

MOSSEY ADAMS

**PUBLIC UTILITY DISTRICT NO. 1  
OF OKANOGAN COUNTY, WASHINGTON**

**INDEPENDENT AUDITOR'S REPORT**

**AND FINANCIAL STATEMENTS  
AND REQUIRED SUPPLEMENTARY INFORMATION**

**DECEMBER 31, 2009**

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**INDEPENDENT AUDITOR'S REPORT**

To the Commissioners  
Public Utility District No. 1  
of Okanogan County, Washington  
Okanogan, Washington

We have audited the accompanying balance sheet of Public Utility District No. 1 of Okanogan County, Washington (the District) as of December 31, 2009, and the related statements of revenues, expenses, and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Public Utility District No. 1 of Okanogan County as of December 31, 2009, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 14, the District corrected an error related to its accounting for unbilled revenue, and has restated its net assets as of January 1, 2009, to conform with accounting principles generally accepted in the United States of America.

The accompanying management's discussion and analysis is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures that consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.



Everett, Washington  
May 28, 2010

**PUBLIC UTILITY DISTRICT NO. 1 OF OKANOGAN COUNTY, WASHINGTON  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
YEAR ENDED DECEMBER 31, 2009**

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The following discussion and analysis is designed to assist the reader in focusing on the significant financial issues, provide an overview of Public Utility District No. 1 of Okanogan County (the District) financial activity, and identify changes in the District's financial position during 2009. Please consider the information presented here in conjunction with the financial statements as a whole, including the footnotes and other supplementary information that is provided.

The District, a municipal corporation of the state of Washington, was established in 1936 and began operations in 1945. The District is governed by a three-member Board of Commissioners locally elected to six-year terms. The District operates both electric and telecommunications systems that are accounted for in a single proprietary fund.

### **Overview of the Financial Statements**

The financial statements include the management's discussion and analysis and basic financial statements with accompanying notes. In accordance with the Governmental Accounting Standards Board (GASB), the District's financial statements are presented on an accrual basis of accounting, which recognizes revenues when earned and expenses when incurred, regardless of when cash is received or paid.

The basic financial statements are presented as of and for the year ended December 31, 2009, and consist of:

**Balance sheet** - The balance sheet presents information on the District's assets, liabilities, and net assets at year-end. It also provides information about the nature and amounts of investments in resources (assets) and the District's obligations to its creditors (liabilities).

**Statement of revenues, expenses, and changes in net assets** - The statement of revenues, expenses, and changes in net assets accounts for the year's revenue and expense transactions. This statement measures the District's operations over the past year and may be used to determine if the District has been successful in recovering its costs through rates and other charges.

**Statement of cash flows** - The statement of cash flows provides information on the District's cash receipts and disbursements during the year. The statement reports changes in cash resulting from operations, investing, and financing activities.

The notes to the financial statements provide additional information that is an integral part of the financial statements. This information includes the disclosure of significant accounting policies, financial activities, risks, commitments, and obligations.

**PUBLIC UTILITY DISTRICT NO. 1 OF OKANOGAN COUNTY, WASHINGTON  
MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)  
YEAR ENDED DECEMBER 31, 2009**

**Selected Financial Information**

	DECEMBER 31,	
	2009	2008 (Prior to Restatement)
<b>ASSETS</b>		
Current and other assets	\$ 32,013,840	\$ 44,126,751
Net utility plant	75,506,178	63,948,537
Total assets	<u>\$ 107,520,018</u>	<u>\$ 108,075,288</u>
<b>LIABILITIES</b>		
Current liabilities	\$ 9,010,911	\$ 9,259,289
Long-term debt	13,184,589	14,021,625
Total liabilities	<u>22,195,500</u>	<u>23,280,914</u>
<b>NET ASSETS</b>		
Invested in capital assets, net of debt	61,641,028	49,335,019
Restricted for contingencies	9,157,500	8,199,584
Unrestricted net assets	<u>14,525,990</u>	<u>27,259,771</u>
Total net assets	<u>85,324,518</u>	<u>84,794,374</u>
Total liabilities and net assets	<u>\$ 107,520,018</u>	<u>\$ 108,075,288</u>

	YEAR ENDED DECEMBER 31,	
	2009	2008 (Prior to Restatement)
<b>REVENUE</b>		
Operating		
Electric - retail	\$ 30,564,662	\$ 31,725,275
Electric - wholesale	4,198,885	11,263,827
Telecommunications	1,622,655	1,023,170
Other operating revenue	<u>1,176,193</u>	<u>727,418</u>
Total operating income	<u>37,562,395</u>	<u>44,739,690</u>
Nonoperating		
Interest income	964,500	1,697,562
Other nonoperating income	214,852	
Contributed capital	<u>884,846</u>	<u>1,795,823</u>
Total nonoperating income	<u>2,064,198</u>	<u>3,493,385</u>
Total revenue	<u>39,626,593</u>	<u>48,233,075</u>

**PUBLIC UTILITY DISTRICT NO. 1 OF OKANOGAN COUNTY, WASHINGTON**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**  
**YEAR ENDED DECEMBER 31, 2009**

**Selected Financial Information (continued)**

	YEAR ENDED DECEMBER 31,	
	2009	2008 (Prior to Restatement)
<b>EXPENSES</b>		
Operating		
Cost of power	22,334,570	25,013,021
Taxes	1,876,404	1,921,890
Depreciation	3,118,253	2,953,691
Other operating expenses	11,730,938	10,964,551
Total operating expenses	<u>39,060,165</u>	<u>40,853,153</u>
Nonoperating		
Loss on disposition of plant	7,890	39,598
Interest expense	767,365	798,800
Impairment of investment	1,147,139	
Other deductions	410,786	2,995,409
Total nonoperating	<u>2,333,180</u>	<u>3,833,807</u>
Total expenses	<u>41,393,345</u>	<u>44,686,960</u>
CHANGE IN NET ASSETS	(1,766,752)	3,546,115
NET ASSETS, beginning of period - as originally reported	<u>84,794,374</u>	<u>81,248,259</u>
Prior period adjustment	2,296,896	
NET ASSETS, beginning of period, as restated	<u>87,091,270</u>	
NET ASSETS, end of period	<u>\$ 85,324,518</u>	<u>\$ 84,794,374</u>

**Financial Highlights**

During 2009, the District's overall financial position remained strong despite lower than expected wholesale energy markets and stalled load growth. The nation's economic condition was the leading cause of both retail and wholesale revenue being below expectations. The District's net assets decreased by \$1,766,752 in 2009, compared with an increase of \$3,546,115 in 2008. The District recorded a prior period adjustment to its net assets in order to account for unbilled revenue for year ended December 31, 2008, which resulted in an increase of net assets in the amount of \$2,296,896. This adjustment was necessary to bring the District in line with generally accepted accounting principles. Although the prior period adjustment does not effect the change in net assets for 2009, in the table above, such adjustment is presented as an adjustment in 2009 to align with the presentation in the statement of revenue, expenses, and changes in net assets for the period ended December 31, 2009. As described in Note 14, the prior period adjustment had an immaterial effect on the 2008 change in net assets; therefore, 2009 and 2008 financial results presented above are comparable.

**PUBLIC UTILITY DISTRICT NO. 1 OF OKANOGAN COUNTY, WASHINGTON  
MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)  
YEAR ENDED DECEMBER 31, 2009**

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**Financial Highlights (continued)**

The following is an analysis of key financial factors with an emphasis on changes between 2009 and 2008:

**Cash and investments** - The District had cash and investments totaling \$23,679,666 and \$37,737,758 as of December 31, 2009 and 2008, respectively. The decrease of \$14,058,092 is due in a large part to several capital projects that the District undertook during the year. In addition, as of December 31, 2008, the District had received a refund from the Bonneville Power Administration (BPA) in the amount of \$2,074,618, which was recorded as a deferred credit. During 2009, the District passed \$1,540,522 of this refund to its customers in a form of credits on their monthly bills and placed the remaining balance of \$535,000 in its Rate Stabilization Fund. As noted in Note 1 to the financial statements, investments in the amount of \$9,214,507 are considered restricted as of December 31, 2009. The funds are restricted as follows: \$129,507 for debt service payments, \$1,550,000 for customer deposits and employee compensated absences fund, and the remaining \$7,535,000 in a rate stabilization fund.

**Utility plant** - Net utility plant increased by \$11,557,641, or 18.1%, during 2009, compared with an increase of \$5,600,188, or 9.6%, during 2008. A summary of utility plant in service is included in Note 3 to the financial statements.

**Debt** - The District has not issued debt since 2003. As of December 31, 2009, the District had \$14,480,000 in revenue bonds outstanding, compared with \$15,315,000 as of December 31, 2008. Decrease in total debt outstanding was a result of scheduled debt payments made during 2009.

**Net operating loss** - The District recorded revenues from operations of \$37,562,395, which were \$1,497,770 less than operating expenses of \$39,060,165 in 2009, in comparison with 2008, when operating revenues exceeded operating expenses by \$3,886,537.

**Operating revenue** - Revenues from the retail sale of electricity decreased by 3.7% from \$31,725,275 in 2008 to \$30,564,662 in 2009, compared with growth in retail sales in 2008 of 2.8%. The decrease in retail sales was the result of flat load growth due to current economic conditions and a BPA refund in the amount of \$1,540,522, which the District credited to customer accounts. During 2009, revenue from wholesale sales of electricity plummeted by 62.7% to \$4,198,885 from \$11,263,827, as reported in 2008. The decrease in wholesale sales of electricity was the result of a combination of factors, which included lower quantities of electricity available to be sold in the wholesale market and lower market prices. Wholesale telecommunications continues to expand its market, which is reflected by continued significant revenue increases of 58.6% to \$1,622,655 in 2009, compared with \$1,023,170 in 2008.

**PUBLIC UTILITY DISTRICT NO. 1 OF OKANOGAN COUNTY, WASHINGTON  
MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)  
YEAR ENDED DECEMBER 31, 2009**

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**Financial Highlights (continued)**

**Operating expenses** - Operating expenses decreased by \$1,792,988, or 4.4%, from \$40,853,153 in 2008 to \$39,060,165 in 2009. The driving force behind the decrease was a decrease in 2009 cost of power expenses in the amount of \$2,678,451, or 10.7%. As discussed earlier, during 2008, the District received refunds from BPA amounting to \$2,090,380, of which \$2,074,618 was carried forward into 2009, resulting in a decrease in cost of power expenses in 2009.

**Rates** - The District imposed no rate increases during 2009. The last rate increase was in 2001 in response to the "Energy Crisis." In 2008, the District contracted with R.W. Beck to review its cost of service and formalize the District's financial policies and goals. The District finalized a Cost of Service Study in May 2009 as well as an Equity Management Plan in March 2010. The District has recently finalized a Rate Study, which recommended a series of future rate adjustments. At its May 4, 2010, meeting, the Board of Commissioners passed a resolution approving a series of rate increases with the first adjustment taking effect July 1, 2010.

**Significant Capital Assets and Long-Term Debt**

The District anticipates issuing new debt in the future to finance projects discussed in the following paragraphs:

During 2009, the District undertook several projects, including the construction of a new headquarters building and the implementation of an automated meter infrastructure. In addition, the District continues to pursue the construction of an approximately 26-mile transmission line to serve the Methow Valley. The District is currently funding the costs of these projects out of existing reserves and plans on replenishing reserves by issuing new debt in the future.

The District continues to invest in wholesale telecommunications infrastructure. As of December 31, 2009, the District has invested a total of \$5,285,456 in wholesale telecommunications, which is a decrease of \$173,383 over year ended December 31, 2008. The decrease reflects that the wholesale telecommunications side of the District has turned the corner and is now showing a positive net income, as well as covering debt service. The District's telecommunications network is connected to the Northwest Open Access Network, a fiber optic system that is member-owned. The District plans to move forward in the wholesale telecommunications business using a controlled and methodical approach, as laid out in its 2008 business plan. The District's internal and external communication needs are being financed internally by the District.

The District is the current owner of the Enloe Hydroelectric Dam, a small hydroelectric project on the Similkameen River near Oroville, Washington. The District is in the process of relicensing Enloe Dam and, upon receipt of the Federal Energy Regulatory Commission (FERC) license, will begin construction at an estimated cost of \$35,000,000. The District anticipates issuing future debt to finance the construction.

**PUBLIC UTILITY DISTRICT NO. 1 OF OKANOGAN COUNTY, WASHINGTON  
MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)  
YEAR ENDED DECEMBER 31, 2009**

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**Significant Capital Assets and Long-Term Debt (continued)**

In addition, the District has submitted a Preliminary Permit Application to the Federal Energy Regulatory Commission for a water storage and hydroelectric project located on the Similkameen River in Okanogan County, Washington. The Dam and associated facilities would be located upstream of Enloe Dam at what is commonly referred to as Shanker's Bend. The Shanker's Bend Project will study various alternatives including dam heights ranging from 90 to 260 feet. The likelihood that this project will be pursued at this time is unknown.

Additional information is contained in the notes to the financial statements. Please refer to Note 3 - Utility Plant and Note 4 - Long-Term Debt.

**Contacting the District's Financial Management**

This financial report is designed to provide the District's ratepayers, investors, and other readers with a general overview of the District's finances and to show the District's accountability for money it receives. If you have questions about this report or need additional information, contact the District's Director of Finance at Public Utility District No. 1 of Okanogan County, P.O. Box 912, Okanogan, WA 98840, or by phone at (509)422-3310.



Don Coppock  
Director of Finance/Auditor

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**PUBLIC UTILITY DISTRICT NO. 1 OF OKANOGAN COUNTY, WASHINGTON**  
**BALANCE SHEET**  
**DECEMBER 31, 2009**

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**ASSETS**

CURRENT ASSETS

Cash and temporary investments	
Cash and cash equivalents	\$ 2,385,905
Temporary investments	12,079,254
Accounts receivable, less allowance for doubtful accounts of \$25,000	1,493,952
Unbilled revenue	2,697,011
Materials and supplies	3,054,100
Prepayments and other	19,180
	<hr/>
Total current assets	21,729,402

RESTRICTED ASSETS

Bond reserve	129,507
Board designated reserve	9,085,000
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Total special funds	9,214,507

UTILITY PLANT, at cost

Plant in service	105,275,372
Construction work in progress	22,329,965
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	127,605,337
Less accumulated depreciation and amortization	52,099,159
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Net utility plant	75,506,178

OTHER ASSETS

Conservation loans and notes receivable	815,559
Deferred charges	254,372
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Total other assets	1,069,931

Total assets	<u><u>\$ 107,520,018</u></u>
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**PUBLIC UTILITY DISTRICT NO. 1 OF OKANOGAN COUNTY, WASHINGTON**  
**BALANCE SHEET**  
**DECEMBER 31, 2009**

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**LIABILITIES AND NET ASSETS**

CURRENT LIABILITIES

Accounts payable	\$ 5,734,765
Accrued compensated absences	1,037,556
Accrued taxes	809,632
Customer deposits and prepayments	501,951
Accrued bond interest	57,007
Current portion of long-term debt	<u>870,000</u>
Total current liabilities	<u>9,010,911</u>

LONG-TERM DEBT

Revenue bonds	13,610,000
Bond issue discount	(101,464)
Loss on debt refunding	<u>(323,947)</u>
Total long-term debt	<u>13,184,589</u>
Total liabilities	<u>22,195,500</u>

NET ASSETS

Invested in capital assets, net of related debt	61,641,028
Restricted for	
Debt service	72,500
Other	<u>9,085,000</u>
Total restricted	9,157,500
Unrestricted	<u>14,525,990</u>
Total net assets	<u>85,324,518</u>
Total liabilities and net assets	<u><u>\$ 107,520,018</u></u>

**PUBLIC UTILITY DISTRICT NO. 1 OF OKANOGAN COUNTY, WASHINGTON**  
**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS**  
**YEAR ENDED DECEMBER 31, 2009**

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OPERATING REVENUES	
Electric - retail	\$ 30,564,662
Electric - wholesale	4,198,885
Telecommunications	1,622,655
Other operating revenue	<u>1,176,193</u>
Total operating revenue	<u>37,562,395</u>
OPERATING EXPENSES	
Cost of power	22,334,570
Transmission	95,078
Distribution - operation	5,214,906
Telecommunications	690,763
Customer accounts	1,391,185
Customer service and information	571,666
Administration and general	3,767,340
Depreciation and amortization	3,118,253
Taxes	<u>1,876,404</u>
Total operating expenses	<u>39,060,165</u>
Net operating expense	<u>(1,497,770)</u>
NONOPERATING REVENUES (EXPENSES)	
Interest income	964,500
Grant revenue	214,852
Contributed capital	884,846
Interest on long-term debt	(767,365)
Impairment of investment	(1,147,139)
Other expenses	<u>(418,676)</u>
Net nonoperating expense	<u>(268,982)</u>
CHANGE IN NET ASSETS	<u>(1,766,752)</u>
ACCUMULATED NET ASSETS	
Beginning of year - as previously reported	84,794,374
Prior period adjustment	<u>2,296,896</u>
Beginning of the year - as restated	<u>87,091,270</u>
End of year	<u><u>\$ 85,324,518</u></u>

**PUBLIC UTILITY DISTRICT NO. 1 OF OKANOGAN COUNTY, WASHINGTON**  
**STATEMENT OF CASH FLOWS**  
**YEAR ENDED DECEMBER 31, 2009**

<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>	
Receipts from customers	\$ 36,561,392
Payments to suppliers and employees	<u>(35,930,901)</u>
Net cash from operating activities	<u>630,491</u>
 <b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>	
Acquisition and construction of capital assets	(15,094,570)
Cash contributions in aid of construction	884,846
Proceeds from grants	214,852
Scheduled payments debt	(835,000)
Interest paid on debt	<u>(737,605)</u>
Net cash from capital and related financing activities	<u>(15,567,477)</u>
 <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>	
Purchases of investments	(32,112,681)
Sales and maturities of investments	47,560,088
Interest on investments	964,500
Payments for joint venture assessments	<u>(85,609)</u>
Net cash from investing activities	<u>16,326,298</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	1,389,312
 <b>CASH AND CASH EQUIVALENTS</b>	
Beginning of year	<u>996,593</u>
End of year	<u><u>\$ 2,385,905</u></u>
 <b>RECONCILIATION OF NET OPERATING REVENUES (EXPENSES) TO CASH FLOWS FROM OPERATING ACTIVITIES</b>	
Net operating expenses	\$ (1,497,770)
Adjustments to reconcile net operating revenues (expenses) to net cash from operating activities	
Depreciation	3,118,253
Cash from changes in operating assets and liabilities	
Receivables	(634,383)
Unbilled revenue	(400,115)
Materials and supplies	(235,465)
Prepaid expenses and other current assets	(1,484)
Deferred charges	561,632
Accounts payable	(463,185)
Accrued compensation, benefits, and taxes	<u>183,008</u>
NET OPERATING ACTIVITIES	<u><u>\$ 630,491</u></u>

**PUBLIC UTILITY DISTRICT NO. 1 OF OKANOGAN COUNTY, WASHINGTON**  
**NOTES TO FINANCIAL STATEMENTS**

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**Note 1 - Summary of Significant Accounting Policies**

**Organization** - Public Utility District No. 1 of Okanogan County is a municipal corporation governed by an elected three-member Board of Commissioners. The District owns, operates, and maintains an electric distribution system incorporating both electrical and telecommunication facilities and equipment. Financial information for both divisions is presented in a consolidated format.

**Reporting entity** - For financial reporting purposes the District includes activities over which it exercises oversight responsibility. As required by generally accepted accounting principles, management has considered all potential component units in defining the reporting entity. The District has no component units.

**Basis of accounting and presentation** - The accounting policies of Public Utility District No. 1 of Okanogan County (the District) conform to generally accepted accounting principles (GAAP) as applicable to proprietary funds of governmental units. The District adheres to the accounting standards and pronouncements of the Governmental Accounting Standards Board (GASB), which is the accepted standard setting body for governmental entities, and has not adopted Financial Accounting Standards Board (FASB) Statements and Interpretations issued after November 30, 1989. The accounting records of the District are maintained in accordance with methods prescribed by the State Auditor under the authority of Chapter 43.09 RCW. The District uses the Federal Energy Regulatory Commission (FERC) Uniform System of Accounts.

**Cash and cash equivalents** - The District considers all highly liquid investments with a maturity of three months or less to be cash equivalents.

**Investments and restricted assets** - The District records investments at cost, which approximates fair value. The District's investment portfolio consists entirely of fully insured, interest-bearing institutional deposits with terms of one year or less where the redemption value equals the purchase price plus a stated rate of interest. Therefore, the District's financial statements reflect no market adjustments.

In accordance with Board Resolutions and Bond Covenants, a number of separate funds have been established, and cash and investments held in these funds are restricted for special uses as follows:

Rate stabilization fund	\$ 7,535,000
Employee compensated absences fund	1,100,000
Customer deposit fund	450,000
Sinking funds - 2002 Bonds	56,766
Sinking funds - 2003 Bonds	72,741
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	\$ 9,214,507

**PUBLIC UTILITY DISTRICT NO. 1 OF OKANOGAN COUNTY, WASHINGTON**  
**NOTES TO FINANCIAL STATEMENTS**

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**Note 1 - Summary of Significant Accounting Policies (continued)**

**Accounts receivable and allowance for uncollectable accounts** - The District renders billings for electrical consumption, sales, and services on both a monthly and bi-monthly basis, and for wholesale power and telecom sales and services on a monthly basis. Management reviews accounts receivable for collectability on a regular basis and an allowance for uncollectable accounts is established based in evaluation of specific accounts and historical experience. If the account is determined to be uncollectible, it is turned over to the local credit bureau for collection.

**Materials and supplies** - Material and supplies provide for additions, maintenance, and repairs to the utility plant and are valued at weighted average cost, which approximates fair value.

**Utility plant and depreciation** - See Note 3 for asset capitalization, depreciation, and retirement policies.

**Compensated absences** - The District accrues unpaid personal leave benefit amounts as earned. The recorded liability for unpaid personal leave benefits at December 31, 2009, was \$1,037,556. Personal leave, which may be accumulated up to 1,200 hours, is payable in full upon resignation, termination, retirement, or death.

**Deferred charges** - Deferred charges consist primarily of costs relating to the sale of bonds. These costs are amortized over the lives of the various bond issues using the straight-line method. Unamortized bond issue costs amounted to \$189,439 as of December 31, 2009.

**Revenue recognition** - The District recognizes revenue as earned on a monthly basis based on rates established by the District's Board of Commissioners. Because the customer meters are read and billed at various times during each month, the District estimates unbilled revenues for energy delivered to customers between their last respective cycle billing date and December 31, and records that amount as unbilled revenue for the current year.

**Revenues and expenses** - The District distinguishes between operating and nonoperating revenues and expenses. Operating revenues and expenses are derived directly from the provision of wholesale and retail electrical generation, transmission, and distribution sales and service and from providing wholesale telecommunications sales and service. Revenues and expenses ancillary to these purposes are treated as nonoperating.

**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. These payments are recognized in nonoperating revenue as contributed capital when the associated facilities are constructed or acquired.

**PUBLIC UTILITY DISTRICT NO. 1 OF OKANOGAN COUNTY, WASHINGTON**  
**NOTES TO FINANCIAL STATEMENTS**

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**Note 1 - Summary of Significant Accounting Policies (continued)**

**Net assets** - Net assets consist of:

- *Invested in capital assets, net of related debt* - This component of net assets consists of capital assets, net of accumulated depreciation, less outstanding balances of any borrowings that are attributable to the acquisition, construction, or improvement of those assets.
- *Restricted* - This component consists of net assets on which constraints are placed as to their use. Constraints include those imposed by creditors (such as through debt covenants), contributors, or laws or regulation of other governments or constraints imposed by law through constitutional provisions or through enabling legislation. Balances currently classified as restricted by enabling legislation include the rate stabilization fund, employee compensated absences fund, customer deposit fund, and bond principal and interest (net of accrued interest) due in the upcoming year.
- *Unrestricted* - This component of net assets consists of net assets that do not meet the definition of “restricted” or “invested in capital assets, net of related debt.”

**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.

**Significant risk 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; fish and other Endangered Species Act issues; Environmental Protection Agency regulations; federal government regulations or orders; deregulation of the electrical industry; concentration risk in the form Wells Hydro Project, as described in Note 11; and market risks inherent in buying and selling of power, a commodity with inelastic demand characteristics and minimal storage capability.

**Note 2 - Deposits and Investments**

**Custodial credit risk** - Custodial credit risk is that, in the event of the failure of the counterparty, the District will not be able to recover the value of its investments. All District deposits and investments are either insured, registered, or held by the District or its agents in the District’s name and are intended to be held until maturity.

**Credit risk** - Credit risk is the risk that an issuer or counterparty to an investment will not fulfill its obligations. As required by state law, all investments of District funds are obligations of the U.S. Government, bankers’ acceptances, deposits in the Washington State Treasurer’s Investment Pool, or deposits with Washington State banks and savings and loan institutions. All deposits are either entirely covered by Federal Depository Insurance (FDIC) or by collateral held in a multiple financial institution collateral pool administered by the Washington Public Deposit Protection Commission (PDPC).

**PUBLIC UTILITY DISTRICT NO. 1 OF OKANOGAN COUNTY, WASHINGTON**  
**NOTES TO FINANCIAL STATEMENTS**

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**Note 2 - Deposits and Investments (continued)**

**Interest rate risk** - Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. The District's manages this risk by limiting the average maturity of investments to one year or less.

Distribution of the investment portfolio was as follows:

Bank certificates of deposits	\$ 14,755,471
Local Government Investment Pool	<u>6,538,290</u>
	<u><u>\$ 21,293,761</u></u>

**Note 3 - Utility Plant**

Utility plant in service and other capital assets are recorded at cost when the historical cost is known. When historical cost is not known, assets are recorded at estimated fair value. Costs include labor, materials, overhead, and related indirect costs. The District capitalizes assets with cost in excess of \$1,000. Depreciation expense is computed using the straight-line method employing useful lives of 4 to 50 years. Repairs and minor replacements are charged to operating expenses.

The original cost of operating property retired or otherwise disposed of and the cost of removal, less salvage, is charged to accumulated depreciation. However, in the case of the sale of a significant operating unit or system, the original cost is removed from the utility plant accounts, accumulated depreciation is charged with the accumulated depreciation related to the property sold, and net gain or loss on disposition is credited or charged to income.

Preliminary costs incurred for proposed projects are deferred pending construction of the asset. Costs relating to projects ultimately constructed are transferred to utility plant, while charges that relate to abandoned projects are expensed.

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**Note 3 - Utility Plant (continued)**

Capital asset activity for the year ended December 31, 2009, was as follows:

	Balance January 1, 2009	Additions	Retirements and Transfers	Balance December 31, 2009
Intangible plant	\$ 92,297			\$ 92,297
Generation plant	588,394			588,394
Transmission plant	3,661,332	\$ 1,280,935	\$ (317,255)	4,625,012
Distribution plant	73,326,222	5,594,198	(1,257,050)	77,663,370
General plant	16,214,790	2,209,484	(453,302)	17,970,972
Telecommunications plant	2,923,656	1,026,683	(247,556)	3,702,783
Acquisition adjustment	632,544			632,544
	97,439,235	10,111,300	(2,275,163)	105,275,372
Construction work in progress	17,568,290	17,964,352	(13,202,677)	22,329,965
Total capital assets	115,007,525	28,075,652	(15,477,840)	127,605,337
Accumulated depreciation	(51,058,988)	(5,057,677)	4,017,506	(52,099,159)
Net capital assets	\$ 63,948,537	\$ 23,017,975	\$ (11,460,334)	\$ 75,506,178

Plant in service balances presented above include land of \$678,067 as of December 31, 2009.

**Note 4 - Long-Term Debt**

In 2002, the District issued \$7,175,000 in 20-year revenue bonds and in 2003, the District issued \$10,565,000 in 20-year serial bonds to finance further capital construction and to refund existing debt obligation. Interest rates on outstanding bonds range from 3.90% to 5.46%. Substantially all revenues are pledged as security for revenue bonds.

The following are changes in long-term debt for the year ended December 31, 2009:

	Balance January 1, 2009	Additions	Payments/ Amortization	Balance December 31, 2009	Current Portion
2002 Revenue Bonds	\$ 6,470,000	\$ -	\$ (380,000)	\$ 6,090,000	\$ 395,000
2003 Revenue Bonds	8,845,000		(455,000)	8,390,000	475,000
Unamortized bond discount	(109,509)		8,045	(101,464)	
Unamortized loss on refunding	(348,866)		24,919	(323,947)	
Total long-term debt	\$ 14,856,625	\$ -	\$ (802,036)	\$ 14,054,589	\$ 870,000

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**NOTES TO FINANCIAL STATEMENTS**

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**Note 4 - Long-Term Debt (continued)**

The annual debt service payment requirements (principal and interest) on debt outstanding as of December 31, 2009, are as follows:

	2002 Bonds		2003 Bonds		Total
	Interest	Principal	Interest	Principal	
2010	\$ 286,188	\$ 395,000	\$ 397,857	\$ 475,000	\$ 1,554,045
2011	269,400	410,000	373,585	500,000	1,552,985
2012	251,462	430,000	348,035	525,000	1,554,497
2013	232,650	450,000	321,207	555,000	1,558,857
2014	212,850	470,000	292,847	580,000	1,555,697
2015-2019	720,880	2,665,000	969,326	3,380,000	7,735,206
2020-2022	96,000	1,270,000	206,781	2,375,000	3,947,781
	<u>\$ 2,069,430</u>	<u>\$ 6,090,000</u>	<u>\$ 2,909,638</u>	<u>\$ 8,390,000</u>	<u>\$ 19,459,068</u>

**Note 5 - Retirement and Deferred Compensation Plans**

**Public Employees' Retirement System** - All full-time District employees and certain qualifying part-time employees participate in the Public Employees' Retirement System (PERS), a statewide local government retirement system administered by the Department of Retirement Systems (DRS), under cost-sharing multiple-employer defined benefit and/or defined contribution plans.

**Plan description** - The State legislature established PERS in 1947 under Chapter 41.40 RCW. Membership in the system includes elected officials; State employees; employees of the Supreme, Appeals, and Superior Courts (other than judges); employees of legislative committees; college and university employees not in national higher education retirement programs; judges of district and municipal courts; and employees of local government. There are approximately 1,192 employers participating in the PERS system.

PERS contains three plans. Participants who joined the system by September 30, 1977, were enrolled in Plan I. Those joining between October 1, 1977, and May 31, 2003, were enrolled in Plan II. With the recent creation of Plan III, new enrollees are given the option of joining either Plan II or Plan III, and existing Plan II members, as of a fixed date, were given the option of transferring to Plan III or remaining in Plan II. Retirement benefits are financed from employee/employer contributions and investment earnings.

Plan I members are eligible for retirement 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 retirement benefit is 2% per service year of the average annual salary for the highest two consecutive service years, capped at 60%. If qualified, after reaching age 66, a cost of living allowance is granted based on years of service credit and is capped at 3% annually.

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**Note 5 - Retirement and Deferred Compensation Plans (continued)**

Plan II members may retire at the age of 65 with 5 years of service, or at the age of 55 with 20 years of service. The annual retirement benefit is 2% per service year of the average annual salary for the highest five consecutive service years with no cap on the percentage. Retirements under Plan II prior to the age of 65 are actuarially reduced; however, Plan II retirees are granted cost-of-living increases capped at 3% annually.

Plan III has a dual benefit structure. The defined benefit portion of Plan III is very similar to the Plan II benefit except that it offers only 1% (instead of 2%) per service year of the average annual salary for the highest five consecutive service years with no cap on the percentage. Retirements under Plan III prior to the age of 65 are also actuarially reduced, and Plan III retirees are granted cost-of-living increases capped at 3% annually. The defined contribution portion of the benefit, funded entirely by employee contributions, provides a chosen annuity payment stream that runs only until the accumulated funds are exhausted.

**Funding policy** - Each biennium, the legislature establishes employer contribution rates for all three plans and employee contribution rates for Plan II. Employee contribution rates for Plan I are established by legislative statute at 6% and do not vary from year to year. Employee rates for Plan III are an individual member choice from options ranging from 5% to 15%. Contribution rates for Plan I are not necessarily adequate to fully fund the plan. All employer rates and the employee rates for Plan II are developed by the Office of the State Actuary to fully fund the system. All employers are required to contribute at the level established by state law. The methods used to determine the contribution requirements were established under state statute in accordance with Chapters 41.40 and 41.45 RCW. Financial and operating information regarding the State of Washington Department of Retirement Systems may be obtained from the Department of Retirement Systems, Communications Unit, P.O. Box 48380, Olympia, WA 98504-8380.

The District's PERS-covered payroll for the year ended December 31, 2009, was \$6,296,310, with total payroll for all employees being \$6,759,022 in 2009. The required contribution rates expressed as a percentage of current-year covered payroll at December 31, 2009, were:

	<u>Plan I</u>	<u>Plan II</u>	<u>Plan III</u>
Employer	5.31%	5.31%	5.31%
Employee	6.00%	3.90%	5% - 15%

Both the District and the employees met their funding obligation, resulting in contributions for the year ending December 31, 2009, as follows:

	<u>Plan I</u>	<u>Plan II</u>	<u>Plan III</u>	<u>Total</u>
Employer	\$ 12,247	\$ 387,320	\$ 25,305	\$ 424,872
Employee	<u>10,890</u>	<u>266,524</u>	<u>19,226</u>	<u>296,640</u>
Total	<u>\$ 23,137</u>	<u>\$ 653,844</u>	<u>\$ 44,531</u>	<u>\$ 721,512</u>

**Note 5 - Retirement and Deferred Compensation Plans (continued)**

**Deferred compensation plans** - The District offers its employees two deferred compensation plan options created in accordance with Internal Revenue Code Section 457, covering all eligible employees of the District, as defined in the plan document. These plans allow employees to defer a portion of their salary until future years. Plan assets are held in trust for the exclusive benefit of the plan participants and their designated beneficiaries and are not subject to the claims of the District's general creditors. Deferred compensation funds are not available to employees until retirement, termination, death, or unforeseeable emergency.

Additionally, the District adopted a 401(a) defined contribution plan (the 401(a) Plan) effective January 1, 2000. Participation in the plan is open to eligible employees of the District as defined in the plan document. The District makes matching contributions to the 401(a) Plan at a rate of 50% of the employee's contribution into one of the District deferred compensation plans. The match is capped at 2% of gross wages for nonexempt employees and 6% of gross wages for exempt employees. During 2009, the District contributed \$179,599 to the 401(a) Plan.

**VEBA plan** - In August 2005, the District implemented a Voluntary Employee Benefits Administration (VEBA) plan designed to provide limited employer funding on a tax-free basis for employee medical premiums and benefits for all eligible employees of the District, as defined in the plan document. The District's current VEBA contribution rate is 2% of the employee's straight time salary. Plan assets, although under District control, are held in trust for the exclusive benefit of the plan participants and their designated beneficiaries and are not subject to the claims of the District's general creditors. During 2009, the District contributed \$123,746 to the VEBA.

**Note 6 - Other Post-Employment Benefits**

The District provides partial reimbursement for healthcare insurance premiums for retired employees. Beginning August 1, 2005, retiring employees choosing to continue medical coverage under the District's plan became eligible to receive \$10 per service year per month toward post-employment medical premiums. 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 is set to decrease \$1 each year until it expires in August 1, 2018. Subsequently, employees retiring between August 1, 2007, and July 31, 2011, are eligible for \$8 per service year per month in reimbursement, with the eligible amount decreasing by \$1 per service year per month each year thereafter. The estimated future liability is \$78,088 at December 31, 2009. The District is funding this liability on a pay-as-you-go basis with contribution of \$3,380 expensed in 2009.

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**Note 7 - Self Insurance**

The District is a member of Public Utility Risk Management Services Joint Self Insurance Fund (the Fund). Chapter 48.62 RCW authorizes the governing body of one or more governmental entities to form together into or join an 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. The Fund was formed on December 31, 1976, when certain Washington PUDs signed an agreement to pool their self-insured losses and jointly purchase insurance and administrative services. There are currently 19 active members in the Fund.

The Fund operates three separate insurance pools: the Liability Pool, the Property Pool, and the Health & Welfare Pool. Fund members may belong to one, two, or all three pools according to their insurance needs. The Liability Pool insures on a \$1,000,000 self-insured retention with a \$250 deductible. Coverage is on an occurrence basis. In addition, the Liability Pool purchases excess general liability and excess public official liability coverage. The Property Pool operates on a maximum \$500,000 self insured retention with a \$75,000 deductible on listed major generating units, and a \$250 deductible on all other listed items of property. Coverage is on an occurrence basis and the Property Pool purchases excess property coverage above the self-insured retention level. The Health & Welfare Pool is funded by paid claims reimbursement from the member generating the claim and by pooled assessment for administration and excess stop-loss insurance coverage. In all pools, members are assessed as necessary to maintain designated minimum pool balances. Since the Fund is a cooperative program, there is joint liability among the participants of each pool. The District participates in only the Liability and Property Pools. Should any member terminate its affiliation with the Fund, they remain financially responsible to the Fund for any unresolved, unreported, and in-process claims for the period they were a signatory to the agreement.

Self-insured retentions are fully funded by current and former members, and settlements have never exceeded coverage limits. Claims are processed by Pacific Underwriters Corporation, P.O. Box 68787, Seattle, WA 98168, a private entity contracted to perform administrative, claims adjustment, and loss prevention services, and who also compiles an Annual Financial Report for the Fund. The Fund is governed by a Board of Directors that consists of one designated representative from each participating member. The Fund Administrator and an elected six-member Administrative Committee (on which a District representative currently serves) are responsible for conducting the daily business affairs of the Fund.

**Note 8 - Conservation Programs**

The District operates a number of energy conservation programs. These include both residential and commercial weatherization loan programs, appliance and water heater rebate programs, appliance loan programs, and residential and commercial energy audits. Loan programs will provide five-year loans of up to \$10,000 on residential dwellings and up to \$25,000 on commercial enterprises for qualifying conservation measures. The District incurred conservation program costs of \$254,594 in 2009, which were charged to operations.

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**Note 9 - Telecommunications**

The District has recognized the necessity of a modern and reliable communications infrastructure in managing its core electric distribution function and now operates and maintains a telecommunications network providing these services for internal use. Additionally, it provides wholesale telecommunications services, in accordance with Washington State law, to qualified retail merchants who, in turn, provide services to end users in the District's service territory.

The ongoing construction and the operations of the telecommunications network are being accomplished using the District's own workforce. Having recognized the benefit of providing a clean separation between electric and telecom functions for both legal and standards compliance purposes, the District has established separate detailed accounting for wholesale telecom activities and has developed a financing arrangement under which the continuing construction of telecom infrastructure and the operations of the telecom network are accomplished using funds loaned from the District's electric reserves. Condensed telecom revenues and expenditures, and assets and liabilities information follows:

Operating revenues	\$ 1,767,215
Operating expenses	(1,031,701)
Nonoperating expenses	<u>(276,354)</u>
Change in net assets	<u>\$ 459,160</u>
Total assets	\$ 103,144
Total liabilities	<u>(2,315,298)</u>
Total net liabilities	<u>\$ (2,212,154)</u>

**Note 10 - Energy Northwest**

**ENW Nuclear Project Nos. 1, 2, and 3** - The District has entered into "Net Billing Agreements" with Energy Northwest (ENW, formerly Washington Public Power Supply System) and the Bonneville Power Administration (BPA). Under terms of these agreements, the District has purchased a maximum of .255%, 1.042% of the capability of ENW's Nuclear Project Nos. 1 and 2, respectively, and .143% of the capability of ENW's 70% ownership share of its Nuclear Project No. 3, and has assigned this capability to BPA. BPA is unconditionally obligated to pay the District, and the District is unconditionally obligated to pay ENW, the pro-rata share of the total annual costs of each project, including debt service on revenue bonds issued to finance the projects, whether or not the projects are completed, operable, or operating and notwithstanding the suspension, reduction, or curtailment of the projects' output.

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**Note 10 - Energy Northwest (continued)**

Nuclear Project Nos. 1 and 3 were approximately 63% and 75% complete, respectively, and had both been in a state of extended construction delay for many years with all systems being maintained in condition to resume construction at any time. However, on May 13, 1994, the ENW Full Board of Directors voted to declare termination of both projects. At this juncture, there has been no resolution concerning the final dispensation of the assets and liabilities associated therewith.

Nuclear Project No. 2 was completed and placed in operation on December 13, 1984.

**Hanford project** - In accordance with agreements between ENW, BPA, and 76 participants, and between ENW and the U.S. Department of Energy (DOE), ENW constructed the Hanford Project, which began commercial operation in 1966 with capacity of approximately 860 MW.

Pursuant to an exchange agreement entered into between the District, ENW, and BPA, the District had purchased .424% of the output of the Hanford Project and is obligated to pay ENW the same percentage of the annual costs.

Under an exchange agreement with the other participants in the Hanford Project, BPA had acquired the capability of the Hanford Project, including the District's share, in exchange for power from BPA. A decision was made in February 1988 by the DOE to maintain the project in a "cold standby" mode of operation.

ENW has evaluated alternative energy uses for the plant to no avail. Current options include a transfer to DOE for removal and site restoration, or removal and site restoration by ENW. At this time, it is unknown what the eventual disposition of the Hanford Project will be. ENW has reduced the project's assets to net realizable value and accrued the estimated cost of removal and site restoration.

**Nine Canyon Wind Project** - On October 1, 2001, the District entered into a power purchase agreement with ENW for output from the Nine Canyon Wind Project. The original project consisted of 37 wind turbines with an aggregate generating capacity of approximately 48 MW and was launched into commercial operation in the fall of 2002. During 2003, a second phase of the project was completed, adding an additional 12 turbines and bringing the total project capacity up to about 63.7 MW. During 2006, a third phase of the project was completed, adding an additional 14 turbines and bringing the expected total project capacity up to about 96 MW.

**Note 10 - Energy Northwest (continued)**

The District is currently one of 10 public utility districts participating in the power purchase agreements for project output. The District purchased a 25% share of the generation output from Phases 1 and 2 and no output at all from Phase 3, bringing its combined share of total project output to 16.61%. The District is committed to paying its pro-rata share of debt service on the Nine Canyon Wind Project Revenue Bonds issued by ENW for Phases 1 and 2. A bond refunding/reissuance process commenced in 2004 and completed in 2005, resulting in the District's estimated liability for project bond principal at \$23,312,500. That amount could escalate to as much as \$29,140,625 after a step-up provision that could trigger in the event that other purchasers defaulted on their contractual obligations. The District pays its share of the ongoing project operational costs through monthly power purchase agreement assessment invoices.

**Note 11 - Other Power Supply Agreements**

**Wells Hydroelectric Project** - Since the initial construction of the Wells Hydroelectric Project, the District has been a party to a power sales contract governing the apportionment of the project output. However, during the 1980s, both the District and Public Utility District No. 1 of Douglas County (Douglas PUD) contested several provisions of the 1963 agreement and sought resolution of the disputed issues in Chelan County Superior Court. All disputes between the parties were resolved with a Memorandum of Understanding signed August 5, 1991, requiring the two Districts to negotiate a new power sale contract commencing in September 2018 and extending for an additional 50 years. Negotiations and relicensing efforts are pending. The District's current share of the total output from Wells Hydroelectric Project is 7.64%, which represents 28.5% of the District's total power purchases in 2009.

**Enloe Hydroelectric Project** - For many years, the District has been pursuing the possible rehabilitation of Enloe Hydroelectric Dam on the Similkameen River near Oroville, Washington. The District is the present owner of the dam and relicensing attempts prior to 2005 were intended to revive an existing facility with its original output of 26,000 MWh annually and installed capacity of 4,100 KW.

On March 3, 1983, the District was issued a license by FERC for renovation and resumed operation of the Enloe project. The District subsequently appealed 14 of the licensing provisions. After extensive review, on March 6, 1986, FERC repealed the license previously granted to the District and placed the license in a "License Application Pending File" until all outstanding issues were resolved. FERC dismissed the license application in December 1987.

In February 1988, the District submitted a new application for a preliminary permit on the project. FERC granted the permit on June 8, 1988, and the District began the required preliminary studies. The District then submitted a license application to FERC on June 1, 1991, and FERC prepared an environmental assessment with the possibility of issuing an operating license.

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**Note 11 - Other Power Supply Agreements (continued)**

On September 13, 1996, FERC again issued a license to the District for restoration of the project. Although fish passage was not a stated requirement of the license, the licensing language left an open-ended opportunity for certain federal agencies to intervene and require fish passage at a later date. The uncertainty of this language made it impossible to accurately forecast the project costs or determine feasibility, so the District, along with several other entities, appealed the licensing conditions. A stay of the license was issued as a result of the pending listing of the Upper Columbia Steelhead under the Endangered Species Act and a determination of the Enloe Project's negative impact upon them. On February 23, 2000, FERC rescinded the license because the National Marine Fisheries Service continued to require upstream fish passage as a condition of the license, while the British Columbia Provincial and Tribal Authorities remain opposed to any such passage requirements.

On January 21, 2005, the District again submitted a new application to FERC for a preliminary permit on the project. The application has been accepted for filing and the District is currently contracting with a team of appropriate experts to assist in the pursuit of a new operating license. The proposed configuration would approximately double the project output to 47,300 MWh per year of energy and 9,000 KW of capacity. The Final License Application was filed with FERC on August 22, 2008, and FERC initiated environmental assessment and Environmental Impact Statement scoping in January 2009. It is anticipated the environmental processes will continue throughout 2010.

**Shanker's Bend Water Storage Dam and Proposed Generation Facility** - In 2007, the District submitted a new Preliminary Permit Application to FERC for a second potential water storage and hydroelectric project that would also be located on the Similkameen River. The proposed dam and associated facilities would be located approximately two miles upstream of Enloe Dam in what is commonly referred to as Shanker's Bend. The Shanker's Bend Project is being proposed for study in coordination with the state of Washington's Columbia River Water Management Program.

In a cooperative effort, the District and the Washington State Department of Ecology (Ecology) began analyzing the next steps to achieve the goals of both organizations. The District received \$325,000 in funding from Ecology to work collectively and collaboratively in performing an appraisal-level study of the Shanker's Bend area as a potential site for water storage, power generation, and a flood control facility. The District also worked with the U.S. Army Corps of Engineers (Corps) in initiating a Hydrology Water Availability Study that was subsequently integrated into the Similkameen River Appraisal Level Study.

All aspects of the study were complete as of April 2009 and the District's obligations under the grant fulfilled as of June 30, 2009.

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**Note 12 - Northwest Open Access Network**

The District is a member of Northwest Open Access Network (NoaNet), a nonprofit mutual corporation formed by the District in collaboration with several other public utilities in the state of Washington. NoaNet was incorporated in February 2000 to facilitate the construction of a communications backbone to accommodate the increasing broadband needs of the member utilities and their customers. The NoaNet network began commercial operation in early 2001.

In July 2001, NoaNet issued \$27 million in Telecommunications Network Revenue Bonds (taxable) to finance the repayment of startup funds advanced by founding members and the initial costs of construction and commissioning. The bonds began maturing in December 2003 and will continue through December 2016, with interest due semi-annually at rates ranging from 5.05% to 7.09%. The District has entered into a repayment agreement to guarantee its 5.45% portion of the NoaNet bond debt, which totaled \$16,500,000 as of December 31, 2009.

In 2006, NoaNet signed an agreement with Yahoo that required NoaNet to install additional capacity on its system. A capital expenditure of \$4.5 million was required for the additional equipment; therefore, a nonrevolving line of credit from a lending institution was procured with the repayment funds to come from the Yahoo revenue stream. Yahoo's contract contains a cancellation penalty clause equivalent to the repayment balance of the \$4.5 million loan. The balance owing on this line of credit at December 31, 2009, is \$1.5 million.

In 2008, NoaNet established an additional nonrevolving line of credit in the amount of \$1.5 million to finance capital expenditures and network upgrades. The outstanding balance on this credit line as of December 31, 2009, is \$1.2 million.

Financial and operating information regarding NoaNet may be obtained from the NoaNet Financial Center, 5802 Overlook Ave NE, Tacoma, WA 98422.

Due to changes in ownership shares, District's ownership interest in NoaNet was 5.5% as of December 31, 2009. In 2009, NoaNet incurred a net loss from operations of \$384,387, offset by member assessments of \$1,571,757, resulting in an accumulated members' equity deficit as of December 31, 2009, of \$8,261,647. NoaNet financial results for 2009 are estimated; however, any variance will not have a material impact on District's financial position. In 2009, the District determined that its investment in NoaNet in the amount of \$1,147,139 was not recoverable; therefore, the entire amount of the investment was written off as impaired. As a result, as of December 31, 2009, the District reports no investment or liability account balance reflecting NoaNet membership.

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**Note 13 - Pending Litigation**

**Pateros-Twisp Transmission Line** - For many years, the District has sought to construct a second transmission line into the Methow Valley. This project, along with a proposed new substation, would alleviate the current issues of both marginal electrical capacity and reliability. A coalition of local citizens and environmental groups has been consistently opposing the project and challenged the validity of the District's Final Environmental Impact Statement (FEIS) on grounds of various alleged deficiencies. On November 22, 2006, a ruling by Okanogan County Superior Court Judge upheld the validity of the FEIS; however, his decision was appealed by the plaintiffs to the Washington State Court of Appeals and spent the entire year of 2007 undergoing further review. On May 1, 2008, the appellate court upheld Okanogan County Superior Court's ruling on all counts. The plaintiffs then filed a petition for review with the Washington State Supreme Court on June 5, 2008, which was subsequently denied on December 2, 2008.

During 2009, the District started the process of acquiring right-of-way easements and various other permits required for construction. Condemnation proceedings have been initiated against two land owners to obtain the remaining easements necessary to complete the route.

**Other litigation** - The District is involved in various claims arising in the normal course of business. The District does not believe that the ultimate outcome of these matters will have a material adverse impact on its financial position or results of operations.

**Note 14 - Prior Period Adjustment**

In prior periods, the District did not record an accrual for unbilled revenues. During 2009, in order to more accurately account for revenues in the period in which they are earned, the District implemented a methodology of accounting for unbilled revenues and now estimates an accrual at year-end. As a result, the District corrected its recording of 2008 unbilled revenue, which resulted in a \$2,296,896 increase to net assets as of January 1, 2009.

The impact to January 1, 2009, net assets for the error correction is as follows:

Net assets, January 1, 2009 - as previously reported	\$ 84,794,374
Accrual for unbilled revenues	<u>2,296,896</u>
Net assets, January 1, 2009 - as restated	<u><u>\$ 87,091,270</u></u>

The correction of the error did not materially impact the District's change in net assets for the year ended December 31, 2008.