Organization and Significant Accounting Policies (continued)

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 \$830,604 and \$880,193 as of December 31, 2013 and 2012, 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 and \$3,809,648 as of December 31, 2013 and 2012, 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, which was recorded as unearned revenue, and will amortize to nonoperating revenue in an amount equal to the net cash outflow for Sullivan Project related activities each year. The District recognized \$33,828 of revenue in 2013.

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.

Unrestricted net position - Amounts included as unrestricted net position do not meet the definition of either net position invested in capital assets, net of related debt 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.

NOTES TO COMBINED FINANCIAL STATEMENTS

Note 1 - Organization and Significant Accounting Policies (continued)

Derivative instruments - Derivative instruments are recorded on the combined statements of net position as an asset or liability measured at fair value. Changes in fair value are recognized as revenue or expense unless the derivative meets specific hedge accounting criteria to be determined as effective. Changes in fair value for effective hedges are deferred outflows or inflows of resources. For power contracts requiring physical delivery, the District applies the normal purchase and normal sales exception under GASB Statement No. 53. District policy is to avoid derivative instruments excepting special situations as may be approved by the board of commissioners. Accordingly, the District had no derivative instruments in either 2013 or 2012.

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.

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. Accounts that are allocated solely by direction of the District's board of commissioners are considered to be board-designated accounts. Board-designated accounts are reported as unrestricted assets because their use may be redirected at any time by approval of the commissioners.

NOTES TO COMBINED FINANCIAL STATEMENTS

Note 2 - Cash and Investments (continued)

The District's investment portfolio consisted of the following cash and cash equivalents and investments:

	Electric System	Box Canyon Production System	Water System	Community Network System	Combined Total Years Ended December 31,	
					2013	2012
Cash and cash equivalents						
Unrestricted assets						
Revenue funds	\$ 13,395,986	\$ 8,112,569	\$ -	\$ 460,374	\$ 21,968,929	\$ 26,775,853
Restricted assets						
Bond principal and interest	1,910,423	7,662,574	-	-	9,572,997	7,902,213
Bond reserve	2,769,778	11,561,546	-	-	14,331,324	15,611,010
Construction and acquisition	-	36,261,516	-	-	36,261,516	56,405,336
Contract obligation	2,466,977	-	-	-	2,466,977	-
Contract security - money market	10,014,152	-	-	-	10,014,152	68,672
Restricted funds	17,161,330	55,485,636	-	-	72,646,966	79,987,231
Investments						
Contract security						
Short-term investment	-	-	-	-	-	10,060,868
Total funds	\$ 30,557,316	\$ 63,598,205	\$ -	\$ 460,374	\$ 94,615,895	\$ 116,823,952
Cash and cash equivalents, at cost, which approximate market value						
Cash deposits	\$ 23,191,744	\$ 598,205	\$ -	\$ 60,374	\$ 23,850,323	\$ 2,841,400
Local government investment pool	7,365,572	63,000,000	-	400,000	70,765,572	103,921,684
Total cash and cash equivalents	30,557,316	63,598,205	-	460,374	94,615,895	106,763,084
Investments						
U.S. treasuries, short-term, at market	-	-	-	-	-	9,998,635
Accrued interest receivable	-	-	-	-	-	62,233
Total investments	-	-	-	-	-	10,060,868
Total cash and investments	\$ 30,557,316	\$ 63,598,205	\$ -	\$ 460,374	\$ 94,615,895	\$ 116,823,952

Interest rate risk - The District's investment policy limits investment maturities to less than five years from the date of purchase unless authorized by the General Manager and Director of Finance for a specific purpose. During 2013 and 2012, 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.

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.

NOTES TO COMBINED FINANCIAL STATEMENTS

Note 2 - Cash and Investments (continued)

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/lcip/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 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.

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, 2013, was invested in a bank trust department deposit subject to PDPC protection.

NOTES TO COMBINED FINANCIAL STATEMENTS

Note 3 - Utility Plant

The following changes occurred in the District's utility plant for the years ended December 31, 2013 and 2012:

	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>
	2011 Balance	Additions	Retirements/ Transfers	2012 Balance
Land and land rights	\$ 3,668,756	\$ 1,700	\$ 508,556	\$ 4,179,012
Hydroelectric plant and equipment	63,976,001	4,055,505	24,693,384	92,724,890
Structures, buildings, and equipment	114,011,122	138,043	1,805,023	115,954,188
Intangible assets	12,690,588	5,074	736,308	13,431,970
Construction work in progress	38,987,870	43,976,156	(26,115,042)	56,848,984
	233,334,337	48,176,478	1,628,229	283,139,044
Less accumulated depreciation and amortization	63,199,744	6,554,931	(1,418,075)	68,336,600
Net utility plant	<u>\$ 170,134,593</u>	<u>\$ 41,621,547</u>	<u>\$ 3,046,304</u>	<u>\$ 214,802,444</u>

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 December 31, 2013 and 2012, were \$12,472,232 and \$12,468,715, with accumulated amortization of \$2,119,273 and \$1,839,689, respectively.

NOTES TO COMBINED FINANCIAL STATEMENTS

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 has an unamortized balance of \$94,464 as of December 31, 2013, which is amortized using the effective interest method over the life of the remaining 2005 Series B bonds. The bonds are recorded in the combined statements of net position net of unamortized premium of \$85,069 for both the Series A and Series B bonds as of December 31, 2012, and \$45,682 for the Series B bonds as of December 31, 2013.

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 bonds are recorded in the combined statements of net position net of unamortized premium of \$346,983 and \$471,943 as of December 31, 2013 and 2012, 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.

NOTES TO COMBINED FINANCIAL STATEMENTS

Note 4 - Long-Term Debt (continued)

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 \$645,577 and \$801,725 as of December 31, 2013 and 2012, 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 \$400,565 and \$409,781 as of December 31, 2013 and 2012, 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 \$185,057 and \$194,005 as of December 31, 2013 and 2012, 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.

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.

NOTES TO COMBINED FINANCIAL STATEMENTS

Note 4 - Long-Term Debt (continued)

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, which was an average of 0.1399% for the year ended December 31, 2013. Monthly principal payments began December 31, 2013, and are due through November 30, 2033.

During the years ended December 31, 2013 and 2012, the following changes occurred in the District's long-term debt:

	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>
	2011 Balance	Additions	Reductions	2012 Balance	Due Within One Year
Revenue bonds, face amount	\$ 135,807,144	\$ 38,000,000	\$ 3,955,714	\$ 169,851,430	\$ 4,705,714
Unamortized bond premium	1,724,676	-	365,939	1,358,737	-
Unamortized bond discount	(418,508)	(195,452)	(10,173)	(603,787)	-
Other long-term debt	547,401	-	50,924	496,477	50,924
Total debt	<u>\$ 137,660,713</u>	<u>\$ 37,804,548</u>	<u>\$ 4,362,404</u>	<u>\$ 171,102,857</u>	<u>\$ 4,756,638</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 12/31/13*
Principal					
2014	\$ 1,373,333	\$ 3,510,714	\$ 37,591	\$ 175,535	\$ 4,921,638
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	37,592	205,938	6,631,639
2019 - 2023	4,486,665	20,012,146	91,963	1,162,591	24,590,774
2024 - 2028	4,681,670	22,745,000	5,635	1,419,517	27,432,305
2029 - 2033	3,390,000	26,265,000	-	1,701,412	29,655,000
2034 - 2038	-	32,695,000	-	-	32,695,000
2039 - 2042	-	19,400,000	-	-	19,400,000
	<u>\$ 22,930,000</u>	<u>\$ 139,320,716</u>	<u>\$ 285,552</u>	<u>\$ 5,235,686</u>	<u>\$ 162,536,268</u>
Interest					
2014	\$ 1,073,645	\$ 7,540,619	\$ 6,214	\$ 6,589	\$ 8,620,478
2015	1,005,789	7,449,075	5,360	6,361	8,460,224
2016	916,749	7,343,597	4,503	6,123	8,264,849
2017	817,596	7,223,851	3,648	5,875	8,045,095
2018	695,038	7,091,861	2,791	5,618	7,789,690
2019 - 2023	2,504,250	33,111,692	3,520	23,843	35,619,462
2024 - 2028	1,452,375	27,892,997	114	15,634	29,345,486
2029 - 2033	259,750	20,590,372	-	5,611	20,850,122
2034 - 2038	-	11,417,363	-	-	11,417,363
2039 - 2042	-	1,519,545	-	-	1,519,545
	<u>\$ 8,725,192</u>	<u>\$ 131,180,972</u>	<u>\$ 26,150</u>	<u>\$ 75,654</u>	<u>\$ 139,932,314</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 2013, approximately 76% of Electric System retail energy deliveries and 69% 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 March 20, 2013, in which the District was no longer granted a license share. Seattle City Light had agreed to extend the District's previous rights into the new license period in exchange for the District's aid in Seattle City Light's relicensing efforts, and both parties are currently engaged in finalizing a new agreement that extends through the current license period. Power deliveries continue to be capped at a 48-megawatt capacity, delivered at cost, and the District expects these parameters to continue in the next agreement.

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%. The District now receives all of its average 29 megawatts through Shaped Block purchases. In February 2014, the District received notice from BPA that the District's load levels had not recovered sufficiently during a three-year provisional period, possibly forcing the District into Tier 2 market-based rates for power purchases exceeding a base load calculation done in 2010. The District is currently evaluating the effect of this notification.

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 web site, 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.

	2013	2012	2011
Employee contribution %			
Plan 1	6.00%	6.00%	6.00%
Plan 2	4.64% - 4.92%	4.64% - 5.00%	3.90% - 4.64%
Plan 3	5.00% - 15.00%	5.00% - 15.00%	5.00% - 15.00%
Employer contribution %			
Plan 1	7.21% - 9.21%	7.08% - 7.25%	5.31% - 7.25%
Plan 2	7.21% - 9.21%	7.08% - 7.25%	5.31% - 7.25%
Plan 3	7.21% - 9.21%	7.08% - 7.25%	5.31% - 7.25%
Contribution dollars			
Employee	\$ 403,996	\$ 401,781	\$ 342,474
Employer	688,211	614,712	495,110
	<u>\$ 1,092,207</u>	<u>\$ 1,016,493</u>	<u>\$ 837,584</u>
PERS covered payroll	<u>\$ 8,342,466</u>	<u>\$ 8,552,316</u>	<u>\$ 7,830,011</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 2013 and 2012 were \$148,046 and \$142,752, 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 choose to continue medical coverage under the District's plan do so primarily at their own cost, but are eligible to receive between \$10 and \$6 per year of service, per month, toward postemployment medical premiums if they retired prior to August 1, 2013. The reimbursement begins at the later of the month of retirement or at age 60 and expires when the retiree reaches age 65. The dollar value of the reimbursement decreased to \$5 effective August 1, 2013, and drops by \$1 annually thereafter, reaching zero on August 1, 2018. The estimated liability for this benefit as of December 31, 2013 and 2012, is \$73,413 and \$92,562, respectively. The District has elected to finance this plan under a pay-as-you-go method, disbursing \$184 for the year ended December 31, 2012. 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	
	2013	2012	2013	2012
Electric System	\$ 131,211	\$ 95,535	\$ 35,686	\$ 45,251
Box Canyon Production System	48,748	36,768	138,971	177,074
Water System	5,853	4,355	2,952	3,734
Community Network System	9,920	4,871	539	686
	<u>\$ 195,732</u>	<u>\$ 141,529</u>	<u>\$ 178,148</u>	<u>\$ 226,745</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 February 1, 2052. 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 \$99.5 million in construction funds have been expended on the project through 2013, with approximately \$36 million in borrowed funds left to complete the project. The fourth and final turbine replacement began in December 2013, with expected completion of the project in November 2014. The District anticipates that at the conclusion of the project, there will be an estimated \$10 million in borrowed funds to use on fish passage and total dissolved gas construction projects.

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 2014. 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 2012 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 \$214,966 and \$214,995 in 2013 and 2012, 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 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 2014, 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. Subsequent payments are expected in the next two years, with the majority of the money disbursed after completion of the cold water pipe, which is 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 from the first payment were recorded as unearned revenue and will amortize in 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 \$187,465 and \$183,663 under the terms of this agreement for 2013 and 2012, 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 1,000 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 \$8,185,000 outstanding as of December 31, 2013, is \$320,034, with a maximum exposure of \$400,042 in the event other members fail to honor their guarantees.

In November 2008, NoaNet established a \$1.5 million variable rate, junior lien, nonrevolving line of credit that had a balance outstanding of \$300,000 as of December 31, 2012. This line of credit was repaid in full during 2013.

In August 2009, NoaNet established a \$1.5 million variable rate, junior lien, nonrevolving line of credit that has a balance outstanding of \$166,667 and \$500,000 as of December 31, 2013 and 2012, respectively. The District has guaranteed its 3.94% ownership share of this line of credit.

In October 2012, NoaNet established a \$5 million variable rate, junior lien, nonrevolving line of credit that has a balance outstanding of \$5 million and \$756,400 as of December 31, 2013 and 2012, respectively. The District has guaranteed its 3.94% ownership share of this line of credit.

In 2012, NoaNet reported \$772,685 in operating net income, \$276,973 of nonoperating expense, and \$47,213,541 of grant revenue for a total increase in net position of \$47,709,253.

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. \$7,847 and \$5,497 was recorded as grant revenue in 2013 and 2012, respectively; 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 Community Development Block Grant (CDBG) - In 2010, the state awarded the town of Metaline Falls, with the District as subrecipient, a CDBG grant to replace approximately 5,800 feet of water distribution main line, as well as to install water meters, hydrants, and valves. The project was completed in 2012. Expenditures and associated grant revenue totaled \$10,831 for 2012.

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 District realized \$749,357 and \$49,137 in costs and associated revenue during 2013 and 2012, respectively. The project is expected to be completed in 2014.

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 provides \$27,257,838 for construction costs and requires 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 encompasses 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 will be 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,				
	2013	2012	2011	2010	2009
Average number of customers					
Residential	7,912	7,896	7,921	7,922	7,868
Commercial	836	838	836	825	820
Industrial	8	8	8	8	8
Other	62	38	37	36	36
Total District customers	8,818	8,780	8,802	8,791	8,732
Sales for resale	2	2	7	3	2
Total	8,820	8,782	8,809	8,794	8,734
Revenues from sale of energy (000s)					
Residential	\$ 9,052	\$ 8,461	\$ 8,392	\$ 7,142	\$ 7,707
Commercial	2,434	2,297	2,242	1,917	2,088
Industrial	32,122	32,048	28,466	29,435	23,570
Other	38	38	35	32	31
Total District customers	43,646	42,844	39,135	38,526	33,396
Intersystem sales	142	153	161	712	83
Sales for resale	3,920	2,645	4,674	4,028	5,806
Total energy sales	47,708	45,642	43,970	43,266	39,285
Other operating revenues	950	528	558	664	1,424
Total	\$ 48,658	\$ 46,170	\$ 44,528	\$ 43,930	\$ 40,709
Energy (MWh)					
Residential	143,077	138,253	149,656	133,607	157,981
Commercial	47,340	46,462	48,462	43,952	49,945
Industrial	808,082	814,788	793,722	805,936	759,622
Other	301	301	308	311	310
Total District customers	998,800	999,804	992,148	983,806	967,858
Intersystem sales	3,534	4,063	5,130	22,863	2,774
Sales for resale	131,358	131,968	202,317	136,344	207,365
Total sales	1,133,692	1,135,835	1,199,595	1,143,013	1,177,997
Peak demand (MW)	153	149	159	152	159
Energy requirements (MWh)					
Ponderay Newsprint Company	765,225	774,568	755,387	772,666	718,303
All other retail customers	237,109	229,299	241,891	234,003	252,329
Total retail sales	1,002,334	1,003,867	997,278	1,006,669	970,632
Sales for resale	131,358	131,968	202,317	136,344	207,365
Total sales	1,133,692	1,135,835	1,199,595	1,143,013	1,177,997
Electric System losses	16,790	12,177	10,332	849	5,631
Total energy requirements	1,150,482	1,148,012	1,209,927	1,143,862	1,183,628
Energy resources (MWh)					
Box Canyon Project	433,381	460,771	451,790	453,621	451,083
Boundary Project	372,221	369,284	366,025	369,573	368,931
Bonneville and other sources	344,880	317,957	392,112	320,668	363,614
Total energy resources	1,150,482	1,148,012	1,209,927	1,143,862	1,183,628

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

	For the Years Ended December 31,				
	2013	2012	2011	2010	2009
Operating revenues (000s)					
Energy sales	\$ 47,708	\$ 45,642	\$ 43,970	\$ 43,266	\$ 39,285
Other	950	528	558	664	1,424
Total operating revenues	48,658	46,170	44,528	43,930	40,709
Operating expenses (1)					
Power costs	30,849	28,233	27,685	28,416	24,916
Operations and maintenance	5,287	5,115	4,548	4,646	4,686
Administrative and general	3,066	3,309	3,484	3,214	3,117
Taxes	2,394	2,320	2,016	1,907	1,705
Total operating expenses	41,596	38,977	37,733	38,183	34,424
Investment income (2)	110	126	122	117	158
Net revenue available for debt service	7,172	7,319	6,917	5,864	6,443
Senior lien debt service	2,461	4,359	4,234	3,160	3,109
Net revenue available for capital	\$ 4,711	\$ 2,960	\$ 2,683	\$ 2,704	\$ 3,334
Debt service coverage ratio (3)	2.91x	1.68x	1.63x	1.86x	2.07x

This table reports the Electric System senior lien parity debt service coverage excluding the Economic Development Revolving Fund blended combined unit, which monies and operating results are not available for debt service purposes.

- (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,				
	2013	2012	2011	2010	2009
Operating revenues (000s)					
Energy sales					
Electric System	\$ 17,883	\$ 17,068	\$ 14,690	\$ 15,597	\$ 10,483
Tribal use of lands	215	190	158	293	253
All other (1)	59	7	1,448	2	2
Total operating revenues	18,157	17,265	16,296	15,892	10,738
Operating expenses (2)					
Power costs	917	1,533	896	2,463	742
Operations and maintenance	5,365	5,651	5,600	6,172	5,279
Administrative and general	2,249	2,174	2,192	2,089	1,996
Taxes	99	105	103	104	104
Total operating expenses	8,630	9,463	8,791	10,828	8,121
Investment income	125	126	141	162	107
Other nonoperating (3)	2,041	1,431	1,225	1,225	-
Net revenue available for debt service (4)	11,693	9,359	8,871	6,451	2,724
Senior lien debt service (5)	11,095	8,386	7,565	5,986	1,162
Junior lien debt service	-	-	-	-	-
Net revenue available for capital	\$ 598	\$ 973	\$ 1,306	\$ 465	\$ 1,562
Debt service coverage ratio (6)	1.05x	1.12x	1.17x	1.08x	2.34x

- (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.
- (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	April D. Owen
Chief Operating Officer	Charles O'Hare
Auditor/Customer Service Manager	Elaine Averyt
Treasurer	Sarah L. Holderman
Director, Regulatory and Environmental Affairs	Mark J. Cauchy
Director, Information Technology	Rhonda Thomas
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

District Staff

Jethro Allen, Journeyman Lineman
Elaine Averyt, Treasurer/Customer Services Manager
Patrick Barley, CNS Technician
Jerry Beacham, Power Supply Operator
Paul Boxleitner, Human Resources Manager
Mike Boyle, Software Engineer
Gary Brathovde, Meter Reader
Pat Buckley, Natural Resources Manager
Teresa Carr, Power Scheduler
Mark Cauchy, Director, Regulatory & Envir. Affairs
Chris Chaney, System Operator
J.L. Chantry, Journeyman Lineman
Mike Chantry, IT Support Analyst
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. Secretary/CSR
Lisa Enyeart, Hydro Maintenance
Kevin Fisher, Warehouseman
Chuck Frandrup, Engineering Manager
Robert Fritz, CNS Operations Supervisor
Kim Gentle, Power & Risk Manager
Rusty Gill, Water System Operator
Shawn Gumenberg, Technician/Electrician I
Stan Haney, Hydro Mechanic Foreman
Jacob Hanson, Power Supply Operator
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, Operations Manager
John Jordan, General Manager
Scott Jungblom, Resource Biologist
Duncan Keogh, Journeyman Tree Trimmer Foreman
Bill Kershul, Project Mgr. Operations
Bob Kirby, Meter Reader
Paul Kiss, Line Foreman
Bryant Kramer, Senior System Operator
Brodie Larson, 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, Meter Reader
Brenda Miller, Administrative Supervisor, Production
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
Rhonda Odell, Customer Service Representative
Charlie O'Hare, Chief Operating Officer
Joe Onley, CNS Engineer
Dave Osborne, Lead Mechanic
April Owen, Assist. General Manager
Christy Parry, Customer Service Representative
Sandra Pea, Compliance Manager
Mike Peterson, Natural Resources Field Technician
John Petrich, Lead Technician/Electrician
Tommy Petrie, Natural Resources Field Technician
Frank Phelps, Meter Reader
James Reed, Journeyman Lineman
Michael Reed, CNS Technician I
Autumn Rice, Administrative Support
Marty Robinson, Energy Services Specialist
Keith Saxe, Hydro Mechanic
Kelly Scherf, Accountant
Dennis Schult, Natural Resources, MS Hydrology
Mark "Bubba" Scott, Water Systems Manager
Dick Shaw, Hydro Maintenance
John Shukle, Journeyman Lineman
Laura Smith, Customer Service Representative
Spencer Smith, Journeyman Lineman
Amy Smock, Admin. Assistant, Engineering
Todd Swegle, Drafting Technician
Cecil Taylor, Safety Coordinator
Larry Taylor, Hydro Mechanic
Rhonda Thomas, Director, Information Technology
Nancy Thompson, Administrative Assistant
Dale Weathers, Distribution Field Engineer
Dean Welter, System Operator
Tanner Williams, Journeyman Lineman
Colin Willenbrock, General Counsel/Government Affairs
Karen Willner, Assistant to the General Manager
Janice York, Customer Service Representative
Fred Zakar, System Operator
Dick Zimmerman, Power Supply Operator



Pend Oreille PUD Crews prepare 2013 U.S. Capital Christmas Tree



Public Utility District No. 1
of Pend Oreille County
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