

Washington State Auditor's Office
Financial Statements Audit Report

**Public Utility District No. 1 of Douglas
County**

Audit Period
January 1, 2005 through December 31, 2005

Report No. 71017

Issue Date
June 30, 2006



Washington _____
State Auditor
_____ Brian Sonntag



**Washington State Auditor
Brian Sonntag**

June 30, 2006

Board of Commissioners
Public Utility District No. 1 of Douglas County
East Wenatchee, Washington

Report on Financial Statements

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

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

In addition to this work, we look at other areas of our audit client's operations for compliance with state laws and regulations. The results of that audit will be included in a separately issued accountability report.

Sincerely,

BRIAN SONNTAG, CGFM
STATE AUDITOR

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January 1, 2005 through December 31, 2005**

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Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters in Accordance with *Government Auditing Standards*

Public Utility District No. 1 of Douglas County January 1, 2005 through December 31, 2005

Board of Commissioners
Public Utility District No. 1 of Douglas County
East Wenatchee, Washington

We have audited the accompanying financial statements of each major fund of Public Utility District No. 1 of Douglas County, Washington, as of and for the year ended December 31, 2005, and have issued our report thereon dated May 22, 2006. The prior year partial comparative information has been derived from the District's 2004 basic financial statements that we issued our report thereon dated September 19, 2005.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit, we considered the District's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving internal control over financial reporting and its operation that we consider to be material weaknesses.

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 the District's compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, the objective of our audit of the financial statements was not to provide an opinion on overall compliance with these provisions. 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 herein under *Government Auditing Standards*.

This report is intended for the information and use of management and the Board of Commissioners. However, this report is a matter of public record and its distribution is not limited. It also serves to disseminate information to the public as a reporting tool to help citizens assess government operations.

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BRIAN SONNTAG, CGFM
STATE AUDITOR

May 22, 2006

Independent Auditor's Report on Financial Statements

Public Utility District No. 1 of Douglas County January 1, 2005 through December 31, 2005

Board of Commissioners
Public Utility District No. 1 of Douglas County
East Wenatchee, Washington

We have audited the accompanying financial statements of each major fund of Public Utility District No. 1 of Douglas County, Washington, as of and for the year ended December 31, 2005, as listed on page 5. These financial statements are the responsibility of the District's management. Our responsibility is to express opinions on these financial statements based on our audit. The prior year partial comparative information has been derived from the District's 2004 financial statements and, in our report dated September 19, 2005, we expressed an unqualified opinion on the basic financial statements.

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

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 Douglas County, as of December 31, 2005, and the changes in financial position and cash flows, where applicable, thereof, for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The financial statements include partial prior-year comparative information. Such information does not include all of the information required for a presentation in conformity with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with the District's financial statements for the year ended December 31, 2004, from which such partial information was derived.

In accordance with *Government Auditing Standards*, we have also issued our report 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 the 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 management's discussion and analysis on pages 6 through 9 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of

management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

A handwritten signature in black ink, appearing to read "Brian Sonntag". The signature is fluid and cursive, with the first name "Brian" and last name "Sonntag" clearly distinguishable.

BRIAN SONNTAG, CGFM
STATE AUDITOR

May 22, 2006

Financial Section

Public Utility District No. 1 of Douglas County January 1, 2005 through December 31, 2005

REQUIRED SUPPLEMENTAL INFORMATION

Management's Discussion and Analysis – 2005

BASIC FINANCIAL STATEMENTS

Balance Sheet – 2005 and 2004

Statement of Revenues, Expenses and Changes in Net Assets – 2005 and 2004

Statement of Cash Flows – 2005 and 2004

Notes to Financial Statements – 2005 and 2004

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following management's discussion and analysis presents an overview and analysis of the financial activities of Public Utility District No. 1 of Douglas County (the District) during the fiscal year ended December 31, 2005. This supplementary information should be read in conjunction with the accompanying audited financial statements and related notes.

OVERVIEW OF FINANCIAL STATEMENTS AND OPERATIONS

The District is organized in two primary operating systems: the Electric Distribution System (Distribution System) and the Wells Hydroelectric Project (Wells Project). The Distribution System provides retail electric and wholesale broadband communication to customers in Douglas County, Washington. The Wells project is a hydroelectric facility, owned and operated by the District and located on the Columbia River in the state of Washington. Generation from the Wells Project is sold at cost to four Pacific Northwest investor owned utilities (the Power Purchasers), pursuant to long term power sales contracts, to the District's Distribution System and to the Colville Confederated Tribes (the Tribes) under the terms of a settlement agreement. See the notes to the financial statements for information regarding the Colville Settlement Agreement.

The financial report includes the Management's Discussion and Analysis (MD&A), the Independent Auditor's Report, the audited financial statements and the notes to the financial statements. The financial statements of the District report information using accounting methods similar to those used by private utility companies. These statements offer short and long term financial information about the District's activities. For additional information on the District's capital assets and long-term debt activity please refer to the footnotes.

- The balance sheet is a statement of position; it includes all of the District's investments in resources (assets), obligations to creditors (liabilities) and net assets (equity).
- The statement of revenues, expenses, and changes in net assets reflect the transactions and events that increase and decrease the economic resources of the district (operations). Revenues and expenses are summarized by major source and use. Revenues and expenses are further summarized by operating and nonoperating based on the nature of the transaction.
- The statements of cash flows reflect the District's sources and uses of cash separated into operating, investing, and capital activities.

DISTRIBUTION SYSTEM

The service area of the Electric Distribution System includes Douglas County with an area of 1,820 square miles. The assets (properties) of the Distribution System include 16 miles of 115-kV transmission lines, 13 substations, 1,600 miles of overhead and underground distribution lines, 200 miles of fiber optic lines and other buildings, equipment, inventories and related facilities.

Condensed Comparative Financial Information

Distribution System Balance Sheet
(Dollars in Thousands)

	12/31/2005	12/31/2004	Increase (Decrease) 2005-2004		12/31/2003
			\$	%	
Capital Assets	\$ 102,060	\$ 98,789	\$ 3,271	3.3%	\$ 94,199
Current & Other Assets	66,540	58,775	7,765	13.2%	49,174
Total Assets	168,600	157,564	11,036	7.0%	143,373
Noncurrent Liabilities	14,338	15,403	(1,065)	-6.9%	8,916
Current Liabilities	9,570	9,014	556	6.2%	8,506
Total Liabilities	23,908	24,417	(509)	-2.1%	17,422
Invested in Capital Assets, <small>net of debt</small>	84,564	80,760	3,804	4.7%	84,437
Unrestricted	60,118	52,387	7,731	14.8%	41,514
Total Net Assets	\$ 144,682	\$ 133,147	\$ 11,535	8.7%	\$ 125,951

Distribution System Statement of Earnings and Net Assets

(Dollars in Thousands)

	12/31/2005	12/31/2004	Increase (Decrease)		12/31/2003
			2005-2004		
			\$	%	
Operating Revenues					
Retail Electric Sales	\$ 12,526	\$ 12,150	\$ 376	3.1%	\$ 11,672
Electric Sales For Resale	31,158	26,713	4,445	16.6%	24,815
Broadband	525	480	45	9.4%	292
Other	306	271	35	12.9%	243
Operating Expenses					
Purchased Power	22,356	22,268	88	0.4%	23,199
Other	12,618	12,019	599	5.0%	11,686
Net Operating Revenues	9,541	5,327	4,214	79.1%	2,137
Nonoperating Revenues	2,049	1,535	514	33.5%	1,915
Nonoperating Expenses	(714)	(714)	0	0.0%	(562)
Contributed Capital	658	1,048	(390)	-37.2%	632
Net Earnings	11,534	7,196	4,338	60.3%	4,122
Beginning Net Assets	133,147	125,951	7,196	5.7%	121,829
Ending Net Assets	\$ 144,681	\$ 133,147	\$ 11,534	8.7%	\$ 125,951

Financial Analysis

During 2005 the Distribution System's overall financial position and results of operation improved. Net assets increased by 8.7% or \$11.5 million. The increase in net assets is primarily due to increased operating revenues from wholesale and retail power sales.

Revenue

Annual fluctuations in energy sales in the Northwest are due to changes in weather conditions, river flows and electrical consumption patterns. Extreme temperatures increase sales to residential and commercial customers who use electricity for heating and cooling, while moderate temperatures produce average sales. Total electric revenue increased 12.4% in 2005. The increase is primarily due to an increase in electric sales for resale in 2005, which increased 16.6% to a total of \$31 million. Retail customer growth of 2% further contributed to an increase in sales to the District's retail customers. Retail customer sales increased 3.1% to \$12.5 million in 2005.

Expenses

The Distribution System purchases a bulk of its power from the Wells Project. Other power resources currently include: Rocky Reach Dam, Nine Canyon Wind Project, and Bonneville Power Administration. The Distribution System's power costs remain stable at \$22 million with only .4% increase from 2004.

Capital Asset and Long Term Debt Activity

During 2005, capital assets, net of construction work-in-progress increased \$6.4 million. The Distribution System's capital additions are associated with a growing customer base, long-term capital improvements of electrical distribution facilities and moving district facilities for road expansion projects.

During 2004 the District refunded outstanding 1995 bonds and issued an additional \$10.4 million in new revenue debt for electrical distribution system upgrades. The Distribution System has \$14.5 million in outstanding bonds; annual debt service payments are \$2.4 million. Debt service coverage ratios for 2005 and 2004 were 6.6 and 4.2, respectively.

WELLS PROJECT

The Wells Project is located 516 river miles from the mouth of the Columbia River. The District was issued a 50-year license, expiring in 2012, to develop the Wells site as the Wells Hydroelectric Project. Commercial operation began on September 16, 1967. The Wells Project is constructed in a hydrocombine design, which includes generating units, switchyard, spillways, and fish passage facilities in a single integrated concrete structure.

Condensed Comparative Financial Information

Well Project Balance Sheets

(Dollars in Thousands)

	12/31/2005	12/31/2004	Increase (Decrease)		12/31/2003
			2005-2004		
			\$	%	
Current and Other Assets	\$ 132,218	\$ 63,418	\$ 68,800	108.5%	\$ 59,024
Capital Assets	176,180	175,307	873	0.5%	170,826
Total Assets	<u>308,398</u>	<u>238,725</u>	<u>69,673</u>	<u>29.2%</u>	<u>229,850</u>
Long-Term Liabilities	216,241	155,488	60,753	39.1%	148,645
Other Liabilities	17,964	13,899	4,065	29.2%	14,322
Total Liabilities	<u>234,205</u>	<u>169,387</u>	<u>64,818</u>	<u>38.3%</u>	<u>162,967</u>
Invested in Capital Assets,					
Net of Related Debt	50,888	35,011	15,877	45.3%	31,228
Restricted	9,355	7,637	1,718	22.5%	8,111
Unrestricted	13,950	26,691	(12,741)	-47.7%	27,544
Total Net Assets	<u>\$ 74,193</u>	<u>\$ 69,339</u>	<u>\$ 4,854</u>	<u>7.0%</u>	<u>\$ 66,883</u>

Wells Project Statements of Earnings and Net Assets

(Dollars in Thousands)

	12/31/2005	12/31/2004	Increase (Decrease)		12/31/2003
			2005-2004		
			\$	%	
Operating Revenues	\$ 31,806	\$ 30,828	\$ 978	3.2%	\$ 33,363
Operating Expenses	17,826	18,959	(1,133)	-6.0%	20,814
Net Operating Revenues	13,980	11,869	2,111	17.8%	12,549
Nonoperating Revenues	1,796	395	1,401	354.7%	416
Nonoperating Expenses	10,921	9,808	1,113	11.3%	9,228
Net Earnings	4,855	2,456	2,399	97.7%	3,737
Beginning Net Assets	69,339	66,883	2,456	3.7%	63,146
Ending Net Assets	<u>\$ 74,194</u>	<u>\$ 69,339</u>	<u>\$ 4,855</u>	<u>7.0%</u>	<u>\$ 66,883</u>

Financial Analysis

During 2005 the major fluctuations in the financial position of the Wells Project were due to the issuance of the 2005 Bonds and the use of the bond proceeds. The bond issue and other significant financial items are discussed in further detail below and in the notes to the financial statements.

Revenues & Expenses

Because the electricity generated by the Wells Project is sold at cost, which, under the terms of the power sales contracts, includes debt service but excludes depreciation, operating revenues fluctuate based on operating expenses and debt service requirements. During 2005 total annual operating expenses decreased by \$1.1 million to \$17.8 million, a 6.0% decrease. The primary reason for the decrease in operating expenses for the year ended December 31, 2005 as compared to the year ended December 31, 2004 was the reduction of expenses due to fish hatchery sharing agreements with neighboring public utility districts. Under the terms of these agreements the other public utility districts utilize excess fish rearing capacity at the Wells Project's fish hatcheries and pay a share of the hatchery expenses. The hatchery sharing agreements were implemented about mid-year in 2004, and 2005 was the first full year of their use.

During 2005 total nonoperating revenues increased by \$1.4 million, due to increased investment earnings resulting from a general increase in interest rates and from investment of the proceeds of the 2005 Bonds. Nonoperating expenses increased by \$1.1 million, due mainly to increased interest expense on long-term debt resulting from issuance of the 2005 Bonds

Capital Assets and Long Term Debt Activity

As of December 31, 2005 the Wells Project had approximately \$176 million invested in capital assets, net of accumulated depreciation, including its hydraulic generation and transmission plant, fish rearing facilities, and related land, office buildings and equipment. Capital costs of the Wells Project, other than major additions or replacements, are typically funded from revenues. Costs of major additions or replacements are funded from bond proceeds.

As of December 31, 2005 the Wells Project had long-term liabilities of \$216 million. This included \$209 million of revenue bonds outstanding, net of the current portion of \$9 million. In July 2005 the District issued \$88 million of Wells Project bonds (the 2005 Bonds) for the purposes of financing a major rebuild of the generating units at the Wells Project, certain other capital projects, payment of the cash portion of a settlement with the Tribes, and refinancing of a portion of the outstanding 1999 Wells Project Bonds. Please see the notes to the financial statements for further information regarding the 2005 Bonds and other Wells Project bonds.

In the spring of 2002 the bond rating firm of Standard & Poor's upgraded its rating of the Wells Project to "AA". This rating was affirmed in the fall of 2003. Additionally, in the fall of 2003 Moody's Investors Service upgraded its bond rating for the Wells Project to "Aa2". These ratings were affirmed by Standard & Poor's and Moody's, respectively, in the summer of 2005.

In November 2004 the District reached a settlement with the Tribes regarding use of Tribal lands. The settlement includes three items of compensation from the Wells Project, namely 1) a cash payment; 2) a transfer of land owned by the Wells Project; and 3) an agreement to sell a portion of future Wells Project power generation to the Tribes at cost. The cash payment of \$13.5 million was made during the summer of 2005, and was financed by the 2005 Bonds. This cash payment is reflected as a deferred charge on the balance sheet, and is being amortized to expense over the life of the 2005 Bonds. Title to the land was transferred in early 2005.

CONTACT INFORMATION

This financial report is designed to provide a general overview of the finances of the District. If you have questions about this report or need additional financial information, please contact Public Utility District No. 1 of Douglas County, 1151 Valley Mall Parkway, East Wenatchee, WA 98802.

PUBLIC UTILITY DISTRICT NO. 1 OF DOUGLAS COUNTY

BALANCE SHEET
As of December 31, 2005

<u>ASSETS</u>	Wells	Distribution	TOTAL	
	Hydroelectric Project	System	2005	2004
Non-Current Assets				
Electric Plant:				
Electric Plant	\$ 226,016,160	\$ 141,957,102	\$ 367,973,262	\$ 355,759,286
Construction Work in Progress	10,505,998	2,885,019	13,391,017	15,312,061
Electric Plant - Gross	236,522,158	144,842,121	381,364,279	371,071,347
Less: Accum. Depreciation & Amortization	60,342,080	47,354,436	107,696,516	100,672,200
Net Electric Plant	176,180,078	97,487,685	273,667,763	270,399,147
Deferred Charges:				
Unamortized Debt Discount & Expense	3,439,794	321,425	3,761,219	2,866,941
Unamortized Loss on Reacquired Debt	3,387,743	-	3,387,743	2,960,423
Other Deferred Charges	34,244,237	3,651,003	37,895,240	39,732,932
Total Non-Current Assets	<u>217,251,852</u>	<u>101,460,113</u>	<u>318,711,965</u>	<u>315,959,443</u>
Current Assets				
Restricted:				
Construction Funds	70,587,709	3,965,709	74,553,418	9,888,968
Debt Repayment Funds	9,350,550	167,209	9,517,759	7,845,159
Reserve & Contingency Fund	5,542,764	-	5,542,764	5,278,041
Wells Hydroelectric Project Licensing Fund	-	9,692,911	9,692,911	9,343,286
Total Restricted	<u>85,481,023</u>	<u>13,825,829</u>	<u>99,306,852</u>	<u>32,355,454</u>
Unrestricted:				
Cash	2,007,840	224,734	2,232,574	1,491,121
Investments	1,869,163	26,929,084	28,798,247	24,993,515
Rate Stabilization Fund	-	12,000,000	12,000,000	9,798,811
Receivables - Net	1,196,654	7,729,005	8,925,659	5,444,599
Materials and Supplies	-	3,502,040	3,502,040	2,825,783
Other Current & Accrued Assets	591,748	2,920,505	3,512,253	3,421,178
Total Unrestricted	<u>5,665,405</u>	<u>53,305,368</u>	<u>58,970,773</u>	<u>47,975,007</u>
Total Current Assets	<u>91,146,428</u>	<u>67,131,197</u>	<u>158,277,625</u>	<u>80,330,461</u>
TOTAL ASSETS	<u>\$ 308,398,280</u>	<u>\$ 168,591,310</u>	<u>\$ 476,989,590</u>	<u>\$ 396,289,904</u>

The notes to financial statements are an integral part of these statements.

PUBLIC UTILITY DISTRICT NO. 1 OF DOUGLAS COUNTY

**BALANCE SHEET
As of December 31, 2005**

<u>LIABILITIES & NET ASSETS</u>	<u>Wells</u>	<u>Distribution</u>	<u>TOTAL</u>	
	<u>Hydroelectric Project</u>	<u>System</u>	<u>2005</u>	<u>2004</u>
Non-current Liabilities				
Bonds Payable, excluding current portion	\$ 208,775,000	\$ 13,090,000	\$ 221,865,000	\$ 150,245,000
Unamortized Bond Premiums (Discounts)	<u>6,342,129</u>	<u>461,820</u>	<u>6,803,949</u>	<u>5,136,291</u>
Bonds Payable, Net	<u>215,117,129</u>	<u>13,551,820</u>	<u>228,668,949</u>	<u>155,381,291</u>
Settlement Liability	-	-	-	14,458,140
Deferred Credits	523,633	90,321	613,954	774,737
Intradistrict Note Payable	600,000	-	600,000	-
Unamortized Gain on Redeemed Debt	<u>-</u>	<u>234,328</u>	<u>234,328</u>	<u>276,496</u>
Total Non-current Liabilities	<u>216,240,762</u>	<u>13,876,469</u>	<u>230,117,231</u>	<u>170,890,664</u>
Current Liabilities				
Accounts Payable	2,670,906	2,668,069	5,338,975	5,193,891
Other Accrued Liabilities	1,983,529	5,864,891	7,848,420	5,801,025
Payable from Restricted Assets:				
Accrued Interest Payable	3,954,518	49,560	4,004,078	2,428,305
Current Portion Long-Term Debt	<u>9,355,000</u>	<u>1,450,000</u>	<u>10,805,000</u>	<u>9,490,000</u>
Total Current Liabilities	<u>17,963,953</u>	<u>10,032,520</u>	<u>27,996,473</u>	<u>22,913,221</u>
Total Liabilities	<u>234,204,715</u>	<u>23,908,989</u>	<u>258,113,704</u>	<u>193,803,885</u>
Net Assets				
Invested in Capital Assets, Net of Related Debt	50,888,337	84,397,377	135,285,714	115,563,083
Restricted For Debt Service	9,355,000	167,209	9,522,209	7,845,159
Unrestricted	<u>13,950,228</u>	<u>60,117,735</u>	<u>74,067,963</u>	<u>79,077,777</u>
Total Net Assets	<u>74,193,565</u>	<u>144,682,321</u>	<u>218,875,886</u>	<u>202,486,019</u>
TOTAL LIABILITIES AND NET ASSETS	\$ <u>308,398,280</u>	\$ <u>168,591,310</u>	\$ <u>476,989,590</u>	\$ <u>396,289,904</u>

The notes to financial statements are an integral part of these statements.

PUBLIC UTILITY DISTRICT NO. 1 OF DOUGLAS COUNTY

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
For The Fiscal Year Ended December 31, 2005

	Wells			TOTAL	
	Hydroelectric Project	Distribution System	Intersystem Eliminations	2005	2004
Operating Revenues					
Retail Sales of Electric Energy	\$ -	\$ 12,526,283	\$ -	\$ 12,526,283	\$ 12,149,959
Energy Sales for Resale	31,806,066	31,158,007	(11,572,446)	51,391,627	45,675,814
Broadband	-	525,250	-	525,250	479,567
Other	-	305,895	-	305,895	271,486
Total Operating Revenues	<u>31,806,066</u>	<u>44,515,435</u>	<u>(11,572,446)</u>	<u>64,749,055</u>	<u>58,576,826</u>
Operating Expenses					
Operations	10,716,458	27,576,491	(11,572,446)	26,720,503	27,101,407
Maintenance	2,332,894	2,441,678	-	4,774,572	5,004,409
Depreciation	3,631,020	3,974,817	-	7,605,837	7,181,993
Taxes	1,145,372	980,587	-	2,125,959	2,093,426
Total Operating Expenses	<u>17,825,744</u>	<u>34,973,573</u>	<u>(11,572,446)</u>	<u>41,226,871</u>	<u>41,381,235</u>
Operating Income	<u>13,980,322</u>	<u>9,541,862</u>	<u>-</u>	<u>23,522,184</u>	<u>17,195,591</u>
Non-operating Revenues (Expenses)					
Interest Income	1,796,361	1,915,574	-	3,711,935	1,805,126
Interest Expense	(8,692,358)	(628,841)	-	(9,321,199)	(8,102,213)
Debt Expense	(2,229,568)	(85,212)	-	(2,314,780)	(1,461,933)
Settlement Expense	-	-	-	-	(958,140)
Other	-	133,988	-	133,988	125,757
Total Non-operating Revenues (Expenses)	<u>(9,125,565)</u>	<u>1,335,509</u>	<u>-</u>	<u>(7,790,056)</u>	<u>(8,591,403)</u>
Income Before Contributions	<u>4,854,757</u>	<u>10,877,371</u>	<u>-</u>	<u>15,732,128</u>	<u>8,604,188</u>
Capital Contributions	<u>-</u>	<u>657,739</u>	<u>-</u>	<u>657,739</u>	<u>1,047,939</u>
Change In Net Assets	<u>4,854,757</u>	<u>11,535,110</u>	<u>-</u>	<u>16,389,867</u>	<u>9,652,127</u>
Net Assets, Beginning of Year	<u>69,338,808</u>	<u>133,147,211</u>	<u>-</u>	<u>202,486,019</u>	<u>192,833,892</u>
Net Assets, End of Year	<u>\$ 74,193,565</u>	<u>\$ 144,682,321</u>	<u>\$ -</u>	<u>\$ 218,875,886</u>	<u>\$ 202,486,019</u>

The notes to financial statements are an integral part of these statements.

PUBLIC UTILITY DISTRICT NO. 1 OF DOUGLAS COUNTY

STATEMENT OF CASH FLOWS
For The Fiscal Year Ended December 31, 2005

	Wells			TOTAL	
	Hydroelectric Project	Distribution System	Intersystem Eliminations	2005	2004
Cash Flow from Operating Activities					
Receipts from Customers	\$ 31,580,868	\$ 48,735,061	\$ (11,589,506)	\$ 68,726,423	\$ 77,899,204
Receipts for Other Agencies	-	16,290,475	-	16,290,475	-
Receipts for Internal Services Provided	1,245,723	292,700	(1,538,423)	1,538,423	-
Payments for Internal Services Used	(292,700)	(1,245,723)	1,538,423	(1,538,423)	-
Payments to Employees & Payroll Related	(8,206,075)	(5,066,339)	-	(13,272,414)	(12,373,648)
Payments to Suppliers & Other Agencies	(6,911,247)	(48,893,937)	11,589,506	(44,215,678)	(41,379,311)
Net Cash Provided by Operating Activities	<u>17,416,569</u>	<u>10,112,237</u>	<u>-</u>	<u>27,528,806</u>	<u>24,146,245</u>
Cash Flows from Investing Activities					
Purchase of Investments	(171,120,257)	(17,981,000)	-	(189,101,257)	(50,189,284)
Proceeds from Sales and Maturities of Investments	101,767,018	17,806,253	-	119,573,271	63,384,657
Interest on Investments	1,709,139	1,898,007	-	3,607,146	2,347,453
Net Cash Provided by Investing Activities	<u>(67,644,100)</u>	<u>1,723,260</u>	<u>-</u>	<u>(65,920,840)</u>	<u>15,542,826</u>
Cash Flows from Capital and Related Financing Activities					
Additions to Electric Plant in Service	(7,373,664)	(6,544,695)	-	(13,918,359)	(10,008,954)
Net Additions to Construction Work in Progress	1,827,694	93,350	-	1,921,044	(5,680,001)
Proceeds from Intradistrict Note Payable	14,100,000	(14,100,000)	-	-	-
Required Contribution to Plan Species Account - HCP	-	-	-	-	(2,272,740)
Payments on Intradistrict Note Payable	(13,500,000)	13,500,000	-	-	-
Proceeds from Bond Issuance	87,585,000	-	-	87,585,000	18,420,000
Premium (Discount) and Expenses Related to Issuance of Bonds	793,294	-	-	793,294	(381,439)
Payment of Colville Settlement	(13,500,000)	-	-	(13,500,000)	-
Proceeds from Capital Contributions	-	657,739	-	657,739	1,047,939
Principal Payments on Long-term Debt	(12,740,000)	(1,910,000)	-	(14,650,000)	(18,505,000)
Interest Payments on Long-term Debt	(7,157,851)	(594,706)	-	(7,752,557)	(7,126,760)
Net Cash Used in Capital and Related Financing Activities	<u>50,034,473</u>	<u>(8,898,312)</u>	<u>-</u>	<u>41,136,161</u>	<u>(24,506,955)</u>
Net Increase (Decrease) in Cash and Cash Equivalents	<u>(193,058)</u>	<u>2,937,185</u>	<u>-</u>	<u>2,744,127</u>	<u>15,182,116</u>
Cash & Cash Equivalents, Beginning of Year	<u>3,050,527</u>	<u>20,874,968</u>	<u>-</u>	<u>23,925,495</u>	<u>8,743,379</u>
Cash & Cash Equivalents, End of Year	<u>\$ 2,857,469</u>	<u>\$ 23,812,153</u>	<u>\$ -</u>	<u>\$ 26,669,622</u>	<u>\$ 23,925,495</u>

The notes to financial statements are an integral part of these statements.

PUBLIC UTILITY DISTRICT NO. 1 OF DOUGLAS COUNTY

STATEMENT OF CASH FLOWS
For The Fiscal Year Ended December 31, 2005

	Wells Hydroelectric Project	Distribution System	Intersystem Eliminations	TOTAL	
				2005	2004
Reconciliation of Net Operating Income to Net Cash Provided by Operating Activities					
Operating Income	\$ 13,980,322	\$ 9,541,862	\$ -	\$ 23,522,184	\$ 17,195,591
Adjustments to Reconcile Operating Income to Net Cash					
Provided by Operating Activities:					
Depreciation	3,631,020	3,974,817	-	7,605,837	7,181,993
Amortization	-	43,044	-	43,044	37,510
Net Cash From Jobbing Activities	-	66,046	-	66,046	59,844
Payment of Interest on Customer Deposits	-	(34,133)	-	(34,133)	(13,939)
Amort. of Discounts on U.S. Gov. Securities	-	-	-	-	(54,901)
Cash Provided by changes in Operating Assets and Liabilities:					
Accounts Receivable	(73,148)	(2,720,690)	-	(2,793,838)	644,486
Prepaid Expenses	(54,137)	(6,476)	-	(60,613)	52,336
Materials and Supplies	-	(676,527)	-	(676,527)	225,034
Excess Revenue Fund	(225,198)	-	-	(225,198)	496,759
Other Accrued Expenses	(697,124)	-	-	(697,124)	(24,014)
Accounts Payable	782,067	(636,982)	-	145,085	(2,556,420)
Customer Deposits	-	9,711	-	9,711	19,998
Power Sales Settlement	-	559,918	-	559,918	851,307
Retainage and Other Accrued Liabilities	72,767	61,046	-	133,813	(53,235)
Customer Advances for Construction	-	(69,399)	-	(69,399)	83,896
Net Cash Provided by Operating Activities	\$ 17,416,569	\$ 10,112,237	\$ -	\$ 27,528,806	\$ 24,146,245

The notes to financial statements are an integral part of these statements.

Notes to Financial Statements

These notes are an integral part of the accompanying financial statements:

NOTE 1 - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Public Utility District No. 1 of Douglas County, Washington (the District) is a municipal corporation of the State of Washington established in 1936. The District is administered by a three person Board of Commissioners, elected by the voters of Douglas County. The District is organized in two primary operating systems: the Electric Distribution System and the Wells Hydroelectric Project. The Electric Distribution System provides retail electricity and broadband communication to customers in Douglas County, Washington. The Wells Hydroelectric Project generates electricity from a hydroelectric dam located on the Columbia River.

Accounting Policies:

The accounting policies of the District conform to generally accepted accounting principals (GAAP) as applicable to proprietary funds of governments. The Governmental Accounting Standards Board (GASB) is the accepted standard setting body for establishing governmental accounting and financial reporting principals. Accounting records are maintained in accordance with the Uniform System of Accounts of the Federal Power Act, prescribed by the Federal Energy Regulatory Commission (FERC). The District's accounting records are further maintained in accordance with methods prescribed by the State Auditor under the authority of Chapter 43.09 RCW.

GASB Statement No. 20 requires that the District apply all GASB pronouncements as well as the pronouncements issued on or before November 30, 1989, by the Financial Accounting Standard Board (FASB) and its predecessor organizations, unless those pronouncements conflict with or contradict GASB pronouncements. As provided for in GASB Statement No. 20, the District has elected not to implement FASB Statements and Interpretations issued after November 30, 1989.

During 2003, the District adopted GASB Statement No. 34, Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments; GASB Statement No. 37, Basic Financial Statements—Management's Discussion and Analysis—for State and Local Governments: Omnibus—an amendment of GASB Statements No. 21 and No. 34; and GASB Statement No. 38, Certain Financial Statement Note Disclosures; all of which address financial statement presentation and disclosure. Significant reporting changes include using the direct method of the Statement of Cash Flows presentation, and reclassification of Net Assets (equity) into three components: Invested in capital assets, net of related debt; Restricted; and Unrestricted. The statements also require a Management's Discussion and Analysis introducing financial statements and providing an overview of the District's financial activities.

Revenue Recognition:

The Distribution System recognizes revenue as billed on a monthly and bi-monthly basis. Service rates are established by the District's publicly elected Board of Commissioners. Revenues from the Wells Project are derived through the sale of power to four major Pacific Northwest electric utilities, under the terms of long term power sales contracts, and to the District's Distribution System. Revenue for the Wells Project is billed monthly and pays all annual expenses and debt service, whether or not the project is operable.

Utility Plant and Depreciation:

Distribution System plant assets are stated at cost. New construction, betterments and major renewals are capitalized. Maintenance and repairs are charged to operation as incurred. Depreciation is calculated on the straight-line method over the estimated useful lives of the asset, ranging from 12.5 to 35 years and on the double-declining balance method which is applied for 5 years on vehicles. Composite rates are used for depreciation of asset groups and accordingly, no gain or loss is recorded on the disposition of an asset. When operating plant assets are retired, their estimated original cost together with removal costs, less salvage, is charged to accumulated depreciation.

Wells Project plant, including land and all related facilities, is recorded at cost. Cost is comprised of the following: **(a)** all direct construction and acquisition costs; **(b)** all indirect costs up to the commencement of initial power generated on September 7, 1967, and only those indirect costs related to the construction and acquisition since that date; and **(c)** interest costs capitalized up to certain dates, which were subsequent to the date generating units were placed in service. Under FERC accounting, interest costs would cease to be

capitalized after units are placed in service. Management of the District elected to capitalize interest costs through January 1, 1969, as to the 1963 series bonds, and to September 1, 1972, as to the 1965 series bonds, because it believed this was the accounting treatment specifically prescribed in the bond resolutions and power sales contracts. Depreciation of substantially all depreciable assets is provided over estimated useful lives ranging from 15 to 95 years, using the sinking fund method (6% rate).

Receivables:

Distribution System uncollectible accounts are estimated based on an experience percentage of sales to ultimate consumers. The District's Commissioners approve all write-offs.

The Wells Project does not have an allowance for uncollectable accounts.

Inventories:

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

Cash and Cash Equivalents:

For purposes of the statements of cash flows, the District considers all short-term investments with a remaining maturity of three months or less when purchased to be cash equivalents. This definition of cash equivalents excludes investments with a maturity of less than three months, which are pooled with investments with longer maturity periods.

Investments and Deposits:

Investments of the District are in the form of time certificates, deposits with banks, direct obligations of the U.S. Government, or direct obligations of the Government National Mortgage Association (GNMA), which are full guaranteed by the U.S. Government, pursuant to the requirements of Chapter 39.58 RCW. The District's deposits and certificates of deposit are entirely covered by federal depository insurance (FDIC) or by collateral held in a multiple financial institution collateral pool administered by the Washington State Public Deposit Protection Commission (PDPC).

Unamortized Debt Expense:

Costs related to the sale of bonds are deferred and amortized on the straight-line method over the lives of the various bond issues. The straight-line method results in amortization not significantly different than that which would result from use of the interest method of amortization.

Excess Revenue Fund:

The Wells Project Excess Revenue Fund represents working capital in the Revenue Fund, as defined in the bondholders' resolution, in excess of the amount of working capital required by the power sales contracts. The excess revenue fund will be used to offset the monthly payments due from the power purchasers during fiscal year 2005-2006, until the balance has been exhausted.

Compensated Absences:

Employees accrue personal leave to be used for vacation, sick, and family leave purposes. Annual leave granted each employee varies in accordance with years of service and may be carried forward from year-to-year, capped at a maximum bank of 1200 hours. The District records the cost of personal leave as the leave is taken.

Accounting Estimates:

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

Reclassifications:

Certain prior year balances have been reclassified to be consistent with the current year presentation.

NOTE 2 – DEPOSITS AND INVESTMENTS

Investments: The District had the following investments as of December 31, 2005 and 2004, respectively:

	Wells		Distribution	
	2005	2004	2005	2004
Municipal Money Market	\$ -	\$ -	\$ 22,202,002	\$ 19,242,771
U.S. Treasury Securities	-	-	2,666,000	2,148,668
Repurchase Agreement	70,255,844			
Certificates of Deposit	16,244,713	16,928,018	27,801,338	25,428,300
Total	\$ 86,500,557	\$ 16,928,018	\$ 52,669,340	\$ 46,819,739

NOTE 3 – UTILITY PLANT

The following changes occurred in the District's utility plant:

Electric Plant Assets	December 31, 2004	Increase	Decrease	December 31, 2005
Hydraulic Generation	\$ 196,855,982	\$ 3,423,071	\$ 1,474,514	\$ 198,804,539
Transmission	21,891,899	22,821	-	21,914,720
Distribution	97,467,855	5,177,568	221,516	102,423,907
General	38,521,321	5,636,635	374,541	43,783,415
Miscellaneous	1,022,229	24,452		1,046,681
Subtotal	355,759,286	14,284,547	2,070,571	367,973,262
Construction Work in Progress	15,312,061	10,225,438	12,146,482	13,391,017
Less: Accumulated Depreciation	(100,672,200)	1,342,729	8,367,045	(107,696,516)
Net Utility Plant	\$ 270,399,147	\$ 25,852,714	\$ 22,584,098	\$ 273,667,763

NOTE 4 – LONG TERM DEBT

Wells Hydroelectric Project

Following is a summary of Wells Hydroelectric revenue bond (nonvoted State I.D. No. 252.11) activity for the year ended December 31, 2005:

	Purpose	Balance 12/31/2004	Additions	Reductions	Balance 12/31/2005	Due Within One Year
Series of 1986A, term bonds maturing September 1, 2018, interest at 8.75%	Turbine Runner Replacement	14,080,000	-	-	14,080,000	435,000
Series of 1986B, term bonds maturing September 1, 2006, interest at 8.75%	Turbine Runner Replacement	1,315,000	-	830,000	485,000	485,000
Series of 1999A, serial bonds maturing annually to September 1, 2019 and term bonds maturing September 1, 2029; interest at 5.15% - 6.125%	Land Purchases, Recreation Action Plan, Habitat Conservation Plan, and Capital Improvements	9,520,000	-	180,000	9,340,000	190,000
Series of 1999B, serial bonds maturing annually to September 1, 2009; interest at 4.95% - 5.20%	Land Purchases, Recreation Action Plan, Habitat Conservation Plan, and Capital Improvements	5,790,000	-	5,275,000	515,000	120,000
Series of 2000A, serial bonds maturing annually to September 1, 2010 and term bonds maturing September 1, 2015 and 2018, interest at 5.65% - 6.35%	Refunding	7,835,000	-	375,000	7,460,000	395,000
Series of 2003A, serial bonds maturing annually to September 1, 2018, interest at 2.25% - 5.25%	Refunding	14,040,000	-	570,000	13,470,000	470,000
Series of 2003B, serial bonds maturing annually to September 1, 2018, interest at 2.50% - 5.00%	Refunding	58,800,000	-	5,510,000	53,290,000	5,730,000
Series of 2003C, serial bonds maturing annually to September 1, 2014, interest at 4.125% - 5.00%	Refunding	31,905,000	-	-	31,905,000	-
Series of 2005A, serial bonds maturing annually to September 1, 2025 and term bonds maturing September 1, 2030 and 2035, interest at 3.70% - 5.00%	Capital Improvements	-	43,010,000	-	43,010,000	530,000
Series of 2005B, serial bonds maturing annually to September 1, 2026 and term bonds maturing September 1, 2022, 2030 and 2035, interest at 3.20% - 5.25%	Refunding, Capital Improvements, and Colville Settlement	-	35,580,000	-	35,580,000	515,000
Series of 2005C, serial bonds maturing annually to September 1, 2014 and term bonds maturing September 1, 2018, interest at 4.16% - 5.11%	Colville Settlement	-	8,995,000	-	8,995,000	485,000
Total revenue bonds		\$ 143,285,000	\$ 87,585,000	\$ 12,740,000	\$ 218,130,000	\$ 9,355,000

Following is a summary of future debt service requirements for Wells Project revenue bonds outstanding at December 31, 2005:

	Principal	Interest	Total
2006	\$ 9,355,000	\$ 10,888,808	\$ 20,243,808
2007	10,095,000	10,155,307	20,250,307
2008	10,590,000	9,678,333	20,268,333
2009	11,025,000	9,224,112	20,249,112
2010	11,535,000	8,728,254	20,263,254
2011-2015	64,030,000	34,847,838	98,877,838
2016-2020	46,365,000	18,280,318	64,645,318
2021-2025	16,130,000	11,703,260	27,833,260
2026-2030	19,510,000	7,128,090	26,638,090
2031-2035	19,495,000	2,542,888	22,037,888
Total	\$ 218,130,000	\$ 123,177,208	\$ 341,307,208

Interest on all bonds for the Wells Hydroelectric Project is payable on March 1 and September 1. All bond covenants were complied with for fiscal years 2005 and 2004.

Advance Debt Refunding

In December 2003 the Wells Project issued its Wells Hydroelectric Revenue Bonds, Refunding Series 2003A, 2003B, 2003C, and 2003D (the "2003 Bonds"), in the total par amount of \$111,340,000. The 2003 Bonds advance refunded the following outstanding bonds:

Bond Series	Amount Outstanding
1963	\$ 93,955,000
1965	5,500,000
1978	2,720,000
1993A	14,810,000
1993B	1,165,000
Total Refunded	\$ 118,150,000

This advance refunding resulted in a reduction of \$10,167,000 in total Wells Project debt service over the next 15 years and an economic gain (difference between the present values of the old and new debt service requirements) of \$2,504,000.

In July 2005, the Wells Project issued its Wells Hydroelectric Revenue and Refunding Bonds, Series 2005A, 2005B, and 2005C (the 2005 Bonds), in the total par amount of \$87,585,000. The issuance of the 2005 bonds resulted in a premium of \$2,027,482. A portion of the 2005 Bonds refinanced and legally defeased \$5,160,000 of the outstanding 1999B Bonds. This refinancing resulted in a reduction of \$1,058,000 in total Wells Project debt service over the next 24 years and an economic gain (difference between the present values of the old and new debt service requirements) of \$358,000.

Debt service on these refunded bonds and other outstanding Wells Project bonds which were refunded in prior years is met by cash and investments held in irrevocable trust with an escrow agent. As of December 31, 2005, the escrow agent was holding cash and investments of \$45,149,000 which are expected to fully fund debt service on all outstanding Wells Project refunded bonds. The trust account assets and the liability for the corresponding refunded bonds are not included in the District's financial statements.

Distribution System

In January 2004 the Distribution System issued \$10.4 million of new revenue bonds to pay for capital improvements to electrical facilities. The Distribution System outstanding 1995 bonds were refunded. In total \$18,420,000 of revenue bonds were issued in January 2004. These bonds are non-voted State I.D. No. 252.11. The bonds will mature and be retired during the next five years ending December 31 as follows:

	Principal	Interest	Total
2006	\$ 1,450,000	\$ 556,506	\$ 2,006,506
2007	680,000	527,506	1,207,506
2008	695,000	512,206	1,207,206
2009	715,000	486,144	1,201,144
2010	735,000	466,481	1,201,481
2011-2023	10,265,000	3,485,000	13,750,000
Total	\$ 14,540,000	\$ 6,033,843	\$ 20,573,843

The 2004 Distribution bonds are serial bonds through 2020 and term bonds maturing in 2021, 2022 and 2023. Interest rates range from 2.0% to 5.00% and interest is payable on June 1 and December 1. The bondholders' resolution requires the District to maintain at least 125% coverage for debt service. The required coverage was maintained for 2005 and 2004.

NOTE 5 – OTHER COMMITMENTS AND CONTINGENCIES

a) Colville Confederated Tribes Settlement

In January 2003 the Colville Confederated Tribes (“Tribes”) presented an economic consultant’s study indicating the District owes the Tribes approximately \$950,000,000 for past annual charges and approximately \$18,000,000 annually for use of freeboard lands previously considered tribal lands and one-half of the bed of the Okanogan and Columbia Rivers bordering the Colville Reservation. The District has been aware of a claim made by the Tribes for the use of the bed of the river for years, but there has never been a claim to shore land that the District owns. The bed of the river claim has surfaced on several occasions over the past 25 years, but the Tribes chose not to pursue it seriously until January 2003. The Tribes’ claim in 2003 included annual charges, past and future, for all of the lands that the District previously acquired in fee title from allottees, individuals of the Tribes, and the Bureau of Indian Affairs, as well as for one-half of the bed of the Okanogan and Columbia Rivers abutting the Colville Reservation. The District has recorded fee title deeds to all of the shore land below Project Boundary abutting the Colville Reservation.

In 2004 the District and the Tribes entered into a settlement of this claim which provided for a \$13,500,000 cash payment and the transfer of land with a book value of \$958,140 to the Tribes. Additionally the District agreed to sell to the Tribes 4.5% of the output of the Wells Project through August 31, 2018, and 5.5% thereafter, at Wells Project cost, for so long as the District holds a license for the Wells Project. In return the Tribes granted and affirmed all land rights previously conveyed by the Tribes to the District; granted to the District overflow rights to the bed of the Okanogan and Columbia Rivers; covenanted not to compete for a license for the Wells Project and to support the District’s relicensing application; and granted the District certain water rights in connection with the Wells Project.

The total cash payment and land transfer book value is reported as a settlement liability on the balance sheet as of December 31, 2004. The land portion of the settlement was transferred in March 2005. The cash portion of the settlement was paid in July 2005, financed with Wells Project Revenue Bonds, and is reported as a deferred charge on the balance sheet, to be amortized over the corresponding revenue bond debt service period.

The Wells Project's four investor-owned Power Purchasers approved the settlement, as evidenced by an Endorsement Agreement between the Power Purchasers and the District dated November 1, 2004. The District, the Tribes, and the Power Purchasers filed a joint application with the Federal Energy Regulatory Commission (“FERC”) seeking approval of the Colville Settlement Agreement and the Colville Power Sales Contract. FERC formally approved the contracts on February 11, 2005.

b) Power Purchasers Settlement Agreement

Under this agreement the District must offer certain temporary, non-firm energy to the Wells Project Power Purchasers under two pricing strategies which are subject to annual adjustments. Annual adjustments are made when the Wells Annual Power Cost has been determined; after the end of each Wells fiscal year. The adjustment is based on the computed excess of District reserved share power and effectively adjusts the Power Purchaser’s cost of this energy to the Wells Annual Power Cost Rate. The District estimates the adjustment to revenue each month required by this agreement.

c) Memo of Understanding with Okanogan County PUD

The District and Okanogan PUD entered into a written Memorandum of Understanding granting Okanogan the first right of refusal to any power and energy the District makes available after meeting the needs within Douglas County and contractual commitments in place on the date of the Memorandum. The two Districts also committed to negotiate a Power Sales Contract intended to allocate an additional 22% share of the output of Wells Project to Okanogan after expiration of the current Power Sales Contracts in 2018. The additional share is contingent upon each of the following: (1) The District and Okanogan PUD successfully relicensing the Project and obtaining 100% of the Project output; (2) the new license entitling the District to 92 percent of the output and Okanogan PUD to 8 percent of the output of the Project; and (3) the District's compliance with the Power Sales Contracts with each of the four Wells Power Purchasers. Okanogan PUD and the District are in the process of negotiating a long-term power sales contract.

d) Endangered Species

Several species of fish in the vicinity of the Wells Project were listed as threatened or endangered under the Endangered Species Act. Steelhead and spring chinook were listed as endangered species on August 18, 1998 and March 16, 1999, respectively. Bull trout were listed as a threatened species on June 10, 1998. Summer chinook salmon migrating above Rock Island Dam were petitioned for listing in June 1993; however National Marine Fisheries Service declined to list summer chinook.

The District has negotiated with state and federal fisheries resource agencies and Indian tribes, a multispecies Habitat Conservation Plan ("HCP"). The HCP species are spring chinook, summer/fall chinook, steelhead, sockeye, and coho salmon. The purpose of the HCP is to have legally enforceable measures in place to either avoid a listing under the Endangered Species Act ("ESA") or, in the event of a listing, allow continued operation of the Wells Project under an incidental take permit. The HCP satisfies all FERC relicensing and ESA requirements for the Plan species. FERC approved the HCP in June of 2004 and amended the Wells Project license accordingly. At the District's request, FERC also issued an Order on Rehearing in November 2004, clarifying several technical items.

Bull trout have been observed at the Wells Project but are not covered in the HCP. The United States Fish and Wildlife Service ("USF&W") issued a biological opinion for bull trout for the operations of the Wells Project under the terms of the HCP in May of 2004. Under the amended Wells license FERC has the authority to require the District to carry out specified measures for the purpose of participating in the development and implementation of a bull trout recovery plan.

There is extensive litigation in the federal court system under the ESA, challenging actions taken by the responsible federal agencies in regard to anadromous fish. Future legal actions to protect fish may have a significant impact on the amount and/or cost of power generated at the Wells Project.

e) Land Acquisition

Recent surveys by the District's contracted surveyors have revealed errors on portions of the original survey of the Wells Project. There are a few locations where the Wells Project boundary is under water. The District has determined that the appropriate course of action will involve relocation of portions of the Wells Project boundary, which will require acquisition of additional property rights at these locations. A property owner with water from the Wells Project encroaching on his property could pursue legal action in order to remedy the situation. The District intends to vigorously pursue acquisition in fee title of any lands upon which the Wells Reservoir is encroaching.

f) Energy Northwest – Nine Canyon Wind Project

The Nine Canyon Wind Project is located eight miles southwest of Kennewick, Washington in the Horse Heaven Hills. The project was developed in two phases. Phase I consists of thirty seven 1.3 MW wind turbine generators and Phase II consists of an additional twelve 1.3 MW units. The District is responsible for 6.25% of Phase I debt service and 43.59% of Phase II debt service, and 15.4% of operations and maintenance costs.

g) Douglas PUD – Chelan PUD Power Sales Contract

The District has a long term power sales contract with Chelan PUD to purchase 2.77% of the output of Chelan PUD's Rocky Reach Project. The contract is a take-or-pay contract requiring the District to pay costs associated with operation, maintenance, renewals and replacements to Rocky Reach, whether or not the project is operable or operating. The initial term of the power sales contract expires on October 31, 2011. The District recently exercised its option to extend the contract and purchase an additional 2.77% (5.44% total) of the output. The District has the right to extend the term of the contract for 5 successive 10-year periods. Discussions with Chelan PUD are on-going regarding the appropriate pricing for its post 2011 share of Rocky Reach output.

h) Avista Energy Long-Term Firm Power Agreement

The District entered into an agreement with Avista Energy, Inc. to exchange power from October 1, 2000 through July 31, 2017. The District is obligated to deliver fixed annual amounts of energy totaling 1.9 million MWh of energy to Avista from October 1, 2000 through March 31, 2006; and Avista is subsequently obligated to deliver a like amount of firm energy to the District from August 1, 2006 through July 31, 2017.

i) Relicensing

The Wells Project License expires May 31, 2012. The District intends to use its best efforts to obtain a new license. The District intends to file a Notice of Intent ("NOI") to relicense the Wells Project with the FERC in December 2006. The District is preparing a Pre-Application Document which it also intends to file with the FERC, along with the NOI, in December 2006, pursuant to the Integrated Licensing Process. The District will seek a 50 year license.

j) Generating Unit

In February 2005, Generating Unit 1 ("Unit 1") at the Wells Project experienced a fault in the generator windings, was taken out of service and has remained out of service. The District awarded a contract to have the unit repaired. Including change orders the contract amount is \$5.4 million. The repair is expected to be completed in June 2006. The other nine generating units will be rebuilt over the next several years.

The District had an insurance policy covering the failure of Unit 1. The District settled its claim with the insurance carrier for \$3.6 million in February 2006, and will apply those funds to the repair of Unit 1. The remaining cost of the Unit 1 repair, as well as the cost to rebuild the other nine generating units, will be paid with bond proceeds.

NOTE 6 – PENSION PLANS, DEFERRED COMPENSATION PLANS

Substantially all District full-time and qualifying part-time employees participate in one of the following statewide retirement systems administered by the Washington State Department of Retirement Systems, under cost-sharing multiple-employer public employee defined benefit and defined contribution retirement plans. The Department of Retirement Systems (DRS), a department within the primary government of the State of Washington, issues a publicly available comprehensive annual financial report (CAFR) that includes financial statements and required supplementary information for each plan. The DRS CAFR may be obtained by writing to: Department of Retirement Systems, Communications Unit, P.O. Box 48380, Olympia, WA 98504-8380.

The PERS system includes two defined benefit pension plans, Plan 1 and Plan 2, and a combination defined benefit/defined contribution plan, Plan 3. Participants who joined the system by September 30, 1977, are Plan 1 members. Plan 1 members are eligible for retirement at any age after 30 years of service, or at age 60 with five years of service, or at age 55 with 25 years of service. The average pension is two percent of the average final compensation per year of service, capped at 60 percent.

Plan 2 members may retire at age 65 with five years of service, or at age 55 with 20 years of service, with an allowance of two percent per year of service of the average final compensation. Plan 2 retirements prior to age 65 are actuarially reduced. There is no cap on years of service credit and a cost-of-living allowance is granted, capped at three percent annually.

Plan 3 members may retire with at least 10 years of service; or five years, including twelve months that were earned after age 54; or 5 service credit years earned in Plan 2 prior to June 1, 2003.

Employer and employee contribution rates are established periodically by the State Legislature. The required contribution rates expressed as a percentage of current year covered payroll, as of December 31, 2005 were:

	PERS Plan 1	PERS Plan 2	PERS Plan 3
Employer	2.44%*	2.44%*	2.44%*
Employee	6.00%	2.25%	Variable 5-15% employee selected

*employer rates include an administrative expense fee of .19%

Both the District and the employees made the required contributions. The District's required contributions for the years ended December 31 were:

	PERS Plan 1	PERS Plan 2	PERS Plan 3
2005	\$22,136	\$193,378	\$7,054
2004	17,542	129,618	4,964
2003	57,611	98,164	17,275

The District also offers its employees deferred compensation plans created in accordance with Internal Revenue Code Sections 457 and 401(a) permitting employees to defer a portion of their salary until future years. The District provides a 50% match of employee contributions capped at a percentage of employee regular straight-time wages for the pay period equal to 7.32%, less the PERS 2 employer contribution percentage, less one and one half percent (1.5%). In the event the District match drops to or below 2%, the match will then remain at 2% and will no longer vary with the PERS 2 employer rate. The deferred compensation is not available to employees until separation from service through termination, retirement, death, or unforeseeable emergency. The plan assets are held in trust for the exclusive benefit of plan participants and beneficiaries.

NOTE 7 – DEFERRED DEBITS AND CREDITS

Distribution System

The Distribution System has deferred debits of \$3,651,003 and \$3,357,300 respectively at December 31, 2005 and 2004. The deferred debits consist of preliminary survey and investigation, such as wind development costs, undistributed balances in clearing accounts, miscellaneous work in progress and retiree employee benefits. The employee benefits are amortized and the remaining deferred debits are capitalized or expended according to generally accepted accounting principles. The Distribution System has deferred credits of \$90,321 and \$98,673 respectively at December 31, 2005 and 2004. The deferred credits consist of funds retained for contract performance, secured funds for installation costs, and retired employee benefits.

Wells Hydroelectric Project

The Wells Hydroelectric Project has deferred debits of \$34,244,237 and \$36,375,632 respectively at December 31, 2005 and 2004. The deferred debits consist of improvements to recreational facilities, repair and maintenance costs, miscellaneous fish improvements, preliminary survey and investigation, and miscellaneous clearing accounts. The deferred debits are amortized over the life of the 1986, 1990 and 1993 bonds which were issued to fund the projects except for the miscellaneous clearing accounts which are cleared annually. The Wells Hydroelectric Project has deferred credits of \$523,633 and \$676,064 respectively at December 31, 2005 and 2004. The deferred credits consist of funds retained for contract performance and power cost adjustments not taken by Power Purchasers.

NOTE 8 – BROADBAND SERVICES

Douglas County Community Network (DCCN):

Since the 1960's the District has owned and operated data communication facilities that provide communication for District electrical equipment, employees and office equipment. The communication system has grown to become an integral part of the District's electrical system, providing remote monitoring, switching, metering, internal communication, and security to District assets. In 2000 the Washington State Legislature gave Public Utility Districts the authority to offer wholesale telecommunication services. The District named its broadband network the Douglas County Community Network (DCCN). DCCN provides wholesale broadband data communication services to customers of the District. As of December 31, 2005 the District has capitalized \$12.2 million dollars of communication equipment.

Douglas County Community Network

2005 Operating Revenue	\$	525,250
2005 Operating Expense		650,108
Capital Investment Since 2000	\$	6,286,953

Northwest Open Access Network (NoaNet):

The District, along with 14 other Washington State Public Utility Districts and Energy Northwest, is a member of NoaNet, a Washington nonprofit mutual corporation. NoaNet was incorporated in February 2000 to provide a broadband communications backbone, over Public Benefit Fibers leased from Bonneville Power Administration, throughout the State of Washington for assisting its members in the efficient management of load, conservation and acquisition of electric energy as well as other purposes. The network began commercial operation in January 2001.

In July 2001, NoaNet issued \$27 million in telecommunications network revenue bonds (taxable) to finance the repayment of the founding members and the costs of initial construction, operations and maintenance. The Bonds become due beginning in December 2003 through December 2016 with interest due semi-annually at rates ranging from 5.05% to 7.09%. As of December 31, 2005 \$21,675,000 (unaudited) of the bonds remain outstanding. In addition, in January 2003 NoaNet opened a \$5 million line of credit with Bank of America to fund capital expenditures. The line of credit is not being fully utilized, only \$1,307,692 (unaudited) remains outstanding at December 31, 2005. Each member of NoaNet has entered into a repayment agreement to guarantee the debt of NoaNet. In November 2005, the District made a \$150,000 capital contribution to NoaNet in order to increase the District's membership percentage. The District's guarantee of NoaNet's liabilities is limited to a 5.74% interest.

The management of NoaNet anticipates meeting operating costs through profitable operations, however members have been contributing to help meet debt service obligations. A NoaNet annual report may be obtained by writing to Northwest Open Access Network, 3511 Norfolk Court, Olympia, WA 98501. NoaNet's web site is www.noanet.net.

NOTE 9 – SUBSEQUENT EVENT

2006 Refunding Bonds

The District intends to refinance its 1986 Wells Project Bonds, currently outstanding in the par amount of \$14,080,000. This will be done by issuing the 2006 Wells Project Refunding Bonds in the summer of 2006. It is anticipated this refinancing will result in significant debt service savings to the District.