



Report of Independent Auditors
and Financial Statements and
Required Supplementary Information for
**Public Utility District No. 1 of
Okanogan County, Washington**
December 31, 2011 and 2010

MOSS-ADAMS LLP

Certified Public Accountants | Business Consultants

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REPORT OF INDEPENDENT AUDITORS

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

We have audited the accompanying balance sheets of Public Utility District No. 1 of Okanogan County, Washington (the District) as of December 31, 2011 and 2010, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years 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 audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing 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 over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide 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 Public Utility District No. 1 of Okanogan County as of December 31, 2011 and 2010, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated May 10, 2012, 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* and should be considered in assessing the results of our audit.

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

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The schedule of expenditures of federal awards has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain other procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards is fairly stated in all material respects in relation to the financial statements as a whole.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary schedules of comparative results of operations and debt service coverage (unaudited), customer statistical data (unaudited), and other financial data (unaudited) are not a required part of the basic financial statements, but are supplementary information presented for the purposes of additional analysis. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and, accordingly, we express no opinion on it.

A handwritten signature in cursive script that reads "Moss Adams LLP".

Everett, Washington
May 10, 2012

PUBLIC UTILITY DISTRICT NO. 1 OF OKANOGAN COUNTY, WASHINGTON

MANAGEMENT'S DISCUSSION AND ANALYSIS

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's (the District) financial activity, and identify changes in the District's financial position during 2011. 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 years ended December 31, 2011 and 2010, 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 capital and related 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)**

Selected Financial Information

	December 31,		
	2011	2010	2009
ASSETS			
Current and other assets	\$ 35,993,121	\$ 40,941,123	\$ 32,013,840
Net utility plant	92,263,566	88,003,113	75,506,178
Total assets	<u>\$ 128,256,687</u>	<u>\$ 128,944,236</u>	<u>\$ 107,520,018</u>
LIABILITIES			
Current liabilities	\$ 8,088,669	\$ 8,258,702	\$ 9,010,911
Long-term debt	37,955,948	39,112,237	13,184,589
Total liabilities	<u>46,044,617</u>	<u>47,370,939</u>	<u>22,195,500</u>
NET ASSETS			
Invested in capital assets, net of debt	60,460,089	61,069,526	61,641,028
Restricted	8,450,023	8,008,700	9,157,500
Unrestricted	13,301,958	12,495,071	14,525,990
Total net assets	<u>82,212,070</u>	<u>81,573,297</u>	<u>85,324,518</u>
Total liabilities and net assets	<u>\$ 128,256,687</u>	<u>\$ 128,944,236</u>	<u>\$ 107,520,018</u>
Years Ended December 31,			
	2011	2010	2009
REVENUE			
Operating			
Electric - retail	\$ 33,355,835	\$ 29,102,331	\$ 30,564,662
Electric - wholesale	6,741,527	5,801,904	4,198,885
Telecommunications	1,955,276	1,912,283	1,622,655
Other operating revenue	964,149	1,024,195	1,176,193
Total operating income	<u>43,016,787</u>	<u>37,840,713</u>	<u>37,562,395</u>
Nonoperating			
Interest income, net	113,944	214,510	964,500
Other nonoperating income	1,096,958	140,331	214,852
Contributed capital	974,691	996,025	884,846
Total nonoperating income	<u>2,185,593</u>	<u>1,350,866</u>	<u>2,064,198</u>
Total revenue	<u>45,202,380</u>	<u>39,191,579</u>	<u>39,626,593</u>

PUBLIC UTILITY DISTRICT NO. 1 OF OKANOGAN COUNTY, WASHINGTON
MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Selected Financial Information (continued)

	Years Ended December 31,		
	2011	2010	2009
EXPENSES			
Operating			
Cost of power	24,860,599	24,501,801	22,334,570
Taxes	2,138,550	1,839,338	1,876,404
Depreciation	4,258,323	3,428,771	3,118,253
Other operating expenses	<u>11,172,318</u>	<u>11,927,132</u>	<u>11,730,938</u>
Total operating expenses	<u>42,429,790</u>	<u>41,697,042</u>	<u>39,060,165</u>
Nonoperating			
Interest expense	1,407,221	992,488	767,365
Other expense	726,596	253,270	418,676
Impairment of investment	<u>-</u>	<u>-</u>	<u>1,147,139</u>
Total nonoperating	<u>2,133,817</u>	<u>1,245,758</u>	<u>2,333,180</u>
Total expenses	<u>44,563,607</u>	<u>42,942,800</u>	<u>41,393,345</u>
CHANGE IN NET ASSETS	638,773	(3,751,221)	(1,766,752)
NET ASSETS, beginning of period	<u>81,573,297</u>	<u>85,324,518</u>	<u>87,091,270</u>
NET ASSETS, end of period	<u>\$ 82,212,070</u>	<u>\$ 81,573,297</u>	<u>\$ 85,324,518</u>

Financial Highlights

During 2011, the District's overall financial position remained strong with the help from a 7% increase in retail electric load, the second of three 6.5% retail electric rate increases, and stronger-than-expected wholesale energy sales. The nation's economic condition continued to hold down market prices for wholesale energy sales, and several of the District's largest customers still remain idle. The District's net assets increased by \$638,773 compared with a decrease in net assets in 2010 of \$3,751,221.

The following is an analysis of key financial factors with an emphasis on changes between 2010 and 2011:

Cash and investments - The District had cash and investments totaling \$27,469,235, \$31,269,254, and \$23,679,666 as of December 31, 2011, 2010, and 2009, respectively. The decrease of \$3,800,019 is due to a drawdown of the 2010 Bond Construction Fund for eligible capital outlays. As noted in Note 1 to the financial statements, investments in the amount of \$17,687,451 are considered restricted as of December 31, 2011. The funds are restricted as follows: \$289,504 for debt service payments, \$1,944,500 for bond reserve requirements, \$7,318,447 for bond construction funds, \$2,000,000 for customer deposits and compensated absences, and the remaining \$6,135,000 is restricted in a rate stabilization fund.

PUBLIC UTILITY DISTRICT NO. 1 OF OKANOGAN COUNTY, WASHINGTON MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Financial Highlights (continued)

Utility plant - Net utility plant increased by \$4,260,453, or 4.8%, during 2011, compared with an increase of \$12,496,935, or 16.6%, during 2010. A summary of utility plant in service is included in Note 3 to the financial statements.

Long-term debt - As of December 31, 2011, the District had \$39,595,000 in revenue bonds outstanding, compared with \$40,785,000 as of December 31, 2010, and \$14,480,000 as of 2009. During 2011, the District did not issue additional revenue bonds. The decrease in revenue bonds outstanding was a result of scheduled debt payments made during 2011.

In addition, in 2010 the District, authorized a not-to-exceed \$3,667,855 loan with the United States Department of Agriculture (USDA) for broadband improvements (the RUS note). Also during 2010, the District approved a line of credit in the aggregate principal amount not to exceed \$10,000,000 to cover operating costs and capital outlays as the need arises. As of December 31, 2011, the District had drawn on the RUS note in the amount of \$329,606, but has yet to draw on the line of credit.

Net operating revenues (expenses) - The District recorded revenues from operations of \$43,016,787, which were \$586,997 more than operating expenses of \$42,429,790 in 2011, in comparison with 2010, when operating expenditures exceeded operating revenues by \$3,856,329.

Operating revenue - Revenues from the retail sale of electricity increased by 14.6% from \$29,102,331 in 2010 to \$33,355,835 in 2011, compared with a decrease in retail sales in 2010 of 4.8%. This increase was anticipated during 2011 due to a retail rate increase of 6.5% on July 1, 2011, and an increased electric load due to very mild weather in 2010. During 2011, revenue from wholesale sales of electricity increased 16.2% to \$6,741,527 from \$5,801,904, as reported in 2010. The increase in wholesale sales of electricity was the result of 40% more electricity to sell in the wholesale market, which more than made up for lower market prices than 2010. Wholesale telecommunications revenue growth slowed to a modest 2.2% as revenue increased to \$1,955,276 in 2011, compared with \$1,912,283 in 2010.

Operating expenses - Operating expenses increased by \$732,748, or 1.8%, from \$41,697,042 in 2010 to \$42,429,790 in 2011. This moderate increase is much more typical than the noteworthy 6.8% increase that marred 2010's comparison to 2009. The sizable increase there, rather than reflecting increased 2010 costs, had been driven by a one-time power cost refund in excess of \$2,000,000 from BPA in early 2009. Operating expenses for 2009 had been reduced accordingly.

Rates - During 2011 and 2010, the District implemented a rate increase effective July 1. The increase in 2011, in the amount of 6.5%, was the second of three, with the remaining increase approved for July 1, 2012. Each of the three rate increases was projected to bring in an additional \$2,000,000 annually. In addition, the District passed through increased power costs to its customers using a .24¢/kWh cost of power adjustment, effective December 1, 2011. The rate increases were approved during 2010 after extensive studies were performed by a third party, with assistance from District staff.

PUBLIC UTILITY DISTRICT NO. 1 OF OKANOGAN COUNTY, WASHINGTON MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Financial Highlights (continued)

Significant Capital Assets and Long-Term Debt

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

Bond construction funds remain, from the 2010 issue, in the amount of \$7,318,447 to construct an approximately 26-mile transmission line to serve the Methow Valley. The project has been held up as the District tries to obtain a right-of-way across land owned by the state of Washington.

The District continues to invest in wholesale telecommunications infrastructure. As of December 31, 2011, the District has invested a total of \$4,396,550 in wholesale telecommunications, which is a decrease of \$288,717 over year-end 2010. The decrease reflects that the wholesale telecommunications side of the District continues to realize a positive net income, as well as cover debt service. The District's telecommunications network is connected to the Northwest Open Access Network, a fiber optic system that is member owned. The network is currently utilized by 13 retail service providers, supporting over 2,000 end-user customers.

During 2010, the District submitted for and was awarded American Recovery and Reinvestment Act (ARRA) funding to deploy a middle-mile and last-mile broadband communication system throughout Okanogan County. Awarded ARRA funding consists of a \$5,501,782 grant and a \$3,667,855 loan. The proposed last-mile project will bring high-speed broadband to over 6,543 premises that currently lack such access. The proposed funded network design calls for placement of approximately 170 access nodes, as well as extends the fiber backbone approximately 179 miles to provide necessary redundancy to the last-mile network.

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

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

PUBLIC UTILITY DISTRICT NO. 1 OF OKANOGAN COUNTY, WASHINGTON MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

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 phone (509) 422-3310.

A handwritten signature in blue ink, appearing to read "Don Coppock", is displayed within a light gray rectangular box.

Don Coppock
Director of Finance/Auditor

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PUBLIC UTILITY DISTRICT NO. 1 OF OKANOGAN COUNTY, WASHINGTON
BALANCE SHEETS

ASSETS

	December 31,	
	<u>2011</u>	<u>2010</u>
CURRENT ASSETS		
Cash and temporary investments		
Cash and cash equivalents	\$ 3,777,466	\$ 1,946,428
Temporary investments	6,004,318	6,172,971
Accounts receivable, less allowance for doubtful accounts of \$25,000 for 2011 and 2010	2,255,576	2,449,895
Unbilled revenue	1,995,503	2,321,032
Materials and supplies	3,080,057	3,224,633
Prepayments and other	<u>92,980</u>	<u>378,472</u>
Total current assets	<u>17,205,900</u>	<u>16,493,431</u>
RESTRICTED ASSETS		
Bond reserve and debt service	2,234,004	2,511,398
Board-designated reserve	8,135,000	7,685,000
Construction funds	<u>7,318,447</u>	<u>12,953,457</u>
Total restricted assets	<u>17,687,451</u>	<u>23,149,855</u>
UTILITY PLANT, at cost		
Plant in service	129,714,078	120,970,358
Construction work in progress	<u>18,385,929</u>	<u>21,080,431</u>
	148,100,007	142,050,789
Less accumulated depreciation and amortization	<u>55,836,441</u>	<u>54,047,676</u>
Net utility plant	<u>92,263,566</u>	<u>88,003,113</u>
OTHER ASSETS		
Conservation loans and notes receivable	649,074	791,704
Deferred charges	<u>450,696</u>	<u>506,133</u>
Total other assets	<u>1,099,770</u>	<u>1,297,837</u>
Total assets	<u><u>\$ 128,256,687</u></u>	<u><u>\$ 128,944,236</u></u>

PUBLIC UTILITY DISTRICT NO. 1 OF OKANOGAN COUNTY, WASHINGTON
BALANCE SHEETS

LIABILITIES AND NET ASSETS

	December 31,	
	2011	2010
CURRENT LIABILITIES		
Accounts payable	\$ 3,670,413	\$ 4,048,806
Accrued compensated absences	1,190,705	1,199,092
Accrued taxes	944,276	832,198
Customer deposits and prepayments	568,355	557,542
Accrued bond interest	159,920	431,064
Current portion of long-term debt	1,555,000	1,190,000
Total current liabilities	8,088,669	8,258,702
LONG-TERM DEBT		
Revenue bonds	38,040,000	39,595,000
Other long-term debt	329,606	-
Bond issue premium	413,279	427,571
Bond issue discount	(56,731)	(65,183)
Loss on debt refunding	(770,206)	(845,151)
Total long-term debt	37,955,948	39,112,237
Total liabilities	46,044,617	47,370,939
NET ASSETS		
Invested in capital assets, net of related debt	60,460,089	61,069,526
Restricted	8,450,023	8,008,700
Unrestricted	13,301,958	12,495,071
Total net assets	82,212,070	81,573,297
Total liabilities and net assets	\$ 128,256,687	\$ 128,944,236

PUBLIC UTILITY DISTRICT NO. 1 OF OKANOGAN COUNTY, WASHINGTON
STATEMENTS OF REVENUE, EXPENSES, AND CHANGES IN NET ASSETS

	Years Ended December 31,	
	2011	2010
OPERATING REVENUES		
Electric - retail	\$ 33,355,835	\$ 29,102,331
Electric - wholesale	6,741,527	5,801,904
Telecommunications	1,955,276	1,912,283
Other operating revenues	964,149	1,024,195
Total operating revenues	43,016,787	37,840,713
OPERATING EXPENSES		
Cost of power	24,860,599	24,501,801
Transmission	33,775	82,188
Distribution - operation	4,720,693	5,380,943
Telecommunications	601,857	638,124
Customer accounts	1,344,117	1,285,263
Customer service and information	515,590	677,404
Administration and general	3,956,286	3,863,210
Depreciation and amortization	4,258,323	3,428,771
Taxes	2,138,550	1,839,338
Total operating expenses	42,429,790	41,697,042
Net operating revenues (expenses)	586,997	(3,856,329)
NONOPERATING REVENUES (EXPENSES)		
Interest income	113,944	214,510
Grant revenue	494,408	-
Contributed capital	974,691	996,025
Interest on long-term debt	(2,068,361)	(992,488)
Allowance for funds used during construction	661,140	-
Other revenue	602,550	140,331
Other expenses	(726,596)	(253,270)
Net nonoperating revenues	51,776	105,108
CHANGE IN NET ASSETS	638,773	(3,751,221)
ACCUMULATED NET ASSETS		
Beginning of year	81,573,297	85,324,518
End of year	\$ 82,212,070	\$ 81,573,297

PUBLIC UTILITY DISTRICT NO. 1 OF OKANOGAN COUNTY, WASHINGTON
STATEMENTS OF CASH FLOWS

	Years Ended December 31,	
	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from customers	\$ 43,690,076	\$ 37,340,195
Payments to suppliers and employees	<u>(37,960,667)</u>	<u>(40,551,714)</u>
Net change in cash from operating activities	<u>5,729,409</u>	<u>(3,211,519)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisition and construction of capital assets, net	(9,218,122)	(16,128,758)
Proceeds from borrowings	329,606	32,460,000
Cash contributions in aid of construction	974,691	996,025
Proceeds from grants	494,408	-
Scheduled payments debt	(1,190,000)	(6,155,000)
Interest paid on debt	<u>(1,006,705)</u>	<u>(535,450)</u>
Net change in cash from capital and related financing activities	<u>(9,616,122)</u>	<u>10,636,817</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of investments	(19,823,674)	(46,149,732)
Sales and maturities of investments	25,454,731	38,120,666
Interest on investments	113,944	214,510
Payments for joint venture assessments	<u>(27,250)</u>	<u>(50,219)</u>
Net change in cash from investing activities	<u>5,717,751</u>	<u>(7,864,775)</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	1,831,038	(439,477)
CASH AND CASH EQUIVALENTS		
Beginning of year	<u>1,946,428</u>	<u>2,385,905</u>
End of year	<u>\$ 3,777,466</u>	<u>\$ 1,946,428</u>
RECONCILIATION OF NET OPERATING REVENUES (EXPENSES)		
TO CASH FLOWS FROM OPERATING ACTIVITIES		
Net operating revenues (expenses)	\$ 586,997	\$ (3,856,329)
Adjustments to reconcile net operating revenues (expenses)		
to net cash from operating activities		
Depreciation and amortization	4,258,323	3,428,771
Cash from changes in operating assets and liabilities		
Receivables	336,949	(932,088)
Unbilled revenue	325,529	375,979
Materials and supplies	144,576	(170,533)
Prepayments and other	285,492	(359,292)
Deferred charges	55,437	(251,761)
Accounts payable	(378,393)	(1,685,959)
Accrued compensation, benefits, customer deposits,		
and taxes	<u>114,499</u>	<u>239,693</u>
NET OPERATING ACTIVITIES	<u>\$ 5,729,409</u>	<u>\$ (3,211,519)</u>

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

Note 1 - Summary of Significant Accounting Policies

Organization - Public Utility District No. 1 of Okanogan County (the District) 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 (GAAP), 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 the District conform to 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 the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Statements and Interpretations. The accounting records of the District are maintained in accordance with methods prescribed by the Washington 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 an original 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:

	<u>2011</u>	<u>2010</u>
Rate stabilization fund	\$ 6,135,000	\$ 6,135,000
Employee compensated absences fund	1,400,000	1,100,000
Customer deposit fund	600,000	450,000
Sinking funds - 2002 bonds	-	35,662
Sinking funds - 2003 bonds	72,754	72,799
Sinking funds - 2010 bonds	216,750	458,437
Bond reserve fund	1,944,500	1,944,500
Construction funds	<u>7,318,447</u>	<u>12,953,457</u>
	<u>\$ 17,687,451</u>	<u>\$ 23,149,855</u>

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

Note 1 - Summary of Significant Accounting Policies (continued)

Accounts receivable and allowance for doubtful accounts - The District renders billings for electrical consumption, sales, and services and for wholesale power and telecommunication sales and services on a monthly basis. Management reviews accounts receivable for collectibility on a regular basis and an allowance for uncollectible accounts is established based on 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 - Materials 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. 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 related bond issues using the straight-line method. Unamortized bond issue costs amounted to \$389,023 and \$415,193 as of December 31, 2011 and 2010, respectively.

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 it records that amount as unbilled revenue for the current year.

Unamortized loss on debt refunding - The difference between the cost to refund outstanding debt and the carrying value of bonds defeased by refunding bonds is deferred and amortized over the shorter of the remaining term of the refunded bonds or the term of the refunding bonds, using the straight-line or effective-interest method.

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

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, bond principal and interest (net of accrued interest) due in the upcoming year, the debt service reserve fund, and the 2010 bond construction fund, net of related debt.

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 of Wells Hydroelectric 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.

Reclassifications - Certain reclassifications have been made to conform to the current year presentation.

Subsequent events - Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. The District recognizes in the financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the balance sheets, including the estimates inherent in the process of preparing the financial statements. The District's financial statements do not recognize subsequent events that provide evidence about conditions that did not exist at the date of the balance sheets but arose after the balance sheet date and before the financial statements are available to be issued.

The District has evaluated subsequent events through May 10, 2012, which is the date financial statements are available to be issued.

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

Note 2 - Deposits and Investments

Custodial credit risk - Custodial credit risk is the risk 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 the Federal Deposit Insurance Corporation or by collateral held in a multiple financial institution collateral pool administered by the Washington Public Deposit Protection Commission.

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 manages this risk by limiting the average maturity of investments to one year or less.

Distribution of the investment portfolio was as follows:

	<u>2011</u>	<u>2010</u>
Bank certificates of deposit	\$ 8,635,000	\$ 9,335,000
Local Government Investment Pool	<u>15,056,769</u>	<u>19,987,826</u>
	<u>\$ 23,691,769</u>	<u>\$ 29,322,826</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, capitalized interest, 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 and included in construction work in process. Costs relating to projects ultimately constructed are transferred to utility plant, whereas charges that relate to abandoned projects are expensed.

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

Note 3 - Utility Plant (continued)

Capital asset activity for the years ended December 31, 2011 and 2010, was as follows:

	Balance January 1, 2011	Additions	Retirements and Transfers	Balance December 31, 2011
Intangible plant	\$ 92,297	\$ -	\$ -	\$ 92,297
Generation plant	588,394	-	-	588,394
Transmission plant	4,670,463	54,506	(13,461)	4,711,508
Distribution plant	84,145,081	10,113,788	(2,428,414)	91,830,455
General plant	26,740,339	964,909	(646,796)	27,058,452
Telecommunications plant	4,101,240	715,928	(16,740)	4,800,428
Acquisition adjustment	632,544	-	-	632,544
	120,970,358	11,849,131	(3,105,411)	129,714,078
Construction work in progress	21,080,431	(2,694,502)	-	18,385,929
Total capital assets	142,050,789	9,154,629	(3,105,411)	148,100,007
Accumulated depreciation	(54,047,676)	(5,389,029)	3,600,264	(55,836,441)
Net capital assets	<u>\$ 88,003,113</u>	<u>\$ 3,765,600</u>	<u>\$ 494,853</u>	<u>\$ 92,263,566</u>
	Balance January 1, 2010	Additions	Retirements and Transfers	Balance December 31, 2010
Intangible plant	\$ 92,297	\$ -	\$ -	\$ 92,297
Generation plant	588,394	-	-	588,394
Transmission plant	4,625,012	519,571	(474,120)	4,670,463
Distribution plant	77,663,370	7,012,476	(530,765)	84,145,081
General plant	17,970,972	10,172,344	(1,402,977)	26,740,339
Telecommunications plant	3,702,783	400,777	(2,320)	4,101,240
Acquisition adjustment	632,544	-	-	632,544
	105,275,372	18,105,168	(2,410,182)	120,970,358
Construction work in progress	22,329,965	(1,249,534)	-	21,080,431
Total capital assets	127,605,337	16,855,634	(2,410,182)	142,050,789
Accumulated depreciation	(52,099,159)	(4,416,080)	2,467,563	(54,047,676)
Net capital assets	<u>\$ 75,506,178</u>	<u>\$ 12,439,554</u>	<u>\$ 57,381</u>	<u>\$ 88,003,113</u>

Plant in service balances presented above include nondepreciable land of \$1,126,051 as of December 31, 2011 and 2010, respectively.

Note 4 - Long-Term Debt

In 2002, the District issued \$7,175,000 in 20-year revenue bonds with interest rates ranging from 3.75% to 5.00% to finance capital construction. During the 2011 year, the outstanding balance on this borrowing was paid in full.

In 2003, the District issued \$10,565,000 in 20-year serial bonds to finance capital construction and to refund a previous short-term debt obligation. Interest rates on the 2003 issuances range from 2.46% to 5.46%.

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

Note 4 - Long-Term Debt (continued)

During 2010, the District issued \$9,105,000 in 10-year Series A bonds with interest rates ranging from 2.00% to 4.50%, and \$23,355,000 in 30-year Series B taxable Build America Bonds with interest rates ranging between 1.095% and 6.046%. These interest rates are subject to a federal subsidy payment from the federal government of 35% of the interest rate. From this issuance, \$5,285,000 was deposited into an escrow account toward defeasance of the 2002 bonds to be fully repaid in 2011. The net present value of the savings on refunding was approximately \$264,040. The remaining \$27,175,000 of the new debt was earmarked for capital projects including, but not limited to, the new District headquarters facility constructed in 2010 and the Pateros-Twisp transmission line, now in its final permitting stage.

During 2011, the District began drawing funds related to the American Recovery and Reinvestment Act (ARRA) award granted in 2010 (Note 9). As of December 31, 2011, a total of \$329,606 in loan funds related to this award had been received. These funds are to be paid back over a 23-year period starting one year after the initial draw. This initial draw occurred on August 15, 2011. This direct cost of money loan will bear interest at the rate applicable to each advance of loan funds based on the average yield on outstanding marketable obligations of the United States having a final maturity comparable to the final maturity of the advance. Interest rates as of December 31, 2011, ranged from 2.75% to 3.34%. Additional information describing this award can be found in Note 9.

Total revenue bonds outstanding at December 31, 2011, are \$39,595,000, for which substantially all revenues of the District are pledged as security.

The following are changes in long-term debt for the years ended December 31, 2011 and 2010:

	Balance <u>January 1, 2011</u>	<u>Additions</u>	Payments/ <u>Amortization</u>	Balance <u>December 31, 2011</u>	Current <u>Portion</u>
2002 revenue bonds	\$ 410,000	\$ -	\$ (410,000)	\$ -	\$ -
2003 revenue bonds	7,915,000	-	(500,000)	7,415,000	525,000
2010 revenue bonds	32,460,000	-	(280,000)	32,180,000	1,030,000
2011 ARRA loan	-	329,606	-	329,606	-
Unamortized bond premium	427,571	-	(14,292)	413,279	-
Unamortized bond discount	(65,183)	-	8,452	(56,731)	-
Unamortized loss on refunding	(845,151)	-	74,945	(770,206)	-
Total long-term debt	<u>\$ 40,302,237</u>	<u>\$ 329,606</u>	<u>\$ (1,120,895)</u>	<u>\$ 39,510,948</u>	<u>\$ 1,555,000</u>
	Balance <u>January 1, 2010</u>	<u>Additions</u>	Payments/ <u>Amortization</u>	Balance <u>December 31, 2010</u>	Current <u>Portion</u>
2002 revenue bonds	\$ 6,090,000	\$ -	\$ (5,680,000)	\$ 410,000	\$ 410,000
2003 revenue bonds	8,390,000	-	(475,000)	7,915,000	500,000
2010 revenue bonds	-	32,460,000	-	32,460,000	280,000
Unamortized bond premium	-	431,114	(3,543)	427,571	-
Unamortized bond discount	(101,464)	-	36,281	(65,183)	-
Unamortized loss on refunding	(323,947)	(558,630)	37,426	(845,151)	-
Total long-term debt	<u>\$ 14,054,589</u>	<u>\$ 32,332,484</u>	<u>\$ (6,084,836)</u>	<u>\$ 40,302,237</u>	<u>\$ 1,190,000</u>

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

Note 4 - Long-Term Debt (continued)

During 2010, the District established a \$10 million operating line of credit with a financial institution. As of December 31, 2011, there was no outstanding balance on that line of credit.

The annual debt service payment requirements (principal and interest) on debt outstanding as of December 31, 2011, are as follows:

	2003 Bonds		2010 Bonds		Total
	Interest	Principal	Interest	Principal	
2012	\$ 348,035	\$ 525,000	\$ 1,571,008	\$ 1,030,000	\$ 3,474,043
2013	321,207	555,000	1,553,706	1,045,000	3,474,913
2014	292,847	580,000	1,534,208	1,065,000	3,472,055
2015	261,178	615,000	1,507,113	1,075,000	3,458,291
2016	227,600	650,000	1,474,863	1,105,000	3,457,463
2017-2021	651,235	3,665,000	6,832,683	6,130,000	17,278,918
2022-2026	36,094	825,000	5,643,650	4,035,000	10,539,744
2027-2031	-	-	4,412,708	4,980,000	9,392,708
2032-2036	-	-	2,831,131	6,005,000	8,836,131
2037-2040	-	-	879,693	5,710,000	6,589,693
	<u>\$ 2,138,196</u>	<u>\$ 7,415,000</u>	<u>\$ 28,240,763</u>	<u>\$ 32,180,000</u>	<u>\$ 69,973,959</u>

The above table does not reflect the annual debt service relating to the ARRA loan as disclosed previously in this note. In addition to the \$329,606 in loan funds outstanding on December 31, 2011, periodic draws on the ARRA award will be made through the project's expiration date of September 30, 2015. Any funds drawn are restricted to authorized project costs as approved in the project budget. Security for the loan is limited to net revenues, on parity with the lien granted with respect to any parity bonds, and the balance in the District's Pledged Deposit Account. The Pledged Deposit Account balance would be limited to unspent advances, if any.

Note 5 - Retirement and Deferred Compensation Plans

Public Employees' Retirement System - All full-time District employees and certain qualifying part-time employees of the District 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 were 1,325 employers participating in the PERS system as of June 30, 2011.

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

Note 5 - Retirement and Deferred Compensation Plans (continued)

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.

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.

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

Note 5 - Retirement and Deferred Compensation Plans (continued)

The District's PERS-covered payroll for the year ended December 31, 2011, was \$6,869,835, with total payroll for all employees being \$7,116,445 in 2011. The District's PERS-covered payroll for the year ended December 31, 2010, was \$6,865,886, with total payroll for all employees being \$7,078,439 in 2010. The required contribution rates expressed as a percentage of current-year covered payroll at December 31, 2011 and 2010, were:

	<u>Plan I</u>	<u>Plan II</u>	<u>Plan III</u>
2011			
Employer	5.31%-7.25%	5.31%-7.25%	5.31%-7.25%
Employee	6.00%	3.90%-4.64%	5%-15%
2010			
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 years ending December 31, 2011 and 2010, as follows:

	<u>Plan I</u>	<u>Plan II</u>	<u>Plan III</u>	<u>Total</u>
2011				
Employer	\$ 5,610	\$ 400,334	\$ 21,600	\$ 427,544
Employee	<u>5,859</u>	<u>273,293</u>	<u>18,128</u>	<u>297,280</u>
Total	<u>\$ 11,469</u>	<u>\$ 673,627</u>	<u>\$ 39,728</u>	<u>\$ 724,824</u>
2010				
Employer	\$ 8,793	\$ 334,976	\$ 20,809	\$ 364,578
Employee	<u>9,935</u>	<u>246,028</u>	<u>20,203</u>	<u>276,166</u>
Total	<u>\$ 18,728</u>	<u>\$ 581,004</u>	<u>\$ 41,012</u>	<u>\$ 640,744</u>

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 401(a) 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's deferred compensation plans. The match is capped at 2% of gross wages for nonexempt employees and 6% of gross wages for exempt employees. During 2011 and 2010, the District contributed \$211,232 and \$219,095, respectively, to the 401(a) Plan.

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

Note 5 - Retirement and Deferred Compensation Plans (continued)

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 2011 and 2010, the District contributed \$131,817 and \$128,655, respectively, to the VEBA plan.

Note 6 - Other Post-Employment Benefits

The District provides partial reimbursement for health care 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 \$65,577 and \$80,552 at December 31, 2011 and 2010, respectively. The District is funding this liability on a pay-as-you-go basis with contributions of \$0 and \$2,003 expensed in 2011 and 2010, respectively.

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 Public Utility Districts signed an agreement to pool their self-insured losses and jointly purchase insurance and administrative services. There are currently 18 active members in the Fund.

PUBLIC UTILITY DISTRICT NO. 1 OF OKANOGAN COUNTY, WASHINGTON

NOTES TO FINANCIAL STATEMENTS

Note 7 - Self Insurance (continued)

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. In 2011 and 2010, the District contributed \$103,557 and \$97,961, respectively, to the Liability Pool and \$36,989 and \$27,556, respectively, to the Property Pool. Should any member terminate its affiliation with the Fund, it remains financially responsible to the Fund for any unresolved, unreported, and in-process claims for the period that it was 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 which 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 \$224,212 and \$405,279 in 2011 and 2010, respectively, which were charged to operations.

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.

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

Note 9 - Telecommunications (continued)

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 telecommunications functions for both legal and standards compliance purposes, the District has established separate detailed accounting for wholesale telecommunications activities and has developed a financing arrangement under which the continuing construction of telecommunications infrastructure and the operations of the telecommunications network are accomplished using funds loaned from the District's electric reserves.

Condensed telecom revenues and expenditures and assets and liabilities information follows:

	2011	2010
Operating revenues	\$ 1,995,657	\$ 1,944,346
Operating expenses	(1,214,901)	(1,145,039)
Nonoperating revenues - grant	494,408	-
Nonoperating expenses	(226,084)	(249,644)
Change in net assets	\$ 1,049,080	\$ 549,663
Total assets	1,908,072	\$ 499,173
Total liabilities	(2,521,481)	(2,161,666)
Total net liabilities	\$ (613,409)	\$ (1,662,493)

During 2010, the District applied for and was awarded American Recovery and Reinvestment Act (ARRA) funding to further deploy broadband communication services in the underserved areas of Okanogan County. The award package consists of \$5,501,782 in grant money and a \$3,667,855 loan. The proposed project will bring high-speed broadband to approximately 6,543 premises that currently lack access, and calls for placement of approximately 170 access nodes and 179 miles of fiber backbone. Project design and engineering began in 2011, and as of December 31, 2011, the District had received \$494,408 of grant funding and \$329,606 in loan funding against the accumulated project expenditures.

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% and 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.

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

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.

The District's net billing obligations in 2011 and 2010 were as follows:

ENW Fiscal 2012 Budget Year	<u>No. 1</u>	<u>No. 2</u>	<u>No. 3</u>	<u>Total</u>
Annual budget	\$ 322,533,000	\$ 417,510,000	\$ 166,796,000	\$ 906,839,000
District's share	0.00255	0.01042	0.00143	
District's net billing obligation	822,459	4,350,454	238,518	5,411,432
ENW Fiscal 2011 Budget Year				
Annual budget	\$ 184,856,000	\$ 558,930,000	\$ 183,097,000	\$ 926,883,000
District's share	0.00255	0.01042	0.00143	
District's net billing obligation	471,383	5,824,051	261,829	6,557,262

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 a 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 fall 2002. During 2003, a second phase of the project was completed, adding an additional 12 turbines and bringing the 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 current total project capacity up to about 96 MW.

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

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, thereby establishing 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 on 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 32.2% and 28.3% of the District's total power purchases in 2011 and 2010, respectively.

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.

PUBLIC UTILITY DISTRICT NO. 1 OF OKANOGAN COUNTY, WASHINGTON

NOTES TO FINANCIAL STATEMENTS

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 (NMFS) 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. Using the FERC Traditional Licensing Process (TLP), the District filed the license application with FERC on August 22, 2008. The proposed configuration would approximately double the project output to 47,300 MWh of energy per year and 9,000 KW of capacity.

Throughout the licensing process, the District has consulted with many entities, including Native tribes in Washington and Canada; the Bureau of Land Management (the underlying landowner); NOAA Fisheries and the U.S. Department of the Interior, Fish and Wildlife Service (under Section 7 of the Endangered Species Act); U.S. Army Corps of Engineers (under Section 404 of the Clean Water Act); Washington State Department of Ecology (under Section 401 of the Clean Water Act and state law); Washington State Historic Preservation Office (under Section 106 of the National Historic Preservation Act); and Okanogan County. The District responded to additional information requests from FERC on the final license application. Under the National Environmental Policy Act (NEPA), FERC held scoping meetings on the project and issued scoping documents in early 2009. In December 2009, FERC issued the Notice of Application Ready for Environmental Analysis and solicited comments, recommendations, terms and conditions, and prescriptions. Comments were received, and the District filed responses to the comments with FERC on April 12, 2010.

On May 9, 2011, FERC issued the draft Environmental Assessment for the Project. The District also received the District's draft Programmatic Agreement (PA) under Section 106 of the National Historic Preservation Act on May 20, 2011. As part of the consultation with NMFS, and United States Fish and Wildlife Service, the District developed biological assessments for each agency's jurisdiction for the project. On August 31, 2011, FERC issued the Final Environmental Assessment for the Enloe Hydroelectric Project. The District has continued in the development of other state and local permitting processes. The Final PA was signed by all parties and used by FERC on January 30, 2012. The District's draft section 401 water quality permit application with the Washington State Department of Ecology was published for comment on February 17, 2012. The District submitted comments on the draft on March 19, 2012. The District and FERC are still waiting for the Section 401 water quality permit, and NMFS biological opinion, before FERC can issue a license order.

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

Note 11 - Other Power Supply Agreements (continued)

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 began analyzing the next steps to achieve the goals of both organizations. The District received \$325,000 in funding from the Washington State Department of 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 in initiating a hydrology water availability study that was subsequently integrated into the Similkameen River Appraisal Level Study (SRALS). 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.

The District diligently pursued its studies and analysis of the option of developing and licensing the project, as detailed in the progress reports filed under the preliminary permit. Due to a variety of District concerns that became evident in the District's studies of the potential project and also experience gained in the course of the ongoing licensing proceeding for the Enloe project, the District concluded that it would not be prudent to further pursue the licensing of the Shanker's Bend project.

On September 26, 2011, the District submitted to FERC a Petition for Surrender of the Preliminary Permit, and on October 6, 2011, FERC issued the Notice of Surrender of Preliminary Permit.

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 \$13,165,000 and \$14,625,000 as of December 31, 2011 and 2010, respectively.

PUBLIC UTILITY DISTRICT NO. 1 OF OKANOGAN COUNTY, WASHINGTON

NOTES TO FINANCIAL STATEMENTS

Note 12 - Northwest Open Access Network (continued)

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, 2011 and 2010, was \$0 and \$292,280, respectively.

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, 2011 and 2010, is \$0.6 million and \$0.9 million, respectively.

In 2010, NoaNet established yet another nonrevolving line of credit in the amount of \$1.5 million to finance capital expenditures and network upgrades for new customers. The outstanding balance on this credit line as of December 31, 2011 and 2010, was \$833,333 and \$1,166,667 respectively.

The District's ownership interest in NoaNet was 5.5% as of December 31, 2011. During 2011, NoaNet incurred a net profit from operations of \$1,997,475; however, \$500,000 of that amount was actually from membership assessments. This operating margin, when combined with the nearly \$25 million in federal grant revenue brought the entity from a \$1,310,839 net deficit position to having net assets of \$24,845,234 as of December 31, 2011. NoaNet financial results for 2011 are estimated; however, any variance will not have a material impact on District's financial position. At year-end 2009, the District made the determination that its cash 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. From December 31, 2009, forward, the District's financial reports carry no investment or liability account balances reflecting NoaNet membership.

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

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 an Okanogan County Superior Court judge upheld the validity of the FEIS; however, that 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.

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

Note 13 - Pending Litigation (continued)

During 2009, the District started the process of acquiring right-of-way easements and various other permits required for construction. Condemnation proceedings were initiated against two landowners, one being a private individual and one being a state entity, to obtain the remaining easements necessary to complete the route. In 2010, Okanogan County Superior Court granted “public use and necessity” against the two landowners. The condemnation process moved to the appraisal stage and a court date was set for July 5, 2011, to determine values for the take. This court date was “stayed” by the Appeals Court pending the decision from the Washington State Supreme Court regarding a potential appeal by the Washington State Department of Natural Resources with regard to the Superior Court decision to allow the condemnation. In early 2012, the Washington State Supreme Court ruled in favor of the Washington State Department of Natural Resources, which will send the District to the Court of Appeals to rule on the 2010 Okanogan County Superior Court decision. This hearing should occur sometime in 2012.

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.

**REPORT OF INDEPENDENT AUDITORS ON INTERNAL CONTROL OVER FINANCIAL
REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF
FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT
AUDITING STANDARDS***

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

We have audited the financial statements of Public Utility District No. 1 of Okanogan County, Washington (the District) as of and for the year ended December 31, 2011, and have issued our report thereon dated May 10, 2012. We conducted our audit 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.

Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the District's internal control over financial reporting as a basis for designing our auditing procedures 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 over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the District's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of management, the Board of Commissioners, others within the entity, and the U.S. Department of Agriculture Rural Development, and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in cursive script that reads "Moss Adams LLP".

Everett, Washington
May 10, 2012

**REPORT OF INDEPENDENT AUDITORS ON COMPLIANCE WITH REQUIREMENTS THAT
COULD HAVE A DIRECT AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND ON
INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH
OMB CIRCULAR A-133**

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

Compliance

We have audited the financial statements of Public Utility District No. 1 of Okanogan County, Washington (the District) for compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on the District's major federal program for the year ended December 31, 2011. The District's major federal program is identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to its major federal program is the responsibility of the District's management. Our responsibility is to express an opinion on the District's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the District's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the District's compliance with those requirements.

In our opinion, the District has complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on its major federal program for the year ended December 31, 2011.

Internal Control Over Compliance

Management of the District is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the District's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the District's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness* in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

This report is intended solely for the information and use of management, the Board of Commissioners, others within the entity, and the U.S. Department of Agriculture Rural Development, and is not intended to be and should not be used by anyone other than these specified parties.



Everett, Washington
May 10, 2012

PUBLIC UTILITY DISTRICT NO. 1 OF OKANOGAN COUNTY, WASHINGTON
SCHEDULE OF FINDINGS AND QUESTIONED COSTS

I. Summary of Auditor's Results

Financial Statements

Type of auditor's report issued: Unqualified

Internal control over financial reporting:

- Material weakness identified? Yes No
- Significant deficiencies identified? Yes None reported

Noncompliance material to financial statements noted? Yes No

Federal Awards

Internal control over major programs:

- Material weakness identified? Yes No
- Significant deficiencies identified? Yes None reported

Type of auditor's report issued on compliance for major programs: Unqualified

Any audit findings disclosed that are required to be reported in accordance with Section 510(a) of OMB Circular A-133? Yes No

Identification of Major Programs

CFDA Numbers	Name of Federal Program or Cluster
ARRA - 10.787	ARRA - Broadband Initiative Program

Dollar threshold used to distinguish between Type A and Type B programs: \$300,000

Auditee qualified as low-risk auditee? Yes No

II. Financial Statement Findings

No matters were reported

III. Federal Award Findings and Questioned Costs

No matters were reported.

SUPPLEMENTARY INFORMATION

PUBLIC UTILITY DISTRICT NO. 1 OF OKANOGAN COUNTY, WASHINGTON
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
DECEMBER 31, 2011

<u>Federal Grant or Program Title</u>	<u>Federal CFDA Number</u>	<u>Federal EXP</u>
U.S. Department of Agriculture Rural Development:		
ARRA - Broadband Initiatives Program (BIP)	ARRA - 10.787	<u>\$ 1,041,596</u>
Total U.S. Department of Agriculture		<u>\$ 1,041,596</u>
Total Expenditures of Federal Awards		<u><u>\$ 1,041,596</u></u>

PUBLIC UTILITY DISTRICT NO. 1 OF OKANOGAN COUNTY, WASHINGTON
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2011

Note 1 - Basis of Presentation

The accompanying Schedule of Expenditures of Federal Awards (the Schedule) includes the federal grant activity of Public Utility District #1 of Okanogan County (the District) under programs of the federal government for the year ended December 31, 2011. The information presented in this Schedule is presented in accordance with the requirement of the Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Because the Schedule presents only a selected portion of the operations of the District, it is not intended to and does not present the financial position, changes in net assets, or cash flows of the District.

Note 2 - Summary of Significant Accounting Policies

Expenditures reported on the Schedule are reported on the accrual basis of accounting. Such expenditures are recognized following the cost principles contained in OMB Circular A-87, *Cost Principles for State, Local and Indian Tribal Governments*, wherein certain types of expenditures are not allowable or are limited as to reimbursement.

Note 3 - Relationship to the Basic Financial Statements

Federal awards are reported in the financial statements as an increase in value of electric plant assets and grant revenue.

SUPPLEMENTARY INFORMATION (Unaudited)

PUBLIC UTILITY DISTRICT NO. 1 OF OKANOGAN COUNTY, WASHINGTON
COMPARATIVE RESULTS OF OPERATIONS AND DEBT SERVICE COVERAGE (Unaudited)

	Years Ended December 31,				
	2011	2010	2009	2008	2007
OPERATING REVENUES					
Electric - retail	\$ 33,355,835	\$ 29,102,331	\$ 30,564,662	\$ 31,725,275	\$ 30,864,028
Electric - wholesale	6,741,527	5,801,904	4,198,885	11,263,827	11,989,607
Telecommunications	1,955,276	1,912,283	1,622,655	1,023,170	839,421
Other operating revenue	964,149	1,024,195	1,176,193	727,419	706,821
Total operating revenue	43,016,787	37,840,713	37,562,395	44,739,691	44,399,877
OPERATING EXPENSES					
Cost of power	24,860,599	24,501,801	22,334,570	25,013,021	24,719,827
Electric operations and maintenance	4,754,468	5,463,131	5,309,984	5,552,945	4,138,020
Telecommunications operations and maintenance	601,857	638,124	690,763	572,726	437,571
Customer accounting and information	1,859,707	1,962,667	1,962,851	1,943,477	1,737,413
Administration and general	3,956,286	3,863,210	3,767,340	2,895,403	2,500,222
Depreciation and amortization	4,258,323	3,428,771	3,118,253	2,953,691	2,784,547
Taxes	2,138,550	1,839,338	1,876,404	1,921,890	1,896,453
Total operating expenses	42,429,790	41,697,042	39,060,165	40,853,153	38,214,053
Net operating revenue (expense)	586,997	(3,856,329)	(1,497,770)	3,886,538	6,185,824
NONOPERATING REVENUE (EXPENSE)					
Interest income	113,944	214,510	964,500	1,697,562	1,919,001
Grant revenue	494,408	-	-	-	-
Contributed capital	974,691	996,025	884,846	1,795,823	1,951,582
Interest on long-term debt	(2,068,361)	(992,488)	(767,365)	(750,727)	(778,339)
Allowance for funds used during construction	661,140	-	-	-	-
Other revenue	602,550	140,331	214,852	(39,597)	(3,779)
Impairment of investment	-	-	(1,147,139)	(2,995,409)	-
Other expenses	(726,596)	(253,270)	(418,676)	(48,073)	(48,073)
Net nonoperating revenue (expense)	51,776	105,108	(268,982)	(340,421)	3,040,392
CHANGE IN NET ASSETS	\$ 638,773	\$ (3,751,221)	\$ (1,766,752)	\$ 3,546,117	\$ 9,226,216
DEBT SERVICE COVERAGE ADJUSTMENTS					
Interest charges (net AFUDC)	\$ 1,407,221	\$ 992,488	\$ 767,365	\$ 750,727	\$ 778,339
Depreciation and amortization	4,258,323	3,428,771	3,118,253	2,953,691	2,784,547
Capital grant	(494,408)	-	-	-	-
Impairment of investment	-	-	1,147,139	2,995,409	-
Rate stabilization transfer (to) from	-	1,400,000	(535,000)	-	(5,500,000)
AVAILABLE FOR DEBT SERVICE	\$ 5,809,909	\$ 2,070,038	\$ 2,731,005	\$ 10,245,944	\$ 7,289,102
TOTAL DEBT SERVICE	\$ 3,434,230	\$ 1,428,314	\$ 1,557,495	\$ 1,563,293	\$ 1,555,616
DEBT SERVICE COVERAGE	1.69	1.45	1.75	6.55	4.69

PUBLIC UTILITY DISTRICT NO. 1 OF OKANOGAN COUNTY, WASHINGTON
CUSTOMER STATISTICAL DATA (Unaudited)

	Years Ended December 31,				
	2011	2010	2009	2008	2007
ACTIVE CUSTOMER ACCOUNTS					
Residential	\$ 16,892	\$ 16,828	\$ 16,869	\$ 16,702	\$ 16,395
General service	2,369	2,370	2,374	2,349	2,365
Industrial	4	4	4	4	4
Irrigation and frost control	1,331	1,337	1,346	1,349	1,313
Street lighting	21	21	21	21	21
Sales for resale	2	5	3	5	8
Telecommunications ⁽¹⁾	20	21	19	32	33
Total active customer accounts	<u>\$ 20,639</u>	<u>\$ 20,586</u>	<u>\$ 20,636</u>	<u>\$ 20,462</u>	<u>\$ 20,139</u>
REVENUES BILLED					
Residential	\$ 18,089,701	\$ 14,961,740	\$ 15,156,514	\$ 15,268,716	\$ 14,761,937
General service	11,717,785	10,872,507	10,963,211	11,367,403	11,117,623
Industrial	1,052,677	982,599	1,720,197	2,581,701	2,479,156
Irrigation and frost control	2,371,177	2,158,725	2,597,766	2,382,594	2,380,867
Street lighting	124,492	126,761	126,974	124,861	124,445
Sales for resale	6,741,527	5,801,904	4,198,885	11,263,827	11,989,607
Telecommunications	1,955,276	1,912,283	1,622,655	1,023,170	839,421
Other operating revenue	964,149	1,024,195	1,176,193	727,419	706,821
Total revenues billed	<u>\$ 43,016,784</u>	<u>\$ 37,840,714</u>	<u>\$ 37,562,395</u>	<u>\$ 44,739,691</u>	<u>\$ 44,399,877</u>
ENERGY CONSUMED (kWh)					
Residential	324,538,087	289,163,326	312,799,371	301,280,297	290,554,285
General service	202,556,775	197,732,966	206,753,800	207,063,203	202,418,783
Industrial	21,141,320	21,602,188	40,935,028	61,861,650	58,953,315
Irrigation and frost control	60,835,173	60,258,036	75,416,713	68,141,702	68,582,278
Street lighting	1,359,877	1,340,152	1,326,639	1,309,306	1,309,130
Sales for resale	357,255,000	213,866,000	171,965,000	233,706,000	264,004,000
Total energy consumed (kWh)	<u>967,686,232</u>	<u>783,962,668</u>	<u>809,196,551</u>	<u>873,362,158</u>	<u>885,821,791</u>
ANNUAL AVERAGE REVENUE PER CUSTOMER					
Residential	\$ 1,071	\$ 889	\$ 898	\$ 914	\$ 900
General service	4,946	4,588	4,618	4,839	4,701
Industrial	263,169	245,650	430,049	645,425	619,789
Irrigation and frost control	1,782	1,615	1,930	1,766	1,813
Street lighting	5,928	6,036	6,046	5,946	5,926
Sales for resale	3,370,764	1,160,381	1,399,628	2,252,765	1,498,701
Telecommunications ⁽¹⁾	97,764	91,061	85,403	31,974	25,437
Total annual average revenue per customer	<u>\$ 2,038</u>	<u>\$ 1,788</u>	<u>\$ 1,763</u>	<u>\$ 2,151</u>	<u>\$ 2,170</u>
AVERAGE ANNUAL kWh PER CUSTOMER					
Residential	19,213	17,183	18,543	18,039	17,722
General service	85,503	83,432	87,091	88,150	85,589
Industrial	5,285,330	5,400,547	10,233,757	15,465,413	14,738,329
Irrigation and frost control	45,706	45,070	56,030	50,513	52,233
Street lighting	64,756	63,817	63,173	62,348	62,340
Total annual average kWh per customer	<u>29,608</u>	<u>27,728</u>	<u>30,913</u>	<u>31,317</u>	<u>30,939</u>

⁽¹⁾ Customer accounts were consolidated in 2009.

PUBLIC UTILITY DISTRICT NO. 1 OF OKANOGAN COUNTY, WASHINGTON
OTHER FINANCIAL DATA (Unaudited)

	Years Ended December 31,				
	2011	2010	2009	2008	2007
COST OF PURCHASED POWER					
Bonneville Power Administration	\$ 17,100,497	\$ 17,357,446	\$ 14,602,775	\$ 17,542,942	\$ 18,337,324
Douglas County PUD - Wells Hydroelectric Project	3,593,090	3,143,054	3,483,584	2,727,910	2,763,410
Energy NW - Nine Canyon Wind Project	3,060,855	2,963,835	2,953,233	3,015,740	2,346,663
Other cost of power, including market purchases	1,106,157	1,037,466	1,294,978	1,726,429	1,272,430
Total cost of purchased power	\$ 24,860,599	\$ 24,501,801	\$ 22,334,570	\$ 25,013,021	\$ 24,719,827
ENERGY RESOURCES MWh					
Bonneville Power Administration	605,088	530,461	549,191	581,711	580,390
Douglas County PUD - Wells Hydroelectric Project	313,857	228,442	242,781	262,069	289,447
Energy NW - Nine Canyon Wind Project	44,620	37,178	38,961	52,050	41,377
Other cost of power, including market purchases	10,816	11,545	22,101	21,441	16,140
Total energy resources MWh	974,381	807,626	853,034	917,271	927,354
AVERAGE COST PER MWh					
Bonneville Power Administration	\$ 28.26	\$ 32.72	\$ 26.59	\$ 30.16	\$ 31.59
Douglas County PUD - Wells Hydroelectric Project	11.45	13.76	14.35	10.41	9.55
Energy NW - Nine Canyon Wind Project	68.60	79.72	75.80	57.94	56.71
Other cost of power, including market purchases	102.27	89.86	58.59	80.52	78.84
Average cost per MWh (all resources)	\$ 25.51	\$ 30.34	\$ 26.18	\$ 27.27	\$ 26.66
PEAK DEMAND MW	149	155	166	173	161
NET UTILITY PLANT	\$ 91,602,426	\$ 88,003,113	\$ 75,506,178	\$ 63,948,537	\$ 58,348,349
EMPLOYEE DATA					
Full-time employees	90	91	91	88	87
Part-time employees	2	4	4	7	6
Total employees	92	95	95	95	93