Washington State Auditor's Office

Financial Statements Audit Report

Public Utility District No. 1 of Grays Harbor County

Audit Period

January 1, 2012 through December 31, 2012

Report No. 1010291

Issue Date

August 26, 2013

WASHINGTON
TROY KELLEY
STATE AUDITOR

Washington State Auditor
Troy Kelley

August 26, 2013

Board of Commissioners
Public Utility District No. 1 of Grays Harbor County
Aberdeen, Washington

Report on Financial Statements

Please find attached our report on Public Utility District No. 1 of Grays Harbor County's financial statements.

We are issuing this report in order to provide information on the District's financial condition.

Sincerely,

TROY KELLEY
STATE AUDITOR

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January 1, 2012 through December 31, 2012

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Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

Public Utility District No. 1 of Grays Harbor County
January 1, 2012 through December 31, 2012

Board of Commissioners
Public Utility District No. 1 of Grays Harbor County
Aberdeen, Washington

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of Public Utility District No. 1 of Grays Harbor County, Washington, as of and for the years ended December 31, 2012 and 2011, and the related notes to the financial statements, which collectively comprise the District's basic financial statements, and have issued our report thereon dated August 14, 2013. During the year ended December 31, 2012, the District implemented Governmental Accounting Standards Board Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position*.

INTERNAL CONTROL OVER FINANCIAL REPORTING

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

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

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

COMPLIANCE AND OTHER MATTERS

As part of obtaining reasonable assurance about whether the District's financial statements are free from material misstatement, we performed tests of the District's compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

PURPOSE OF THIS REPORT

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the District's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control and compliance. Accordingly, this communication is not suitable for any other purpose. However, this report is a matter of public record and its distribution is not limited. It also serves to disseminate information to the public as a reporting tool to help citizens assess government operations.

Troy X. Kelley

TROY KELLEY
STATE AUDITOR

August 14, 2013

Independent Auditor's Report on Financial Statements

Public Utility District No. 1 of Grays Harbor County
January 1, 2012 through December 31, 2012

Board of Commissioners
Public Utility District No. 1 of Grays Harbor County
Aberdeen, Washington

REPORT ON THE FINANCIAL STATEMENTS

We have audited the accompanying financial statements of Public Utility District No. 1 of Grays Harbor County, Washington, as of and for the years ended December 31, 2012 and 2011, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed on page 5.

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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the 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 District's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Public Utility District No. 1 of Grays Harbor County, as of December 31, 2012 and 2011, and the changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Matters of Emphasis

As discussed in Note 1 to the financial statements, in 2012, the District adopted new accounting guidance, Governmental Accounting Standards Board Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position*. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 6 through 8 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.

OTHER REPORTING REQUIRED BY GOVERNMENT AUDITING STANDARDS

In accordance with *Government Auditing Standards*, we have also issued our report dated August 14, 2013 on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control over financial reporting and compliance.

Troy X. Kelley

TROY KELLEY
STATE AUDITOR

August 14, 2013

Financial Section

Public Utility District No. 1 of Grays Harbor County
January 1, 2012 through December 31, 2012

REQUIRED SUPPLEMENTARY INFORMATION

Management's Discussion and Analysis – 2012 and 2011

BASIC FINANCIAL STATEMENTS

Statement of Net Position – 2012 and 2011
Comparative Statement of Revenue, Expenses and Changes in Net Position – 2012 and 2011
Comparative Statement of Cash Flows – 2012 and 2011
Notes to Financial Statements – 2012 and 2011

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section provides an overview and analysis of key data presented in the basic financial statements for the years ended December 31, 2012 and 2011, with additional comparative data for 2010. Information within this section should be used in conjunction with the basic financial statements and accompanying notes.

OVERVIEW OF THE FINANCIAL STATEMENTS

Public Utility District No. 1 of Grays Harbor County (District) accounts for its financial activities within a single proprietary fund. The District's financial activities are comprised of purchase, generation, transmission, distribution and sale of electric energy, as well as the sale of wholesale telecommunication services.

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

The basic financial statements, presented on a comparative format for the years ended December 31, 2012 and 2011 are comprised of:

Comparative Statement of Net Position: The District presents its statement of net position using the balance sheet format. The Statement reflects assets, liabilities, and net position (equity) of the District at year-end. The net position section of the statements is separated into three categories: net investment in capital assets; restricted net position; and unrestricted net position. The District's accumulated gains and losses in fair value from hedging activities are considered deferred inflows and deferred outflows and have been classified as such on the Statement of Net Position.

Comparative Statement of Revenues, Expenses and Changes in Net Position: This comparative statement reflects the transaction and events that have increased or decreased the District's total economic resources during the period. Revenues are presented net of allowances and are summarized by major source. Revenues and expenses are classified as operating or non-operating based on the nature of the transaction.

Comparative Statement of Cash Flows: The Comparative Statement of Cash Flows provides information about the District's cash receipts and payments for operations, as well as funds provided and used in investing and financing activities.

The notes to the financial statements presented at the end of the basic financial statements are considered an integral part of the District's presentation of financial position, results of operations and changes in cash flow.

The following analysis focuses on the District's Net Assets and Changes in Net Assets during the year.

Statement of Net Position

	2012	2011	2011 to 2012 Change	2010
Current and Other Assets	$ 53,272,479	$ 61,589,334	-13.50%	$ 81,371,980
Capital Assets and Work in Progess	349,731,077	346,454,450	0.95%	333,426,965
Accumulated Depreciation	(123,241,077)	(113,637,326)	8.45%	(104,485,129)
Deferred Outflow of Resources	704,545	1,184,950	-40.54%	
Total Assets and Deferred Outflows	**$ 280,467,024**	**$ 295,591,408**	**-5.12%**	**310,313,816**
Long-Term Liabilities	117,929,956	124,005,296	-4.90%	130,602,716
Other Liabilities	24,866,577	25,789,191	-3.58%	36,332,103
Deferred Inflows of Resources	1,568,786	2,730,499	-42.55%	
Total Liabilties and Deferred Inflows	**144,365,319**	**152,524,986**	**-5.35%**	**166,934,819**
Net Investment in Capital Assets	113,743,564	116,811,413	-2.63%	115,330,848
Restricted for Debt Service	2,709,000	2,709,000	0.00%	2,709,000
Unrestricted	19,649,141	23,546,009	-16.55%	25,339,149
Total Net Position	**136,101,705**	**143,066,422**	**-4.87%**	**143,378,997**
Total Liabilities & Net Position	**280,467,024**	**295,591,408**	**-5.12%**	**310,313,816**

The decrease in total assets is a result of spending down 2010 bond proceeds for capital projects, a slight reduction in cash reserves and reduced impact of GASB 53, which requires the District to book the impact of derivative activities, when compared to 2011 see Note 1 for more detailed information. Long-Term Liabilities decreased as they were no new debt issues in 2012.

Capital Assets

2012 saw an overall increase of approximately $3 million in Net Electric plant in service, which is primarily a result of the improvements to the Transmission and Distribution system. The District did sell the generating equipment at the former Grays Harbor Paper site, see Note 3 for details. The following is a summary of the major projects in 2012:

- New circuit breakers and related equipment were installed at the new Powell Road substation.
- Installed and new power transformer and circuit switcher at the State Street Substation
- Three new fiber nodes were completed in Elma, Montesano and Westport
- Several new poles on the Transmission and Distribution systems were replaced as a result of the District pole treatment and testing program.
- New fiber optic cable was installed at various locations and obsolete microwave equipment was replaced as the District continues to improve communication capabilities throughout the service area.
- Several other projects were completed throughout the service territory as the District strives to increase safety and reliability for its employees and customer owners.

Changes in the District's net assets can be determined by reviewing the following condensed Statement of Revenues, Expenses, and Changes in Net Assets for the year.

Statement of Revenues, Expenses and Changes in Net Position

	2012	2011	2011 to 2012 Change	2010
Operating Revenues:				
Retail Energy Sales	$ 77,178,312	$ 79,703,872	-3.17%	$ 69,013,410
Sales for Resale	14,940,051	18,908,387	-20.99%	37,956,294
Other	11,975,115	11,795,563	1.52%	10,541,858
Total Operating Revenue	$ 104,093,478	$ 110,407,822	-5.72%	$ 117,511,562
Nonoperating Revenue	$ 1,404,107	$ 1,104,965	27.07%	$ 448,571
Total Revenues	**$ 105,497,585**	**$ 111,512,787**	**-5.39%**	**$ 117,960,133**
Operating Expenses:				
Power Supply	$ 61,968,859	$ 62,819,227	-1.35%	$ 72,030,114
Operations and Maintenance	19,409,846	19,624,563	-1.09%	21,347,915
Conservation	1,774,753	2,402,359	-26.12%	2,227,613
Taxes & Depreciation	19,424,021	19,767,844	-1.74%	17,803,360
Total Operating Expenses	$ 102,577,479	$ 104,613,993	-1.95%	$ 113,409,002
Nonoperating Expenses	$ 9,884,053	$ 7,211,369	37.06%	$ 6,431,013
Total Expenses	**$ 112,461,532**	**$ 111,825,362**	**0.57%**	**$ 119,840,015**
Change in Net Position	**$ (6,963,947)**	**$ (312,575)**	2127.93%	**$ (1,879,882)**
Beginning Net Position	$ 143,066,422	$ 143,378,997	-0.22%	$ 145,258,879
Ending Net Position	**$ 136,102,475**	**$ 143,066,422**	**-4.87%**	**$ 143,378,997**

Financial Analysis

During 2012, the District's overall financial position and results of operations decreased from the prior year. The District's net position decreased $7 million. The following narrative is an analysis of the change in net position by major components of income, with a primary focus on changes between 2012 and 2011.

Operating Revenues

In 2012, revenues from sales to retail customers (Retail Energy Sales) decreased by approximately $2.5 million. The District did not raise rates in 2012 and the weather in the service territory was warmer than normal during the winter.

Revenues from wholesale sales decreased approximately $4 million as the region continued to see a drop in demand as the economy continued to struggle.

Operating Expenses

Operating expenses decreased approximately $2.1 million in 2012, the District used reductions in this area to offset the drop in retail energy sales. The reduction in wholesale sales had a corresponding decrease in power supply expenses.

REQUESTS FOR INFORMATION

The basic financial statements, notes and management discussion and analysis are designed to provide a general overview of the District's finances. Questions concerning any of the information provided in this report should be directed to Grays Harbor PUD at PO Box 480, Aberdeen, WA 98520

Sincerely,

Doug Streeter, CPA
CFO/Treasurer

PUBLIC UTILITY DISTRICT No. 1 of GRAYS HARBOR COUNTY
STATEMENT OF NET POSITION
AS OF DECEMBER 31, 2012 and 2011

ASSETS AND DEFERRED OUTFLOWS OF RESOURCES	**2012**	**2011**
ASSETS		
Current Assets:		
Cash and Cash Equivalents	$ 13,381,557	$ 15,307,619
Temporary Investments	3,873,000	6,237,711
Capital Project Investments	-	5,239,289
Other Investments and Special Funds	139,293	139,293
Accounts Receivable (Net)	8,634,474	8,698,794
Notes & Other Receivables	4,563,386	3,020,035
Inventory	5,573,726	6,325,527
Prepayments	224,859	256,834
Derivative Asset (Note 1)	1,568,786	2,730,499
Other Current and Deferred Assets	8,367,069	6,898,531
Restricted Assets		
Bond reserves and other restricted funds	5,033,584	4,709,679
TOTAL CURRENT ASSETS	51,359,734	59,563,812
Noncurrent Assets:		
Unamoritzed Debt Discount and Expense	1,876,992	2,023,103
Preliminary Survey and Investigation (Note 1)	35,753	2,419
Utility Plant		
Plant	340,161,098	336,188,921
Construction in Progress	9,569,979	10,265,529
Less Accumulated Depreciation	(123,241,077)	(113,637,326)
Net Utility Plant	226,490,000	232,817,124
TOTAL NONCURRENT ASSETS	228,402,745	234,842,646
Deferred Outflows of Resources		
Accumulated Decrease in Fair Value of Hedging Derivatives	704,545	1,184,950
TOTAL ASSETS AND DEFERRED OUTFLOWS OF RESOURCES	$ 280,467,024	$ 295,591,408

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE FINANCIAL STATEMENTS

PUBLIC UTILITY DISTRICT No. 1 of GRAYS HARBOR COUNTY
STATEMENT OF NET POSITION
AS OF DECEMBER 31, 2012 and 2011

LIABILITIES, DEFERRED INFLOWS OF RESOURCES AND NET POSITION	2012	2011
LIABILITIES		
Current Liabilities:		
Warrants Payable	$ 353,766	$ 1,228,958
Accounts Payable	4,441,367	5,854,665
Accrued Interest	1,226,425	1,569,927
Accrued Taxes	1,391,234	2,457,720
Customer Deposits	1,253,932	1,466,015
Long-Term Debt, due within one year	3,942,240	3,786,262
Accrued other post employment benefits	8,058,597	6,482,341
Derivative Liability (Note 1)	704,545	1,184,950
Other Current, Accrued Liabilities and Def. Liabilities	3,493,701	1,758,353
TOTAL CURRENT LIABILITIES	24,865,807	25,789,191
Noncurrent Liabilities:		
Long-Term Debt due in more than one year	113,562,760	117,505,000
Unamoritzed Bond Premium	4,144,796	5,546,558
Other Long-Term Debt	222,400	953,738
TOTAL NONCURRENT LIABILITIES	117,929,956	124,005,296
TOTAL LIABILITIES	142,795,763	149,794,487
Deferred Inflows of Resources		
Accumulated Increase in Fair Value of Hedging Derivatives	1,568,786	2,730,499
NET POSITION		
Invested in Capital Assets, Net of Related Debt	113,814,334	116,811,413
Restricted	5,033,584	4,709,679
Unrestricted	17,254,557	21,545,330
TOTAL NET POSITION	136,102,475	143,066,422
TOTAL LIABILITIES, DEFERRED INFLOWS OF RESOURCES AND NET POSITION	$ 280,467,024	$ 295,591,408

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE FINANCIAL STATEMENTS

PUBLIC UTILITY DISTRICT No. 1 of GRAYS HARBOR COUNTY

COMPARATIVE STATEMENT OF REVENUE, EXPENSES AND CHANGES IN NET POSITION

FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

	2012	2011
OPERATING REVENUES		
Residential Sales	$ 42,397,006	$ 43,900,397
Commercial Sales	24,420,669	24,313,108
Industrial Sales	9,818,052	10,925,635
Street Lighting	542,585	564,732
Wholesale Sales	14,940,051	18,908,387
Other Operating Revenue	11,975,115	11,795,563
Total Operating Revenues	104,093,478	110,407,822
OPERATING & MAINTENANCE EXPENSES		
Power Supply	55,502,133	56,478,128
Transmission	6,466,726	6,341,099
Operating	10,860,431	11,686,278
Maintenance	8,549,415	7,938,285
Conservation	1,774,753	2,402,359
Depreciation and Amortization	11,019,028	10,698,030
Total Operating & Maintenance Expenses	94,172,486	95,544,179
OTHER OPERATING EXPENSES		
Taxes and Tax Equivalents	8,404,993	9,069,814
Total Other Operating Expenses	8,404,993	9,069,814
OPERATING INCOME (LOSS)	1,515,999	5,793,829
NONOPERATING REVENUE (EXPENSES)		
Interest and Dividend Income	1,111,500	956,674
Interest Expense	4,727,919	7,153,894
Gain (Loss) on Capital Asset Disposition	(5,139,046)	-
Federal & State Grants	-	-
Other Nonoperating Revenues	292,607	148,291
Other Nonoperating Expenses	17,088	57,475
Total Nonoperating Revenues (Expenses)	(8,479,946)	(6,106,404)
Income Before Contributions and Transfers	(6,963,947)	(312,575)
Transfers In (Out)	-	-
Extraordinary Items	-	-
CHANGE IN NET POSITION	(6,963,947)	(312,575)
TOTAL NET POSITION, January 1	$ 143,066,422	$ 143,378,997
TOTAL NET POSITION, December 31	$ 136,102,475	$ 143,066,422

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE FINANCIAL STATEMENTS

PUBLIC UTILITY DISTRICT NO.1

OF GRAYS HARBOR COUNTY, WASHINGTON

COMPARATIVE STATEMENT OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 2012 and 2011

(page 1 of 2)

	2012	2011
Cash Flows from Operating Activities		
Cash Received from Customers	$100,051,551	$ 101,889,024
Payments for Purchased Power	(61,968,859)	(62,819,227)
Payments for Operations, Maintenance and Conservation	(7,548,828)	(8,480,470)
Cash Payments to Employees	(13,635,771)	(13,546,452)
Taxes Paid	(8,404,993)	(9,069,814)
Customer Deposits Received, net	(212,083)	317,347
Net Cash (Used by) Provided by Operating Activities	8,281,017	8,290,408
Cash Flows from Capital and Related Financing Activities		
Repayments of Note	(731,338)	(2,165,811)
Proceeds from Sale of Property	-	-
Bond Principal Payments	(3,786,262)	(3,605,000)
Proceeds from Issuance of Note	50,000	-
Acquisition and Construction of Assets	(9,851,569)	(14,834,372)
Interest paid on Long-term Borrowing	(4,727,919)	(7,153,894)
Miscellaneous Other	17,088	57,475
Net Cash Used in Capital and Related Financing Activities	(19,030,000)	(27,701,602)
Cash Flows from Investing Activities		
Investments (Purchased) or Redeemed	7,711,421	16,449,665
Interest Received on Investments	1,111,500	956,674
Net Cash Provided by Investing Activities	8,822,921	17,406,339
Net (Decrease) Increase in Cash and Cash Equivalents	(1,926,062)	(2,004,855)
Cash and Cash Equivalents and Beginning of Year	15,307,619	17,312,474
Cash and Cash Equivalents at End of Year	$ 13,381,557	$ 15,307,619

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE FINANCIAL STATEMENTS

PUBLIC UTILITY DISTRICT NO.1
OF GRAYS HARBOR COUNTY, WASHINGTON
COMPARATIVE STATEMENT OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2012 and 2011
(page 2 of 2)

	2012	2011
Operating Income	$ 1,515,999	$ 5,793,829
Depreciation and Amortization	11,019,028	10,698,030
Provision for Uncollectible Accounts	221,910	30,364
Changes in Operating Assets and Liabilities		
Special Funds and Other	-	29
Customer Accounts Receivable	64,320	(1,492,045)
Interest Receivable	-	-
Other Receivables	(1,543,351)	2,214,076
Inventories	751,801	(214,317)
Prepayments	31,975	(55,296)
Warrants, Notes, A/P and Construction Payables	(2,288,490)	(310,971)
Changes in Other Payables	(343,502)	(1,946,289)
Customer Deposits	(212,083)	317,347
Accrued Taxes	(1,066,486)	1,560,774
Miscellaneous Deferred, Accrued and Other Liabilities	163,230	(9,108,662)
Preliminary Survey and Temporary Facilities	(33,334)	803,540
Total Changes	(4,475,919)	(8,231,814)
Total Adjustments	6,765,019	2,496,580
Net Cash Provided by Operating Activities	$ 8,281,017	$ 8,290,408

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE FINANCIAL STATEMENTS

Notes to Financial Statements

December 31, 2012 & 2011

NOTE 1 - SUMMARY OF OPERATIONS & SIGNIFICANT ACCOUNTING POLICIES

Public Utility District No. 1 of Grays Harbor County (the District) is a municipal corporation, governed by an elected three-member board, authorized under Title 54 RCW.

As required by generally accepted accounting principles, management has considered all potential component units in defining the reporting entity and has no component units.

The accounting policies of the District conform to generally accepted accounting principles applicable to governmental units. 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 including GASB 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, as well as all applicable Financial Accounting Standards Board (FASB) statements and interpretations, except for those that conflict with or contradict GASB pronouncements. The following is a summary of the more significant policies:

a) Basis of Accounting and Presentation

The accounting and reporting policies of the District are regulated by the Washington State Auditor's Office and are based on the Uniform System of Accounts prescribed for public utilities and licensees by the Federal Energy Regulatory Commission (FERC). The District uses the full accrual basis of accounting where revenues are recognized when earned and expenses are recognized when incurred. Revenues and expenses related to the District's principal operations are considered to be operating revenues and expenses; while revenues and expenses related to capital, financing and investing activities are considered to be non-operating revenues and expenses.

b) Cash and Cash Equivalents

For the purposes of the statement of cash flows, the District considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

c) Accounting Estimates

The preparation of financial statements in conformity with Generally Accepted Accounting Principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities. Estimates may be included in the disclosure of contingent assets and liabilities at the date of the financial statements, and in the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

d) Utility Plant and Depreciation

Utility plant is recorded at the original cost which includes both direct costs of acquisition or construction and indirect costs. The District's capitalization threshold is $5,000. The cost of maintenance and repairs is charged to expense as incurred, while the cost of replacements and improvements is capitalized. Property, plant and equipment is depreciated using the straight-line method over the following estimated useful lives:

Buildings & Improvements	50 years
Generation Plant	20 years
Electric Plant – Transmission	30-40 years
Electric Plant – Distribution	28-40 years
Transportation Equipment	7-10 years
General Plant & Equipment	5-25 years
Telecommunications	20 years

Preliminary survey and investigation costs incurred for proposed projects are deferred pending a final decision to develop the project. Costs relating to projects ultimately constructed are reclassified to utility plant. If the projects are abandoned, the costs are expensed.

e) Investments
(See Note 2)

f) Restricted Funds
In accordance with bond resolutions and other agreements, separate funds have been established for restricted- or limited-use funds. The assets held in these funds are limited as to their use, including debt service, employee medical expenses and other reserve requirements. Restricted and limited-use funds include the following:

Investment Description	2012 Value	2011 Value
Bond Fund	$2,709,000	$2,709,000
Medical Insurance Trust	2,200,584	1,879,679
Rural Economic Development Fund (REDF)	50,000	50,000
Electric License	4,000	4,000
Premera Advance Deposit	70,000	70,000
Total Restricted Investments	$5,033,584	$4,709,679

The District holds in trust all employee and employer medical insurance premiums. The trust pays actual medical claims and administrative costs associated with claims management. The trust also maintains stop-loss insurance, which is administered by the District's Health and Welfare Committee.

g) Receivables and Provision for Doubtful Accounts
Electric meters read but unbilled are reflected in the utility's accounts receivable.

Bad debt expenses, and the accumulated provision for uncollectible accounts, are charged monthly for an amount that provides for estimated losses on accounts receivable that may become uncollectible. Actual losses are then charged against the provision as they are identified.

h) Inventories
Inventories are valued at average cost, which approximates market value.

i) Construction in Progress (CIP)
(See Note 4)

j) Derivative Instruments
The District has adopted GASB Statements No. 53, *Accounting and Financial Reporting for Derivative Instruments*. Subject to certain exceptions, GASB Statement No. 53 requires that every derivative instrument be recorded on the Balance Sheet as an asset or liability measured at its fair value, and that changes in the derivative's fair value be recognized currently in earnings unless such derivatives meet specific hedge accounting criteria to be determined as effective. Effective hedges qualify for hedge accounting and such changes in fair values are deferred. The District uses FASB pronouncements on *Accounting for the Effects of Certain Types of Regulation* to defer unrecognized gains or losses for derivatives that are not deemed to be effective.

It is the District's policy to document and apply as appropriate the normal purchase and normal sales exception under GASB Statement No. 53. The District has reviewed its various contractual arrangements to determine applicability of these standards. Purchases and sales or forward electricity and natural gas that require the physical delivery and which are expected to used or sold by the reporting entity in the normal course of business are generally considered "normal purchases and normal sales." These transactions are excluded from GASB Statement No. 53 and therefore are not required to be recorded at fair value in the financial statements. Financial swaps for electricity and natural gas are considered to be derivatives under GASB Statement No. 53, but generally do not meet the "normal purchases and normal sales" criteria.

At December 31, 2012 the District had the following derivative instruments outstanding:

	Changes in Fair Value	Fair Value at December 31, 2012		
Classification	**Amount**	**Classification**	**Amount**	**Notional**
Cash Flow Hedges Deferred Outflow	$ (1,568,786)	Derivative Liability	$ (1,568,786)	74,660 MWh
Deferred Inflow	$ 704,545	Derivative Asset	$ 704,545	141,220 MWh

At December 31, 2011 the District had the following derivative instruments outstanding:

	Changes in Fair Value	Fair Value at December 31, 2011		
Classification	**Amount**	**Classification**	**Amount**	**Notional**
Cash Flow Hedges:				
Deferred Outflow	$ (1,184,950)	Deferred Liability	$ (1,184,950)	19,720 MWh
Deferred Inflow	$ 2,730,499	Deferred Asset	$ 2,730,499	460,000 MMBtu

The fair values of the commodity swap contracts were based on the futures price curve for the Mid-Columbia Intercontinental Exchange for electricity and the Sumas index for natural gas.

Objectives & Strategies:
The District enters into derivative energy transactions to hedge its known or expected positions within its approved Risk Management policy. Decisions are made to enter into forward transactions to protect its financial position, specifically to deal with expected long and short positions as determined by the projected load and resource balance positions. Generally, several strategies are employed to hedge the District's resource portfolio, including:

- *Combustion Turbine* – The District purchases gas for future periods to generate electricity when the Frederickson Plant (See Note 12) is economically viable on a marginal basis for that period on parameters established by the Risk Management Committee (RMC). If load projections indicate the District does not require the electricity to serve its customers, an equivalent quantity of power will concurrently be sold or otherwise hedged for the same period.

- *Surplus Purchased Power Resources* – The District hedges projected surpluses in future periods by selling power forward, at a fixed price, either physically or financially. The District will, on occasion, will sell physical power forward in the next calendar month at a price based on the Mid-Columbia index to perfect financial forward sales which settle based on the same index.

- *Deficit Power Resources* – The District hedges projected power resource deficits in future periods by purchasing power at a fixed price, either physically or financially. If the Frederickson Project is economically viable for the deficit period, the District will purchase gas to operate the plant.

Authorized Derivatives under the Risk Management Policy:

- Physical power and natural gas forward purchases and sales
- Monthly and daily power and gas physical calls and puts
- Power and natural gas fixed for floating swaps
- Currency swaps relating to managing US/Canadian exchange rate risk resulting from transactions denominated in Canadian dollars

- Monthly financial Asian power and gas put and call options
- Financial daily power and gas put and call options
- Monthly power and natural gas swaptions

Risks

Credit Risk – The District has developed a credit policy that establishes guidelines for setting credit limits and monitoring credit exposure on a continual basis. The policy addresses frequency of counterparty credit evaluations, credit limits per specific counterparty and counterparty credit concentration limits.

Commodity transactions, both physical and financial, are entered into only with counterparties approved by the District's Risk Management Committee for credit worthiness. The District had 52 counterparties with approved credit limits for electric power and natural gas sales and purchases as of December 31, 2012 and 2011. Counterparty credit limits are based on The Energy Authority's (TEA) (see Note 11) proprietary credit rating system and other factors. Credit ratings range from not-rated to AA, with a majority of counterparties rated between BBB- and AA. Not rated counterparties either provide additional security or are assigned credit limits of $25,000 or less.

Basis Risk – The District proactively works to eliminate or minimize basis risk on energy transactions by entering into derivative transactions the settle pursuant to an index derived from market transactions at the point physical delivery is expected to take place. There are no derivative transactions outstanding that carry basis risk as of December 31, 2012 or 2011. As applicable, power related transactions are to be settled on the relevant Mid – Columbia index and all gas transactions are to be settled on the relevant Sumas/Huntingdon index. The District has ready access to electric transmission and natural gas transportation capacity at those respective trading points.

Termination Risk – As of December 31, 2012 and 2011, no termination events have occurred and there are no outstanding transactions with material termination risk.

There is no rollover, interest rate or market access risk for these derivative transactions as of December 31, 2012 or 2011.

k) Personal Leave Plan

The District provides its employees with a single leave, Personal Time Off plan (PTO), in lieu of separate programs for vacation and illness benefits. Employees accrue PTO based upon their length of service. Moreover, employees with a sick leave balance under the terms of the former plan were able to transfer the balance into a Supplemental Leave Bank (SLB). No additional hours may be posted to the SLB, though time off for illness may be charged against the SLB rather than PTO.

Employees hired subsequent to the adoption of PTO may only accrue PTO. Employees may also sell PTO to the District under certain conditions. Upon termination, or resignation with adequate notice, the employee will be paid for all unused PTO, and the District will deposit 30% of the value of any remaining SLB into a qualified MSA VEBA medical reimbursement account.

PTO is charged as a component of payroll overhead as time is incurred by an employee. A corresponding liability is recognized until such time an employee uses or sells PTO to the District in accordance with the terms of the plan.

l) Debt Premiums, Discounts & Expenses

Amounts stemming from original issue and reacquired bonds, including premiums, discounts and expenses, are amortized over the life of the issue whether defeased or held to term. Resulting differences are amortized using the straight-line basis.

m) Financial Statement Reclassifications

Certain prior year amounts have been reclassified to conform to the current year presentation.

NOTE 2 - DEPOSITS AND INVESTMENTS

The District's deposits and certificates of deposit are entirely covered by federal depository insurance (FDIC) or by the collateral held in a multiple financial institution collateral pool administered by the Washington Public Deposit Protection Commission (PDPC). Investments are shown at book value, which approximates market. As of December 31, 2012 and 2011 respectively, the District had the following investments:

Investment Description	2012	2011
Washington State LGIP	$2,887,931	$3,880,399
Certificates of Deposit	-0-	1,993,000
Federal National Mortgage Association	2,299,000	5,325,000
Federal Home Loan Bank	-0-	1,000,000
Federal Home Loan Mortgage Corporation	900,000	1,659,000
Municipal Securities	1,115,000	500,000
FDIC Insured Securities	2,268,000	1,000,000
Total	**$9,469,931**	**$15,357,399**

Interest Rate Risk – The District's investment policy requires matching investment maturities to meet anticipated cash flow requirements. The policy limits investment maturities to not more than three years from the settlement date, unless approved by the Board of Commissioners.

Credit Risk – The District's investment policy conforms with State law which restricts investments of public funds to debt securities and obligations of the U.S. Treasury, U.S. Government agencies and certain U.S. Government sponsored corporations, certificates of deposit and other evidences of deposit at financial institutions qualified by the Washington State Public Deposit Protection Commission (PDPC), bankers' acceptances, investment-grade general obligation debt of state and local governments and public authorities as well as State, County, municipal or school district bonds or in warrants of taxing districts of the State and the Washington State Local Government Investment Pool (LGIP).

Concentration of Credit Risk - The investment policy requires diversification of investments by security type and institution, with the exception of U.S. Treasuries and the LGIP.

Custodial Credit Risk – For deposits, this is the risk that in the event of a bank failure, the District's deposits may not be returned. All District deposits and certificates of deposit are held by public depositories authorized by the PDPC and are not subject to custodial credit risk. State law requires public depositories to fully collateralize their uninsured public deposits with approved third-party safekeeping agents and provide for independent oversight of this program.

NOTE 3 - UTILITY PLANT AND DEPRECIATION

Utility plant activity for the years ended December 31, 2012 was as follows:

	Beginning Balance	Additions	Deletions	Ending Balance
Utility plant not being depreciated:				
Land	10,458,098	200,173	-	10,658,271
Construction in Progress	10,265,529	10,207,549	10,903,099	9,569,979
Total utility plant not being depreciated	20,723,627	10,407,222	10,903,099	20,228,250
Utility plant being depreciated:				
Transmission	30,619,944	1,846,269	80,806	32,385,407
Distribution	218,279,244	8,362,695	736,687	225,905,252
General	49,164,704	871,379	328,300	49,707,782
Other	27,666,930	-	6,162,544	21,504,386
Total utility plant being depreciated	325,730,822	11,080,343	7,308,337	329,502,827
Accumulated Depreciation	113,637,326	11,538,994	1,935,244	123,241,077
Total Utility Plant, Net	232,817,123	9,949,071	16,276,192	226,490,002

In 2006, the District received funding from the State of Washington to acquire/construct a biomass energy project located in Hoquiam, Washington. The funding consisted of a State grant for $5,997,000, a $500,000 loan from the State Forest Products Revolving Fund (FPRF) and a $1,000,000 loan from the Community Economic Revitalization Board (CERB).

The District purchased the existing assets at a paper mill facility and added one more turbine generator to the project. The District then leased the generation assets back to the operator of the paper mill. The FPRF loan was repaid in 2010. Late in 2011, the mill entered State ordered receivership. The outcome of the receivership was a sale of all mill assets to a new owner/operator of the paper mill. The District received $351,098 in cash and $672,400 in loan forgiveness with the balance of the loan converted to zero interest over ten years. The total loss on the sale was $5,139,046.

Utility plant activity for the years ended December 31, 2011 was as follows:

	Beginning Balance	Additions	Deletions	Ending Balance
Utility plant not being depreciated:				
Land	4,732,508	5,725,590	-	10,458,098
Construction in Progress	10,808,174	10,360,377	10,903,022	10,265,529
Total utility plant not being depreciated	15,540,682	16,085,967	10,903,022	20,723,627
Utility plant being depreciated:				
Transmission	30,130,095	568,372	78,523	30,619,944
Distribution	211,238,420	7,241,062	200,238	218,279,244
General	48,152,876	884,325	127,503	49,164,704
Other	28,364,890	-	697,960	27,666,930
Total utility plant being depreciated	317,886,281	8,693,759	1,104,224	325,730,822
Accumulated 9iation	104,485,129	11,194,131	2,041,934	113,637,326
Total Utility Plant, Net	228,941,834	13,585,595	9,965,312	232,817,123

During 2010, the District's combustion turbine plant became temporarily inoperable. The District is currently evaluating several remedies that will determine the future of the plant. Based on the criteria set forth in GASB Statement No. 42 *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries,* the District determined that the asset is temporarily impaired. Accordingly, the District has not written down the asset. The asset's carrying amount as of December 31, 2012 and 2011 was $9,159,640 and $10,107,189, respectively. Refer to Note 11.

NOTE 4 – CONSTRUCTION IN PROGRESS

The following table details construction in progress activity as of December 31:

Project Classification	2012	2011
Transmission	2,502,151	2,874,002
Substation	4,055,053	1,886,874
Distribution	2,914,546	5,447,939
General	98,230	56,715
Total Construction in Progress	**$ 9,569,979**	**$ 10,265,529**

NOTE 5 - SHORT – TERM DEBT

The District opened a line of credit with Key Bank late in 2012, total available under the line of credit is $10,000,000. The line is intended to reduce cash flow risk for unexpected events. The District does not intend to actively use the line, however one term for closing was to draw on the line prior to year end. The following table details short-term debt activity for the year ended December 31, 2012:

Debt Description	Beginning Balance	Issued	Redeemed	Ending Balance
Key Bank Line of Credit	$-0-	50,000	-0-	$ 50,000

The following table details short-term debt activity for the year ended December 31, 2011:

Debt Description	Beginning Balance	Issued	Redeemed	Ending Balance
Bank of America Line of Credit	$2,165,811	-	2,165,811	$-0-

NOTE 5 - LONG-TERM DEBT

During the year ended December 31, 2012, the following changes occurred in long-term debt:

Issue	Beginning Balance 1/1/12	New Issues	Principal Payments/ Refundings	Ending Balance 12/31/12	Due Within One-Year
2005 Electric Revenue Bonds	31,460,000	-	1,505,000	29,955,000	1,585,000
2006 Electric Revenue Bonds	62,695,000	-	2,235,000	60,460,000	2,340,000
2010 Electric Revenue Bonds (Taxable Build America Bonds)	27,090,000	-	-	27,090,000	-
Community Economic Revitalization Board (CERB) Loan	1,000,000	-	827,600	172,400	17,240
Total Long-Term Debt	**$122,245,000**	**$-0-**	**$4,567,600**	**117,677,400**	**$3,942,240**

During the year ended December 31, 2011, the following changes occurred in long-term debt:

Issue	Beginning Balance 1/1/11	New Issues	Principal Payments/ Refundings	Ending Balance 12/31/11	Due Within One-Year
2001 Electric Revenue Bonds	1,525,000	-	1,525,000	-	-
2005 Electric Revenue Bonds	32,900,000	-	1,440,000	31,460,000	1,505,000
2006 Electric Revenue Bonds	63,335,000	-	640,000	62,695,000	2,235,000
2010 Electric Revenue Bonds (Taxable Build America Bonds)	27,090,000	-	-	27,090,000	-
Community Economic Revitalization Board (CERB) Loan	1,000,000	-		1,000,000	42,262
Total Long-Term Debt	**$125,850,000**	**$-0-**	**$3,605,000**	**$122,245,000**	**$3,786,262**

Principal and interest payments due on Revenue Bonds are as follows:

Maturities	Principal	Interest	Total
2013	3,942,240	6,348,139	10,290,379
2014-17	17,843,960	23,298,668	41,142,628
2018-22	25,015,000	23,886,324	48,901,324
2023-32	47,800,000	29,778,503	77,578,503
2033-2040	22,990,000	6,524,570	29,514,570
Less Current Portion	(3,942,240)	(6,348,139)	(10,290,379)
Total	$113,735,160	$83,488,065	$197,223,225

NOTE 6 - PENSION PLAN

Substantially all District full-time and qualifying part-time employees participate in one of the following statewide retirement systems administered by the Washington State Department of Retirement Systems, under cost-sharing multiple-employer public employee defined benefit and defined contribution retirement plans. The Department of Retirement Systems (DRS), a department within the primary government of the State of Washington, issues a publicly available comprehensive annual financial report (CAFR) that includes financial statements and required supplementary information for each plan. The DRS CAFR may be obtained by writing to: Department of Retirement Systems, Communications Unit, P.O. Box 48380, Olympia, WA 98504-8380; or it may be downloaded from the DRS website at www.drs.wa.gov. The following disclosures are made pursuant to GASB Statements No. 27, *Accounting for Pensions by State and Local Government Employers* and No. 50, *Pension Disclosures, an Amendment of GASB Statements No. 25 and No. 27*.

Public Employees' Retirement System (PERS) Plans 1, 2, and 3

Plan Description

The Legislature established PERS in 1947. Membership in the system includes: elected officials; state employees; employees of the Supreme, Appeals, and Superior courts; employees of legislative committees; community and technical colleges, college and university employees not participating in higher education retirement programs; employees of district and municipal courts; and employees of local governments. Approximately 50% of PERS salaries are accounted for by state employment. PERS retirement benefit provisions are established in chapters 41.34 and 41.40 RCW and may be amended only by the State Legislature.

PERS is a cost-sharing multiple-employer retirement system comprised of three separate plans for membership purposes: Plans 1 and 2 are defined benefit plans and Plan 3 is a defined benefit plan with a defined contribution component.

PERS members who joined the system by September 30, 1977 are Plan 1 members. Those who joined on or after October 1, 1977 and by either, February 28, 2002 for state and higher education employees, or August 31, 2002 for local government employees, are Plan 2 members unless they exercised an option to transfer their membership to Plan 3. PERS members joining the system on or after March 1, 2002 for state and higher education employees, or September 1, 2002 for local government employees have the irrevocable option of choosing membership in either PERS Plan 2 or Plan 3. The option must be exercised within 90 days of employment. Employees who fail to choose within 90 days default to Plan 3. Notwithstanding, PERS Plan 2 and Plan 3 members may opt out of plan membership if terminally ill, with less than five years to live.

PERS is comprised of and reported as three separate plans for accounting purposes: Plan 1, Plan 2/3, and Plan 3. Plan 1 accounts for the defined benefits of Plan 1 members. Plan 2/3 accounts for the defined benefits of Plan 2 members and the defined benefit portion of benefits for Plan 3 members. Plan 3 accounts for the defined contribution portion of benefits for Plan 3 members. Although members can only be a member of either Plan 2 or Plan 3, the defined benefit portions of Plan 2 and Plan 3 are accounted for in the same pension trust fund. All assets of this Plan 2/3 defined benefit plan may legally be used to pay the defined benefits of any of the Plan 2 or Plan 3 members or beneficiaries, as defined by the terms of the plan. Therefore, Plan 2/3 is considered to be a single plan for accounting purposes.

PERS Plan 1 and Plan 2 retirement benefits are financed from a combination of investment earnings and employer and employee contributions. Employee contributions to the PERS Plan 1 and Plan 2 defined benefit plans accrue interest at a rate specified by the Director of DRS. During DRS' Fiscal Year 2012, the rate was five and one-half percent compounded quarterly. Members in PERS Plan 1 and Plan 2 can elect to withdraw total employee contributions and interest thereon upon separation from PERS-covered employment.

PERS Plan 1 members are vested after the completion of five years of eligible service.

PERS Plan 1 members are eligible for retirement after 30 years of service, or at the age of 60 with five years of service, or at the age of 55 with 25 years of service. The monthly benefit is 2% of the average final compensation (AFC) per year of service, but the benefit may not exceed 60% of the AFC. The AFC is the monthly average of the 24 consecutive highest-paid service credit months.

The monthly benefit is subject to a minimum for retirees who have 25 years of service and have been retired 20 years, or who have 20 years of service and have been retired 25 years. If a survivor option is chosen, the benefit is reduced. Plan 1 members retiring from inactive status prior to the age of 65 may also receive actuarially reduced benefits. Plan 1 members may elect to receive an optional COLA that provides an automatic annual adjustment based on the Consumer Price Index. The adjustment is capped at 3% annually. To offset the cost of this annual adjustment, the benefit is reduced.

PERS Plan 1 provides duty and non-duty disability benefits. Duty disability retirement benefits for disablement prior to the age of 60 consist of a temporary life annuity. The benefit amount is $350 a month, or two-thirds of the monthly AFC, whichever is less. The benefit is reduced by any workers' compensation benefit and is payable as long as the member remains disabled or until the member attains the age of 60, at which time the benefit is converted to the member's service retirement amount. A member with five years of covered employment is eligible for non-duty disability retirement. Prior to the age of 55, the benefit amount is 2% of the AFC for each year of service reduced by 2% for each year that the member's age is less than 55. The total benefit is limited to 60% of the AFC and is actuarially reduced to reflect the choice of a survivor option. Plan 1 members may elect to receive an optional COLA amount (based on the Consumer Price Index), capped at 3% annually. To offset the cost of this annual adjustment, the benefit is reduced.

PERS Plan 1 members can receive credit for military service while actively serving in the military if such credit makes them eligible to retire. Members can also purchase up to 24 months of service credit lost because of an on-the-job injury.

The survivor of a PERS Plan 1 member who dies after having earned ten years of service credit has the option, upon the member's death, of either a monthly survivor benefit or the lump sum of contributions plus interest.

PERS Plan 2 members are vested after the completion of five years of eligible service. Plan 2 members are eligible for normal retirement at the age of 65 with five years ofservice. The monthly benefit is 2% of the AFC per year of service. The AFC is the monthly average of the 60 consecutive highest-paid service months. There is no cap on years of service credit; and a cost-of-living allowance is granted (based on the Consumer Price Index), capped at 3% annually.

PERS Plan 2 members who have at least 20 years of service credit and are 55 years of age or older are eligible for early retirement with a reduced benefit. The benefit is reduced by an early retirement factor (ERF) that varies according to age, for each year before age 65.

PERS Plan 2 members who have 30 or more years of service credit and are at least 55 years old can retire under one of two provisions:

- With a benefit that is reduced by 3% for each year before age 65; or.
- With a benefit that has a smaller (or no) reduction (depending on age) that imposes stricter return-to-work rules.

PERS Plan 2 retirement benefits are also actuarially reduced to reflect the choice, if made, of a survivor option.

The surviving spouse or eligible child(ren) of a PERS Plan 2 member who dies after having earned ten years of service credit has the option of either a monthly benefit or a lump sum payment of the member's contributions plus interest.

PERS Plan 3 has a dual benefit structure. Employer contributions finance a defined benefit component and member contributions finance a defined contribution component. As established by chapter 41.34 RCW, employee contribution rates to the defined contribution component range from 5% to 15% of salaries, based on member choice. There are currently no requirements for employer contributions to the defined contribution component of PERS Plan 3.

PERS Plan 3 defined contribution retirement benefits are dependent upon the results of investment activities. Members may elect to self-direct the investment of their contributions. Any expenses incurred in conjunction with self-directed investments are paid by members. Absent a member's self-direction, PERS Plan 3 investments are made in the same portfolio as that of the PERS 2/3 defined benefit plan.

For DRS' Fiscal Year 2012, PERS Plan 3 employee contributions were $95.2 million, and plan refunds paid out were $66.2 million.

The defined benefit portion of PERS Plan 3 provides members a monthly benefit that is 1% of the AFC per year of service. The AFC is the monthly average of the 60 consecutive highest-paid service months. There is no cap on years of service credit, and Plan 3 provides the same cost-of-living allowance as Plan 2.

Effective June 7, 2006, PERS Plan 3 members are vested in the defined benefit portion of their plan after ten years of service; or after five years of service, if twelve months of that service are earned after age 44; or after five service credit years earned in PERS Plan 2 by June 1, 2003. Plan 3 members are immediately vested in the defined contribution portion of their plan.

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

- If they have at least ten service credit years and are 55 years old, the benefit is reduced by an ERF that varies with age, for each year before age 65.
- If they have 30 service credit years and are at least 55 years old, they have the choice of a benefit that is reduced by 3% for each year before age 65; or a benefit with a smaller (or no) reduction factor (depending on age) that imposes stricter return-to-work rules.

PERS Plan 3 benefit retirement benefits are also actuarially reduced to reflect the choice, if made, of a survivor option.

PERS Plan 2 and Plan 3 provide disability benefits. There is no minimum amount of service credit required for eligibility. The Plan 2 monthly benefit amount is 2% of the AFC per year of service. For Plan 3, the monthly benefit amount is 1% of the AFC per year of service. These disability benefit amounts are actuarially reduced for each year that the member's age is less than 65, and to reflect the choice of a survivor option. There is no cap on years of service credit, and a cost-of-living allowance is granted (based on the Consumer Price Index) capped at 3% annually.

PERS Plan 2 and Plan 3 members may have up to ten years of interruptive military service credit; five years at no cost and five years that may be purchased by paying the required contributions.

PERS Plan 2 and Plan 3 members who become totally incapacitated for continued employment while serving the uniformed services, or a surviving spouse or eligible child(ren), may request interruptive military service credit.

PERS Plan 2 and Plan 3 members can purchase up to 24 months of service credit lost because of an on-the-job injury.

PERS members may also purchase up to five years of additional service credit once eligible for retirement. This credit can only be purchased at the time of retirement and
can be used only to provide the member with a monthly annuity that is paid in addition to the member's retirement benefit.

Beneficiaries of a PERS Plan 2 or Plan 3 member with ten years of service who is killed in the course of employment receive retirement benefits without actuarial reduction. This provision applies to any member killed in the course of employment, on or after June 10, 2004, if found eligible by the Director of the Department of Labor and Industries.

A one-time duty-related death benefit is provided to the estate (or duly designated nominee) of a PERS member who dies in the line of service as a result of injuries sustained in the course of employment, or if the death resulted from an occupational disease or infection that arose naturally and proximately out of the member's covered employment, if found eligible by the Department of Labor and Industries.

There are 1,184 participating employers in PERS. Membership in PERS consisted of the following as of the latest actuarial valuation date for the plans of June 30, 2011:

Retirees and Beneficiaries Receiving Benefits	79,363
Terminated Plan Members Entitled to But Not Yet Receiving Benefits	29,925
Active Plan Members Vested	105,578
Active Plan Members Non-vested	46,839
Total	**261,705**

Funding Policy

Each biennium, the state Pension Funding Council adopts PERS Plan 1 employer contribution rates, PERS Plan 2 employer and employee contribution rates, and PERS Plan 3 employer contribution rates. Employee contribution rates for Plan 1 are established by statute at 6% for state agencies and local government unit employees, and at 7.5 % for state government elected officials. The employer and employee contribution rates for Plan 2 and the employer contribution rate for Plan 3 are developed by the Office of the State Actuary to fully fund Plan 2 and the defined benefit portion of Plan 3. Under PERS Plan 3, employer contributions finance the defined benefit portion of the plan and member contributions finance the defined contribution portion. The Plan 3 employee contribution rates range from 5% to 15%, based on member choice. Two of the options are graduated rates dependent on the employee's age.

As a result of the implementation of the Judicial Benefit Multiplier Program in January 2007, a second tier of employer and employee rates was developed to fund, along with investment earnings, the increased retirement benefits of those justices and judges that participate in the program.

The methods used to determine the contribution requirements are established under state statute in accordance with chapters 41.40 and 41.45 RCW.

The required contribution rates expressed as a percentage of current-year covered payroll, as of December 31, 2012, are as follows:

Members Not Participating in JBM:

	PERS Plan 1	**PERS Plan 2**	**PERS Plan 3**
Employer*	7.21%	7.21%	7.21%
Employee	6.00%	4.64%	**

* The employer rates include the employer administrative expense fee currently set at 0.16%.

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

Both district and the employees made the required contributions. The district's required contributions for the years ending December 31 were as follows:

	PERS Plan 1	**PERS Plan 2**	**PERS Plan 3**
2012	$25,478	$885,901	$68,302
2011	$24,257	$755,863	$56,546
2010	$29,135	$634,993	$50,614

The District's payroll subject to PERS plans for the years ended December 31, 2012 and 2011 was $13,635,771 and $13,546,452 respectively. The District's total payroll for all employees for the same periods was $14,158,258 and $13,939,545 respectively.

NOTE 7 - POST EMPLOYMENT BENEFITS OTHER THAN PENSIONS (OPEBs)

Plan Description – In accordance with collective bargaining agreements, the District provides 90%, currently, employer paid post-retirement medical, visions and prescription benefits for qualified retired employees and their eligible dependents until age 65.

Funding Policy – The District funds its post retirement health care benefits when the actual health care costs are incurred for retiree and their eligible dependents. The District is currently evaluating the option of pre-funding all or a portion of the actuarial calculated ARC, but no decision has been made.

Annual OPEB Cost – The District's annual OPEB cost is calculated based on the annual required contribution (ARC) of the employer. The ARC is an amount actuarially determined based on the entry age normal method, determined in accordance with the guidance of GASB Statement 45. The ARC represents level funding, that if paid on an on-going basis, is projected to cover normal costs each year and amortize any unfounded actuarial accrued liabilities over a period not to exceed 30 years. The District implemented GASB 45 prospectively in 2008. The District's annual required OPEB expense is $2,420,466 and is equal to the Annual Required Contribution including interest.

Funding Status and funding progress – In 2012, the payment of employment health care benefits for retirees and qualified dependents totaled $844,210. The current year funding resulted in an accrued OPEB Liability of $1,576,256.

The Schedule of Funding Progress for the unfunded actuarial accrued liability (UALL) is as follows:

Actuarial valuation date	Dec 31, 2012	Dec. 31, 2011
(in thousands)		
Actuarial Value of Assets	$ 844	$ 1,025
Entry age normal actuarial		
Accrued liability	$ 27,661	$ 28,686
UAAL	$ 26,817	$ 27,661
Funded Ratio	3%	3%
Covered Payroll	$ 14,158	$ 13,940

NOTE 8 - DEFERRED COMPENSATION PLANS

The District offers its employees deferred compensation programs created in accordance with Internal Revenue Code Sections 401 and 457. The plans, available to all District employees, permit them to defer a portion of their current salary, up to defined limits, until future years. The deferred compensation is not available to employees until termination, retirement, death or unforeseeable emergency as defined in IRS Code.

In accordance with IRS Code, all plan assets are held in trust for the exclusive benefit of participants and their beneficiaries, and as such are not included in the District's financial statements.

The Grays Harbor County PUD No. 1 401(k) Savings Plan (the Plan) provides that participants may make voluntary payroll deferral contributions, on a pre-tax basis, up to the amount established annually by the Internal Revenue Service as the deferral ceiling.

The District has no liability for losses under the plans but does have the duty of due care that would be required of an ordinary prudent fiduciary. BenefitsCorp, the Trustee of the plans, administers both plans.

NOTE 9 - SELF-INSURANCE

Liability Insurance
The District is a member of the Public Utility Risk Management Services Self-Insurance fund (PURMS). RCW Chapter 48.62 authorizes the governing body of any one or more governmental entities to form together into or join a pool or organization for the joint purchasing of insurance, and/or joint self-insuring, and/or joint hiring or contracting for risk management services to the same extent that they may individually purchase insurance, self insure, or hire or contract for risk management services. An agreement to form a pooling arrangement was made pursuant to the provisions of RCW Chapter 54.16. The liability pool was formed on December 31, 1976 when certain PUDs in the State of Washington joined together by signing an Agreement to pool their self-insured losses and jointly purchase insurance and administrative services. Nineteen members currently belong to PURMS.

Additional pools for property and health and welfare coverage were added in March 1997 and April 2000, respectively, under the same agreements and with the same membership. All members do not participate in all pools. The District does not participate in the PURMS health and welfare pool.

The liability pool has a $1 million self-insured retention with $2 million in reserves. In addition, the fund purchases $60 million of excess general liability insurance and $10 million of professional liability insurance over the $1 million retention. The fund also purchases $35 million in directors and officers' liability coverage with retention of $500,000. The deductible is $250.

The majority of the property in the property pool has a $250,000 self-insured retention. Certain classes of property have higher retention requirements up to $750,000. In response to the changes in retention, PURMS members have increased the reserve from $500,000 to $750,000. In addition, the fund purchases $150 million of excess insurance over the $250,000 (or higher) retention level. The deductible varies, but for most classes or property is $250

Members of each pool are assessed to maintain the designated self-insured retention.

After termination, a member is still responsible for their share of contributions to the pools for any unresolved, unreported, and in-process claims for the period they were a signatory to the agreement.

The pools are fully funded by its current and former members. Claims are filed by members with the Administrator, Pacific Underwriters, Seattle, WA, which has been contracted to perform claims adjustment and loss prevention services.

The pools are governed by a Board of Directors, which is comprised of one designated representative from each participating member. The Administrator and an elected Administrative Committee are responsible for conducting the business affairs of the pool.

Self-Funded Employee Dental, Medical and Vision Coverage
The District provides its employees and retirees with a self-funded dental program, administered for a fee by the Washington Dental Service. The District, through a collective bargaining agreement, is responsible for 90% of the cost of the dental program. The program is reviewed and monitored by the District's Health & Welfare Committee, which recommends funding levels to ensure program solvency. The reserves for the dental program are maintained in the Employee Benefits Trust.

The District and its employees both participate in the cost of monthly medical premiums. Premiums are held in the Medical/Dental Claims Trust Funding Account (Trust). The District uses a Minimum Premium

Funding arrangement. Its service provider, Premera Blue Cross, determines premium levels, and is paid an administrative fee for their services.

The District purchases individual Stop Loss insurance in the amount of $50,000, and maintains a Rate Stabilization Reserve for claims funding.

Medical and Dental claims expenses for 2012 were $3,567,410. Total contributions to the Trust by the District and employees during 2012 for medical and dental coverage were $3,961,267.

Medical and Dental claims expenses for 2011 were $3,578,047. Total contributions to the Trust by the District and employees during 2011 for medical and dental coverage were $3,851,111.

NOTE 10 - CONSERVATION PROGRAMS

The District is required by the state of Washington's Energy Independence Act to "identify and achieve all cost-effective conservation" in the District's service territory. For the 2012-13 biennium, the District's Commission adopted a target of 1.71 average megawatts of conservation.

For residential customers, the District provides rebates on home weatherization, electric heating system upgrades (including duct-testing and sealing), solar water heating systems, energy efficient lighting, and some appliances. Customers may also choose low-interest loans in lieu of rebates for weatherization and heating system projects. These loans are available through a local bank with a District-provided subsidy offsetting a portion of the interest.

Non-residential customers can take advantage of a flexible offering of conservation incentives. The majority of projects implemented involve heating and cooling system upgrades, energy efficient lighting, and motor and compressor upgrades for industrial customers.

The District participates in the Bonneville Power Administration's conservation incentive programs to help fund its conservation programs. In 2012, Bonneville provided conservation funding to the District through the Energy Efficiency Incentive (EEI) program. Under the EEI program, the District invoices BPA after conservation projects are completed and receives incentives based upon the type and number of measures implemented. In 2012, the District received approximately $1.28M through the EEI program, a little over 80% of total District spending on conservation.

NOTE 11 - POWER SUPPLY

BPA Power Contract

In October 2011 the District entered a new seventeen-year Block and Slice Power Sales Agreement with BPA commencing October 1, 2011, replacing the previous long-term agreement. These agreements incorporate provisions of the Pacific Northwest Electric Power Planning and Conservation Act of 1980 (Public Law 96-501) and the Bonneville Project Act of 1937 such as preference and priority in the distribution and marketing of BPA's federal power to publicly owned preference customers, such as the District. The contract provides federal power in amounts based on the District's annual Net Requirements in the form of two products: Block and Slice.

The Block product provides power in pre-agreed upon monthly amounts, ranging 43MW to 64MW. The rate for Block power is the lowest applicable Priority Firm rate made available to BPA's preference customers.

The Slice product, on the other hand, provides the District with access to a more variable product: 1.1681% of the Federal System Output (the District's Slice), which is based on the output of the federal system each hour. The output consists of federal hydroelectric projects and some non-federal projects, including thermal projects such as Columbia Generating Station, all adjusted for storage and return obligations. The 2011 applicable base-rate for Slice purchases is $2,213,021 per month for each percent of Slice plus the Load Based Cost Recovery Adjustment Charge (LBCRAC), currently 0%, with the adjusted base rate subject to an annual true up by BPA based upon updated actual costs allocated to the Slice System. Technical Operating Procedures have been established to provide Slice purchasers with the ability to calculate, schedule, and account for their share of Slice Output on an hourly basis. This product does not include transmission services. Moreover, by its nature, there is a greater degree of potential for exposure – and benefit – depending upon snow-pack amount and timing of runoff and other conditions that affect water, and therefore hydroelectric system output.

BPA Transmission Services
The District traditionally purchased bundled electric power and transmission services from BPA under the District's power purchase contract. However, in response to changes in Federal Energy Regulatory Commission regulations in the late 1990s, BPA unbundled their electric power and transmission services, and required that transmission services be purchased separately.

In order to obtain necessary transmission services, the District entered into a long-term service agreement with BPA for Point-To-Point transmission services commencing April 30, 1997, terminating July 1, 2023.

Frederickson CT:
The District has entered into a 20-year purchase commitment for purchase of 45 MW of capacity with displacement and sales rights from the Frederickson Project, a natural gas-fired combined-cycle combustion turbine. The Frederickson Project, located near Tacoma, Washington, became commercially operational in September 2002.

Nine Canyon Wind Project:
In 2002 the District entered into a 20-year purchase agreement with Energy Northwest for 12.5% of the output, or an estimated 8MW of capacity from the Nine Canyon Wind Project, phases I and II, located near Kennewick, Washington. Power costs are estimated to be $37/MWh plus annual escalation based on an estimated 31% capacity factor. The District is also participating in Phase III of the Nine Canyons Wind Project, which is planned to become commercially operable on February 1, 2008. Phase III will provide the District an additional 12MW of nameplate capacity, for a total of 20MW or 20.5% of the 96MW project.

Pasco CT:
The District partnered with Franklin County PUD during 2001-2002 to jointly build and operate the Franklin/Grays Harbor PUDs Peak Generating Station, a 44MW-generating project consisting of four natural gas fueled simple-cycle combustion turbines. The Franklin Project provides the District with both backup and peaking generation capacity. The District's ownership share is one-half of the output of the project, or 22MW. The District's two 11MW units connect to Franklin County PUD's system, where costs incurred are shared equally by both utilities. The project became commercially operational in June of 2002.

In 2010, the District determined that the Pasco Combustion Turbine Generating Station was temporarily impaired. (See Note 15 for additional information)

Coastal Energy Project
The Coastal Energy Project is a 6MW capacity wind farm located outside Grayland, WA and operated by Coastal Community Action Program (CCAP). The District entered into a 20 year power purchase contract with CCAP to purchase the output from the project. The output from the project is compliant with the requirements of the Energy Independence Act, see Note 12.

Sierra Pacific Industries

The Sierra Pacific Industries operates a biomass generation facility and the District has contracted to purchase 6aMW from the plant. The District has the option to purchase additional output from the facility beginning in 2014. The output from the project is compliant with the requirements of the Energy Independence Act, see Note 12.

The Energy Authority

The Energy Authority (TEA) provides professional power supply management services including wholesale open market purchases and sales of electricity on behalf of the District. TEA also negotiates sales of excess transmission and provides power scheduling and gas procurement services to the District.

Market Purchases and Sales

Through its membership in the Western Systems Power Pool (WSPP), the District has the ability to buy and sell power for terms of one year or less with nearly all utilities in the Western United States and Canada, as well as many power marketers. The District has also entered into NAESB and ISDA agreements with several counterparties for the purpose of making financial and gas hedging transactions when market conditions and resource availability warrant.

During 2012 the District purchased 183,297 MWh of short-term market energy from several counterparties. These purchases are 18.78% as large as the District's annual load. Moreover, the District sold 650,946 MWh of short-term market energy and transmission to several counterparties during the year. These sales are 67% as large as the District's annual load.

During 2011 the District purchased 105,743 MWh of short-term market energy from several counterparties. These purchases are 10.69% as large as the District's annual load. Moreover, the District sold 657,433 MWh of short-term market energy and transmission to several counterparties during the year. These sales are 66% as large as the District's annual load.

Power Market Risk Management Policies and Procedures

In December 2000, the District commenced with a comprehensive assessment of its risk profile, and the development of Policies and Procedures for Risk Management and Trading Operations. The results of this effort, completed by July 2001 and updated in August of 2005, are detailed guidelines for considering and/or engaging in any power and gas trading agreements. The District's Risk Management Committee, with oversight and review by the Board of Commissioners, actively manages financial risk. The District periodically updates the risk management policy to incorporate improved procedures and practices.

NOTE 12 - TELECOMMUNICATIONS

The District has constructed a fiber optic backbone that encompasses approximately 159 miles of cable. The District presently operates a digital microwave system that provides communications throughout Grays Harbor County. These systems significantly improve the District's operations and, as an additional benefit, provide state-of-the-art communications to the residents of Grays Harbor County.

The District intends to continue to expand its fiber optic network to critical points in its transmission and distribution systems, as well as to its substation facilities. Under the "Excess Capacity" model, the District allows retail providers to lease wholesale services. These services include excess fiber optic capacity, WDM Circuits, microwave radio circuits, space on District microwave towers and poles, and co-location space. The District sells bandwidth and services to retail providers on a wholesale basis. The District currently operates three fiber optic/co-location nodes within Grays Harbor County and is in the process of constructing two new nodes within the County.

The following table details the telecommunications activity:

	2012	2011
Operating Revenue		
Telecom Revenue	$244,343	$-0-
Dark Fiber Lease		60,857
Co-Location Rental		77,410
Bandwidth (Internet & Intranet)		2,221
Miscellaneous	70	28,399
Total Operating Revenue	**$244,413**	**$168,887**
Operating Expenses		
Administrative & General	39,799	25,777
Repairs & Maintenance	35,715	78,786
Total Operating Expenses	**75,514**	**104,562**

NOTE 13 - LITIGATION

The District was notified of a potential claim relating to an electrical contact by a painter in July 2012, however no dollar amount was stated. The information in the notice has been forwarded to the District's insurance company. Litigation has not yet been commenced and, therefore, the District is unable to assess the merits of the claim or render an opinion regarding the outcome.

Miscellaneous Claims

The District is occasionally the defendant in claims charging negligence in the location of power poles struck by motor vehicles. District employees may also be involved in collisions involving motor vehicles where claims for damages and/or injuries result.

The District is insured against liability over such matters and vigorously defends actions it deems defensible. Because of the District's insurance and defense policy it is believed that none of the claims made or incurred, whether filed or not, is expected to have any material consequence to the District.

NOTE 14 - SUBSEQUENT EVENTS

There were no events subsequent to the balance sheet date that would require additional disclosure

ABOUT THE STATE AUDITOR'S OFFICE

The State Auditor's Office is established in the state's Constitution and is part of the executive branch of state government. The State Auditor is elected by the citizens of Washington and serves four-year terms.

Our mission is to work with our audit clients and citizens as an advocate for government accountability. As an elected agency, the State Auditor's Office has the independence necessary to objectively perform audits and investigations. Our audits are designed to comply with professional standards as well as to satisfy the requirements of federal, state, and local laws.

The State Auditor's Office employees are located around the state to deliver services effectively and efficiently.

Our audits look at financial information and compliance with state, federal and local laws on the part of all local governments, including schools, and all state agencies, including institutions of higher education. In addition, we conduct performance audits of state agencies and local governments and fraud, whistleblower and citizen hotline investigations.

The results of our work are widely distributed through a variety of reports, which are available on our Web site and through our free, electronic subscription service.

We take our role as partners in accountability seriously. We provide training and technical assistance to governments and have an extensive quality assurance program.

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