

# **WELLS HYDROELECTRIC PROJECT**

(A Department of Public Utility District No. 1  
of Douglas County, Washington)  
East Wenatchee, Washington

## **FINANCIAL STATEMENTS**

Including Independent Auditors' Report

As of and for the Years Ended August 31, 2018 and 2017

# WELLS HYDROELECTRIC PROJECT

East Wenatchee, Washington

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## INDEPENDENT AUDITORS' REPORT

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

### **Report on the Financial Statements**

We have audited the accompanying financial statements of Wells Hydroelectric Project (Wells Project or the Project), a department of Public Utility District No. 1 of Douglas County, Washington (the District), as of and for the years ended August 31, 2018 and 2017 and the related notes to the financial statements which collectively comprise the Project's financial statements, as listed in the table of contents.

### ***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditors' Responsibility***

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Projects preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Projects internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

### ***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Wells Hydroelectric Project as of August 31, 2018 and 2017, and the respective changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

***Emphasis of Matter***

As discussed in Note 1, the financial statements present only the financial position of Wells Hydroelectric Project and do not purport to, and do not, present fairly the financial position of the Public Utility District No. 1 of Douglas County, Washington, as of August 31, 2018 and 2017 and the respective changes in financial position, or cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

***Other Matter***

*Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the required supplementary information as listed in the table of contents be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the 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 financial statements, and other knowledge we obtained during our audit of the 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.

*Baker Tilly Virchow Krause, LLP*

Madison, Wisconsin  
November 30, 2018

**MANAGEMENT'S DISCUSSION AND ANALYSIS  
(UNAUDITED)**

## **WELLS HYDROELECTRIC PROJECT**

(A Department of Public Utility District No. 1  
of Douglas County, Washington)

Management's Discussion and Analysis (Unaudited)

August 31, 2018 and 2017

The Management's Discussion and Analysis (MD&A) presents an overview and analysis of the financial activities of the Wells Hydroelectric Project (Wells Project or Project), a department of Public Utility District No. 1 of Douglas County, Washington (District) during the fiscal years ended August 31, 2018 and 2017. Please read it in conjunction with the accompanying audited financial statements and related notes thereto.

### **Overview of the Wells Hydroelectric Project and the Financial Statements**

The Project is a hydroelectric generating facility located on the Columbia River in the State of Washington, owned and operated by the District. The Project is 516 river miles from the mouth of the Columbia River. It was placed in commercial operation in September 1967. The Project has earth embankments and a central integrated concrete structure that incorporates generating units, spillways, a switchyard, and fish passage facilities. It has 10 generating units with an installed nameplate rating of 815,000 kilovolt-amperes (KVA) and peaking capability of 840,000 kilowatts. The Project includes a 29.5-mile reservoir, land surrounding the reservoir, fish hatcheries, transformers, and transmission lines. Generation from the Project is sold at cost to four Pacific Northwest investor-owned utilities and the Colville Confederated Tribes pursuant to long-term power sales contracts, and to the District's Electric Distribution System. In November 2012, the Federal Energy Regulatory Commission issued the Project a new 40-year license to operate the Project.

The financial statements of the Project report information about the Project using accounting methods similar to those used by private utility companies. These statements offer financial information about the Project's activities. The Project's financial statements presented in this report consist of 1) the statements of net position, 2) statement of revenues, expenses, and changes in net position, 3) statements of cash flows, and 4) the notes to the financial statements.

The statements of net position include the assets, liabilities, deferred outflows and deferred inflows of the Project. They provide information about the nature and amounts of the Project's investments in resources (assets) and the obligations to the Project's creditors (liabilities) at August 31, 2018 and 2017.

The statements of revenues, expenses, and changes in net position report each fiscal year's revenues and expenses of the Project and reflect the increase or decrease in net position for each of the years presented.

The statements of cash flows report information about the Project's cash receipts and cash disbursements during each of the years ended August 31, 2018 and 2017, including changes in cash flows from operating, investing, and capital and related financing activities.

The notes to the financial statements provide additional information that is essential for a full understanding of the information provided in the financial statements described above.

**WELLS HYDROELECTRIC PROJECT**  
(A Department of Public Utility District No. 1  
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Management's Discussion and Analysis (Unaudited)

August 31, 2018 and 2017

**Condensed Comparative Financial Information (Amounts in Thousands)**

*Statements of Net Position*

	August 31		
	2018	2017	2016
<b>Assets:</b>			
Current	\$ 31,806	56,830	80,708
Net electric plant	307,134	293,963	281,367
Regulatory assets and deferred outflows	2,997	6,604	11,771
Total assets and deferred outflows	<u>\$ 341,937</u>	<u>357,397</u>	<u>373,846</u>
<b>Liabilities:</b>			
Current	\$ 27,917	36,605	42,079
Noncurrent	154,500	170,051	189,843
Deferred inflows	2,480	1,754	647
Total liabilities	<u>184,897</u>	<u>208,410</u>	<u>232,569</u>
<b>Net position:</b>			
Net investment in capital assets	167,195	158,666	148,347
Restricted for debt service	21,864	26,720	16,683
Unrestricted	(32,019)	(36,399)	(23,753)
Total net position	<u>157,040</u>	<u>148,987</u>	<u>141,277</u>
Total liabilities and net position	<u>\$ 341,937</u>	<u>357,397</u>	<u>373,846</u>

*Statements of Revenues, Expenses, and Changes in Net Position*

	August 31		
	2018	2017	2016
Operating revenues	\$ 51,956	48,603	52,007
Operating expenses	34,127	31,016	32,075
Operating income	17,829	17,587	19,932
Nonoperating expenses	(9,776)	(9,877)	(9,326)
Change in net position	8,053	7,710	10,606
Net position, beginning of year	148,987	141,277	130,671
Effect of adjustment to net position	—	—	—
Net position, beginning of year	148,987	141,277	130,671
Net position, end of year	<u>\$ 157,040</u>	<u>148,987</u>	<u>141,277</u>

(Continued)

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**WELLS HYDROELECTRIC PROJECT**  
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Management's Discussion and Analysis (Unaudited)

August 31, 2018 and 2017

**Financial Analysis**

***Assets***

Current assets decreased 34% from 2017 to 2018 and decreased 30% from 2016 to 2017. The decrease in current assets is primarily from the spending of bond funds on construction projects. Net utility plant increased by \$13.2 million from 2017 to 2018 and increased by \$12.5 million from 2016 to 2017 primarily from construction projects reclassified from construction work on the Hatchery Modernization. Regulatory assets and deferred outflows decreased 55% from 2017 to 2018 and decreased 44% from 2016 to 2017. The Project's regulatory asset balance decreased due to amortization. Regulatory assets include: certain repairs made to turbines and the earthen embankment at the Project, costs related to legal settlements, and recreational property improvements.

***Liabilities***

Current liabilities decreased 24% from 2017 to 2018 and decreased by 13% from 2016 to 2017 because of normal fluctuation in accounts payable and excess cash that is annually refunded to the Project's power purchasers. The decrease in noncurrent liabilities of 9% from 2017 to 2018 and 10% from 2016 to 2017 was due to normal maturities of long-term debt.

***Net Position***

The Project's net position increased 5% from 2017 to 2018 and 6% from 2016 to 2017. The increases are from continued investment in Project capital assets and normal fluctuations to debt service funds that are restricted for debt repayment. In addition, the increase is due to new reporting standards relating to pensions.

***Statement of Revenues, Expenses, and Changes in Net Position***

Project revenue increased 7% from 2017 to 2018 and decreased 6% from 2016 to 2017. Electricity generated by the Project is sold at cost under power sales contracts. The cost of power includes debt service, but excludes depreciation. Operating revenues fluctuate based on operating expenses (exclusive of depreciation) and debt service requirements.

Operating expenses increased 10% from 2017 to 2018 and decreased 2% from 2016 to 2017. The current year increase is primarily due an increase in recreation and hatchery operations and maintenance. Maintenance also increased due to dam safety, equipment upgrades and replacements in the Project's infrastructure.

Investment income decreased 37% from 2017 to 2018 and decreased 4% from 2016 to 2017. This decrease is mainly due to a decrease of the Project's investments in the construction bond fund portfolio.

Interest expense decreased 5% from 2017 to 2018 and 5% from 2016 to 2017. The Project's debt is structured to provide level debt service, so this is an expected outcome. The Project realized lower interest expense due to the call and refunding of our bonds at current lower rates.



## **WELLS HYDROELECTRIC PROJECT**

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Management's Discussion and Analysis (Unaudited)

August 31, 2018 and 2017

### **Capital Asset and Long-Term Debt Activity**

As of August 31, 2018 and 2017, the Project had \$167 and \$158 million invested in capital assets, net of accumulated depreciation. The Project's capital assets consist of a hydroelectric generation plant, transmission facilities, fish facilities, land, office buildings, and equipment. Major additions or replacements are funded from bond proceeds. The District is currently refurbishing generators and turbines at the Project.

All ten of the generators and turbines at the Project are in the process of being refurbished. The refurbishment will continue for the next several years and is expected to cost over \$200 million. Progress of the project is behind schedule, however, two units have been returned to service and have shown improved efficiencies. Work on the third unit is underway and notice to proceed on the 4<sup>th</sup> unit will occur soon. With the addition of a spare shaft and rotor in 2019, we hope to shorten the turn-around time of each of the remaining units. See note 5(c). Costs of the refurbishments, to date, have been financed through the issuance of revenue bonds. In 2010, bonds were issued for this project in the par amount of \$112.9 million, of which \$12.9 million was used to refinance outstanding bonds for debt service savings. These bond proceeds were finally exhausted during 2018. It is anticipated that future borrowings, likely in the form of inter-company loans, will be required to complete the remaining units.

The Wells Project is in the final phase of modernizing their on-site fish hatchery. The 2.5 year, \$46 million dollar project is approximately 99% complete as of August 31, 2018 and is on schedule to be completed next year.

In December 2004, the District Commission authorized a revolving note (Note), from the District's Electric Distribution System to the Project. The purpose of the Note was to finance the cost of relicensing the Project. Amounts borrowed by the Project under the Note were to be due upon the expiration of the current Federal Energy Regulatory Commission (FERC) license and any subsequent annual FERC licenses issued to the District. Accordingly, amounts borrowed under the Note were included in short-term liabilities. When the new 40-year license was approved in November 2012, the District exercised an option to extend the terms of the Note, which will be repaid over the licensing term and is classified as a long-term liability (excluding current portion). As of August 31, 2018 and 2017, the total amount outstanding was \$9.17 and \$9.23 million, respectively.

In 2015, Moody's affirmed its "Aa3" rating of the Project, and changed its outlook to stable from negative due to the expectation the Project will maintain at least 250 days cash on hand, achieve consolidated debt service coverage of 1.15x through 2017, and improve financial performance starting in 2018 under new long-term contracts. During 2015, Standard & Poor's also affirmed its "AA" rating of the Project together with a stable outlook.

### **Contact Information**

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

**WELLS HYDROELECTRIC PROJECT**  
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Statements of Net Position  
August 31, 2018 and 2017

Assets and Deferred Outflows	2018	2017
Current assets:		
Restricted:		
Debt repayment funds – cash	\$ 15,715,110	\$ 19,816,951
Debt repayment funds – investments	6,149,238	6,903,113
Reserve and contingency fund – cash	-	1,755,612
Reserve and contingency fund – investments	-	5,304,209
Plan Species - cash	543,811	-
Plan Species - investments	1,248,740	1,579,738
Total restricted	23,656,899	35,359,623
Unrestricted:		
Cash	2,217,119	1,439,388
Investments	4,990,526	9,500,767
Accounts receivable	496,013	1,148,613
Other assets	445,600	420,213
Total unrestricted	8,149,258	12,508,981
Total current assets	31,806,157	47,868,604
Noncurrent assets:		
Restricted:		
Construction funds – cash	-	7,387,204
Construction funds – investments	-	1,573,884
Total restricted	-	8,961,088
Electric plant:		
Electric plant in service	403,930,504	396,807,246
Construction work in progress	30,559,007	17,025,543
Gross electric plant	434,489,511	413,832,789
Less accumulated depreciation and amortization	127,355,037	119,869,056
Net electric plant	307,134,474	293,963,733
Regulatory assets	2,421,291	5,603,168
Total noncurrent assets	309,555,765	299,566,901
Deferred outflows:		
Loss on reacquired debt	158,004	453,780
Pension related outflows	417,786	547,090
Total assets and deferred outflows	\$ 341,937,712	\$ 357,397,463

**WELLS HYDROELECTRIC PROJECT**  
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Statements of Net Position  
August 31, 2018 and 2017

<b>Liabilities, Deferred inflows and Net Position</b>	<b>2018</b>	<b>2017</b>
Current liabilities:		
Accounts payable	\$ 7,013,800	\$ 7,576,320
Other accrued liabilities	1,122,395	612,245
Excess revenue fund	2,789,318	7,437,103
Payable from restricted assets:		
Accrued interest payable	3,780,943	3,976,533
Current portion long-term debt	13,210,736	17,003,357
Total current liabilities	27,917,192	36,605,558
Noncurrent Liabilities:		
Bonds payable, excluding current portion	137,355,000	150,435,736
Unamortized bond premiums and discounts	3,768,512	4,030,503
Bonds payable, net	141,123,512	154,466,239
Intradistrict note payable	9,035,000	9,165,000
Compensated absences	887,746	919,058
Net Pension Liability	3,454,683	5,500,560
Total noncurrent liabilities	154,500,941	170,050,857
Total liabilities	182,418,133	206,656,415
Deferred inflows:		
Gain on reacquired debt	373,524	395,496
Pension related inflows	2,106,070	1,358,664
Net position:		
Net investment in capital assets	167,195,094	158,666,352
Restricted for debt service	21,864,348	26,720,064
Unrestricted	(32,019,457)	(36,399,528)
Total net position	157,039,985	148,986,888
Total liabilities and net position	\$ 341,937,712	\$ 357,397,463

See accompanying notes to financial statements.

## WELLS HYDROELECTRIC PROJECT

### Statements of Revenues, Expenses, and Changes in Net Position

Year ended August 31, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Operating revenues	\$ 51,956,050	\$ 48,602,813
Operating expenses:		
Operations	18,143,368	17,249,238
Maintenance	8,380,899	6,462,620
Depreciation	6,794,248	6,054,821
Taxes	808,052	1,248,974
Total operating expenses	<u>34,126,567</u>	<u>31,015,653</u>
Net operating revenue	<u>17,829,483</u>	<u>17,587,160</u>
Nonoperating revenues (expenses):		
Interest income	315,732	500,870
Interest expense	(7,560,680)	(7,953,063)
Amortization: other charges, debt discounts and premiums	(3,193,689)	(3,099,976)
Other	<u>662,251</u>	<u>675,322</u>
Total nonoperating expenses	<u>(9,776,386)</u>	<u>(9,876,847)</u>
Change in net position	8,053,096	7,710,313
Net position, beginning of year	<u>148,986,889</u>	<u>141,276,576</u>
Net position, end of year	<u>\$ 157,039,985</u>	<u>\$ 148,986,889</u>

See accompanying notes to financial statements.

**WELLS HYDROELECTRIC PROJECT**  
(A Department of Public Utility District No. 1 of  
Douglas County, Washington)

Statements of Cash Flows

Year ended August 31, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Cash flow from operating activities:		
Receipts from customers	\$ 47,308,265	\$ 53,642,184
Payments to Employees & Payroll Related	(14,655,622)	(14,405,948)
Payments to Suppliers & Other Agencies	<u>(15,615,346)</u>	<u>(11,918,750)</u>
Net cash provided by operating activities	<u>17,037,297</u>	<u>27,317,486</u>
Cash flows from investing activities:		
Purchase of investments	(4,270,716)	(14,242,004)
Proceeds from sales and maturities of investments	15,348,111	32,046,842
Interest on investments	<u>586,912</u>	<u>821,354</u>
Net cash (used in) provided by investing activities	<u>11,664,307</u>	<u>18,626,192</u>
Cash flows from capital and related financing activities:		
Additions to electric plant in service	(18,111,358)	(27,271,159)
Principal payments on long-term debt-scheduled maturities	(17,003,357)	(18,085,000)
Interest payments on long-term debt	(7,756,269)	(7,952,241)
Build America bonds interest rebates	<u>666,528</u>	<u>677,540</u>
Net cash used in capital and related financing activities	<u>(42,204,456)</u>	<u>(52,630,860)</u>
Net decrease in cash and cash equivalents	(13,502,852)	(6,687,182)
Cash and cash equivalents, beginning of year	<u>31,978,892</u>	<u>38,666,074</u>
Cash and cash equivalents, end of year	<u>\$ 18,476,040</u>	<u>\$ 31,978,892</u>
Reconciliation of net operating income to net cash provided by operating activities:		
Operating income	\$ 17,829,483	\$ 17,587,160
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	6,794,248	6,054,821
Cash provided by changes in operating assets and liabilities:		
Receivables	653,368	1,345,394
Other assets	(25,387)	36,584
Excess revenue fund	(4,647,785)	5,039,370
Accounts payable – excluding construction payables	(3,511,638)	(1,909,658)
Other current liabilities	(23,679)	(843,430)
Compensated absences	<u>(31,313)</u>	<u>7,245</u>
Net cash provided by operating activities	<u>\$ 17,037,297</u>	<u>\$ 27,317,486</u>
Reconciliation of Cash and Cash Equivalents to Statements of Net Position accounts:		
Cash and Investments	\$ 2,217,119	\$ 1,439,388
Restricted Cash and Investments	<u>16,258,921</u>	<u>30,539,505</u>
Cash and cash equivalents, end of year	<u>\$ 18,476,040</u>	<u>\$ 31,978,893</u>

See accompanying notes to financial statements.

**WELLS HYDROELECTRIC PROJECT**  
(A Department of Public Utility District No. 1  
of Douglas County, Washington)

Notes to Financial Statements

August 31, 2018 and 2017

**(1) Organization and Summary of Significant Accounting Policies**

Public Utility District No. 1 of Douglas County, Washington (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 (Wells Project or Project). The Wells Hydroelectric Project generates electricity from a hydroelectric dam located on the Columbia River. The Wells Project represents only one department of the District and the Project's financial statements do not purport to, and do not, present fairly the financial position, the changes in financial position or the cash flows of the District for any period presented.

**(a) Accounting Policies**

The accounting policies of the Project are prepared using the economic resources measurement focus and conform to accounting principles generally accepted in the United States of America (GAAP) applicable to municipal utilities. The Governmental Accounting Standards Board (GASB) is the accepted standard setting body for establishing governmental accounting and financial reporting principles. 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).

In January 2016, GASB issued Statement No. 80, *Blending Requirements for Certain Component Units-an amendment to GASB Statement No.14*. This statement provides guidance to improve financial reporting by clarifying the financial statement presentation requirements for certain component units. Wells Project evaluated this statement and determined the Project does not have any component units and therefore there is no impact to its financial statements.

In March 2016, GASB issued Statement No. 81, *Irrevocable Split Interest Agreements*. This statement provides guidance to improve financial reporting for irrevocable split-interest agreements. Wells Project evaluated this statement and determined the Project does not have any irrevocable split interest agreements and therefore there is no impact to its financial statements.

In March 2016, GASB issued Statement No. 82, *Pension Issues-an amendment of GASB Statements No.67, No.68 and No.73*. This statement addresses issues regarding the presentation of payroll related measures in RSI, the selection of assumptions and the treatment of deviations from the guidance in an actuarial standard practice for financial reporting purposes, and the classification of payments made by employers to satisfy employee contribution requirements. Wells Project evaluated this statement and implemented its objective for fiscal year 2018.

In November 2016, GASB issued Statement No. 83, *Certain Asset Retirement Obligations*. This statement provides guidance for determining the timing and pattern of recognition for liabilities and corresponding deferred outflow of resources related to retirement obligations. Wells Project evaluated this statement and does not have any assets that require a retirement obligation; therefore, there is no impact to its financial statements.

**WELLS HYDROELECTRIC PROJECT**  
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Notes to Financial Statements

August 31, 2018 and 2017

In January 2017, GASB issued Statement No. 84, *Fiduciary Activities*. This statement provides guidance for determining criteria for identifying fiduciary activities of all state and local governments. Wells Project evaluated this statement and determined the Project does not have any fiduciary related activities and therefore there is no impact to its financial statements.

In March 2017, GASB issued Statement No. 85, *OMNIBUS 2017*. This statement addresses practice issues regarding blending component units, goodwill, fair value measurement and application, and postemployment benefits. Wells Project evaluated this statement and implemented its objective for fiscal year 2018.

In May 2017, GASB issued Statement No. 86, *Certain Debt Extinguishments issues*. This statement addresses the improvement of consistency in accounting and financial reporting for in-substance defeasance of debt. Wells Project evaluated this statement and determined the Project does not have any debt extinguishments related activities and therefore there is no impact to its financial statements.

In June 2017, GASB issued Statement No. 87, *Leases*. This statement addresses the improvement of accounting and financial reporting of leases by governments. Wells Project evaluated this statement and determined the Project does not have any lease related activities and therefore there is no impact to its financial statements.

**(b) Revenue Recognition**

Wells Project revenues are derived through the sale of power to four major Pacific Northwest electric utilities and the Colville Confederated Tribes, under the terms of long-term power sales contracts, and to the District's Electric Distribution System. The contracts stipulate that the power purchasers will pay annual power costs, which are defined as "all costs and expenses in connection with the Wells Project (excluding depreciation and certain items properly chargeable to cost of acquisition and construction), whether or not the Wells Project is operable or the operation thereof is interrupted, suspended, or interfered with, in whole or in part, during the term of this contract or any portion of said term." Revenues related to the Project's principal operations are considered to be operating revenues. Revenues related to financing and investing activities, and any other revenues not related to the Project's principal operations, are considered to be non-operating revenues.

**WELLS HYDROELECTRIC PROJECT**  
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Notes to Financial Statements

August 31, 2018 and 2017

**(c) *Utility Plant and Depreciation***

Wells Project plant, including land and all related facilities, is recorded at cost. Cost comprises 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 this was the accounting treatment specifically prescribed in the bond resolutions and power sales contracts. Depreciation of generation and transmission plant is provided over estimated useful lives ranging from 15 to 95 years, using the sinking fund method (6% rate). The sinking fund method was selected at the inception of the Wells Project and continues to be applied because its use corresponds more closely to revenue determined from debt service than would an alternative cost allocation method. Depreciation of general plant assets are recorded using the straight-line method.

**(d) *Cash and Cash Equivalents***

For purposes of the statements of cash flows, the Project considers all short-term investments with an initial maturity of three months or less when purchased to be cash equivalents.

**(e) *Cash and Investment Funds***

The Wells Project Revenue Fund represents working capital in the Project. The amount of working capital maintained is determined by the power sales contracts. Excess Revenue Funds are returned to Project participants. Shortfalls in working capital are recovered from Project participants. Reserve & Contingency Funds are used for contingencies, renewals, and replacements of Project assets. The account is funded by transfers from the Revenue Fund. Construction Funds are bond proceeds that are being used for capital improvement projects.

**(f) *Compensated Absences***

Employees accrue personal leave to be used for vacation, sick, and family leave purposes. Personal leave granted each employee varies in accordance with years of service and may be carried forward from year-to-year, capped at a maximum bank of 1,200 hours for employees hired before April 1, 2011 and 700 hours for employees hired on or after April 1, 2011. The Project records personal leave as an expense and liability when earned.

**(g) *Accounting Estimates***

The preparation of financial statements in conformity with GAAP 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.



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**(h) Insurance**

The Project holds insurance policies for general liability, employee benefits liability, directors' and officers' liability, excess liability, and property insurance. Among other things, the property insurance policies cover flood, earth movement, terrorism, pollution liability, unmanned aircraft, and mobile equipment. Other types of insurance carried by the Project include business automobile liability and physical damage, aircraft non-ownership liability, comprehensive crime coverage, and information security and privacy liability coverage.

For purposes of certain employee benefits insurance the Project is a member of the Central Washington Public Utilities Unified Insurance Program Trust (Trust). The Trust was organized pursuant to the provisions of RCW Title 54 and inter-local governmental agreements. Its general objectives include provision for the central collection and disbursement of employee benefit premiums and claims involving medical, dental, life, and long-term disability coverage. The Trust is administered by a Board of Trustees comprised of an appointed Trustee from each of the seven member public utility districts. The Trustees are authorized to negotiate, obtain, and maintain insurance policies, and authorize disbursements made from the Trust to third-party administrators or other entities. Effective August 1, 2002 and January 1, 2009, the Trust established a self-insured medical plan and self-insured dental plan, respectively, approved by the Washington State Office of Risk Management. The audit report for the Trust is available from the Washington State Auditor's Office. Claims settlements have not exceeded insurance coverage during any of the past three years.

**(i) Pensions**

For purposes of measuring the net pension liability, deferred outflows of resources, and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the Public Employees Retirement System (PERS) pension plans, and additions to/deductions from those plans' fiduciary net position have been determined on the same basis as they are reported by the Washington State Department of Retirement Systems. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

**(j) Excess Revenue Fund**

As required by the Power Sales Contracts, the Project returns unspent Revenue Funds in excess of \$750,000 to the Power Purchasers. For 2018, at the conclusion of the contract, this \$750,000 is returned as excess. Similarly, surpluses of the Reserve & Contingency Fund over \$5 million dollars were previously returned, but at the end of the contract, the remaining balance of the fund is returned. As of August 31, 2018 and 2017, the Project calculated Excess Revenue Funds of \$2,789,318 and \$7,437,103. The Excess Revenue Funds are disbursed to the Purchasers in a timely manner, after the completion of the year-end audit in November, (during the following fiscal year).

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**(2) Deposits and Investments**

The Project's deposits 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. Cash held in the Local Government Investment Pool (LGIP) is managed by the Washington State Treasurer's Office. The LGIP is a 2a7-like pool and represents an interest in a group of securities with no specific securities subject to custodial risk. As a pool participant, the Project does not have limitations or restrictions on withdrawals.

The Project's investments consist of direct obligations of the U.S. Government, government sponsored enterprises (agencies), and municipal bonds of U.S., states and local governments, which are all eligible investments for public funds in the state of Washington (RCW 43.84.080). To minimize custodial risk, the District's investments are held in a third-party safekeeping account which uses delivery vs. payment protocol. The Project's practice is to, generally, hold investments to maturity.

**Fair Value** - The Project categorizes its fair value measurement within the hierarchy established by GAAP. The hierarchy is based on the valuation inputs to measure the fair value of the asset. Level 1 inputs are quoted prices in the active markets for identical assets; Level 2 inputs are significant other observable inputs; level 3 inputs are significant unobservable inputs. The valuation method for fair value measurements as of August 31, 2018 and 2017 are as followed:

Investment Type	Balance as of August 31, 2018			2018 Total	2017 Level 2
	Level 1	Level 2	Level 3		
Federal Agency Securities	\$ —	\$ 7,975,357	\$ —	\$ 7,975,357	14,016,964
Municipal Bond Securities	—	4,413,147	—	4,413,147	9,363,569
Total	\$ —	\$ 12,388,504	\$ —	\$ 12,388,504	23,380,533

**Interest Rate Risk** – The risk the value of investments will decrease as a result of a rise in interest rates.

As of August 31, 2018, the average maturities of investments are as follows:

Investment	Fair Value	Less than	
		1 year	1-5 years
Federal Agency Securities	7,975,357	\$ 7,975,357	—
Municipal Bond Securities	4,413,147	3,673,107	740,040
Total	\$ 12,388,504	\$ 11,648,464	\$ 740,040

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As of August 31, 2017 the average maturities of investments are as follows:

<u>Investment</u>	<u>Fair Value</u>	<u>Less than</u>	
		<u>1 year</u>	<u>1-5 years</u>
Federal Agency Securities	14,016,964	\$ 3,997,380	10,019,584
Municipal Bond Securities	9,363,569	645,000	8,718,569
Total	<u>\$ 23,380,533</u>	<u>\$ 4,642,380</u>	<u>\$ 18,738,153</u>

**Credit Risk** – State law limits investment authority to local governments. The projects investments are made in investment types authorized by state law.

As of August 31, 2018, the credit quality ratings of debt securities are as follows:

<u>Investment</u>	<u>Fair Value</u>	<u>Rating</u>	<u>Rating Organization</u>
Federal Agency Securities	\$ 7,975,357	AAA	S&P
Municipal Bond Securities	4,413,147	A1/Aa/AAA	S&P

As of August 31, 2017, the credit quality ratings of debt securities are as follows:

<u>Investment</u>	<u>Fair Value</u>	<u>Rating</u>	<u>Rating Organization</u>
Federal Agency Securities	\$ 14,016,964	AAA	S&P
Municipal Bond Securities	9,363,569	A1/Aa/AAA	S&P

**Concentration of Credit Risk** – As of August 31, 2018, the Project had municipal bond investments in the amount of \$4,413,147 (approximately 35%) of the investment portfolio. As of August 31, 2017, the Project had municipal bond investments in the amount of \$9,363,569 (approximately 30%) of the investment portfolio. These municipal bonds are not guaranteed by the U.S. Government.

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**(3) Utility Plant**

As stated in note 1, utility plant is recorded at cost. Cost includes both direct costs of construction or acquisition and indirect costs. The Project's capitalization threshold is \$5,000 and an expected useful life of three years or more. The cost of maintenance and repairs is charged to expense as incurred, while the cost of additions, replacements, and improvements is capitalized. Major assets are held in the construction work in progress account until the asset is ready for service. When the asset is ready for service, costs are transferred out of construction work in progress to the appropriate plant account. Increases in plant balances are from placing assets in service. Construction work in progress may contain amounts that will be transferred to a deferred charge account. The book cost of operating property retired or otherwise disposed of, less salvage, is charged to accumulated depreciation. Decreases in plant balances are the result of normal retirement, sale and salvage of obsolete plant. The following changes occurred in the Project's utility plant:

<b>Electric Plant Assets Wells Hydroelectric Project</b>	<b>Balance August 31, 2017</b>	<b>Increase</b>	<b>Decrease</b>	<b>Balance August 31, 2018</b>
Utility plant not being depreciated:				
Land and land rights	\$ 52,177,902	—	—	52,177,902
Construction work in progress	17,025,543	22,004,298	(8,470,834)	30,559,007
Subtotal	69,203,445	22,004,298	(8,470,834)	82,736,909
Utility plant being depreciated:				
Hydraulic generation	303,833,294	5,646,125	—	309,479,419
Transmission	18,953,002	—	—	18,953,002
General	21,843,048	1,538,785	(61,652)	23,320,181
Subtotal	344,629,344	7,184,910	(61,652)	351,752,602
Accumulated depreciation	(119,869,056)	(7,542,572)	56,592	(127,355,037)
Net plant being depreciated	224,760,288	(357,662)	(5,061)	224,397,565
Net utility plant – Wells Project	\$ 293,963,733	21,646,636	(8,475,895)	307,134,474

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<b>Electric Plant Assets Wells Hydroelectric Project</b>	<b>Balance August 31, 2016</b>	<b>Increase</b>	<b>Decrease</b>	<b>Balance August 31, 2017</b>
Utility plant not being depreciated:				
Land and land rights	\$ 52,177,902	—	—	52,177,902
Construction work in progress	80,757,206	18,469,294	(82,200,957)	17,025,543
Subtotal	132,935,108	18,469,294	(82,200,957)	69,203,445
Utility plant being depreciated:				
Hydraulic generation	221,575,184	82,263,376	(5,266)	303,833,294
Transmission	18,953,002	—	—	18,953,002
General	21,935,928	231,461	(324,341)	21,843,048
Subtotal	262,464,114	82,494,837	(329,607)	344,629,344
Accumulated depreciation	(114,032,083)	(6,166,580)	329,608	(119,869,056)
Net plant being depreciated	148,432,031	76,328,257	—	224,760,288
Net utility plant – Wells Project	\$ 281,367,139	94,797,551	(82,200,957)	293,963,733

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**(4) Long-Term Debt**

*Wells Hydroelectric Project*

			<b>Balance August 31, 2017</b>	<b>Additions</b>	<b>Reductions</b>	<b>Balance August 31, 2018</b>	<b>Due within one year</b>
		<b>Purpose</b>					
Revenue Bonds:							
Series 2006A, serial bonds		Refunding					
	maturing annually to						
	September 1, 2016 and term						
	bonds maturing						
	September 1, 2018, interest						
	at 4.50% - 5.00%		\$ 2,320,000	\$ -	\$ 1,130,000	\$ 1,190,000	\$ 1,190,000
Series of 2010A, serial bonds		Capital					
	maturing annually to	improvement					
	September 1, 2022 and term						
	bonds maturing						
	September 1, 2030 and 2040,		47,845,000	—	1,095,000	46,750,000	1,135,000
	interest at 1.484%–5.450%						
Series of 2010B, serial bonds		Capital					
	maturing annually to	improvement					
	September 1, 2020 and term						
	bonds maturing						
	September 1, 2030 and 2040,		39,785,000	—	1,125,000	38,660,000	1,155,000
	interest at 1.484%–5.495%						
Series of 2010C, serial bonds		Refunding					
	maturing annually to						
	September 1, 2029,		7,505,000	—	1,025,000	6,480,000	1,070,000
	interest at 3.00%–5.00%						
Series of 2012, serial bonds		Refunding					
	maturing annually to						
	September 1, 2018,		14,670,000	—	9,375,000	5,295,000	5,295,000
	interest at 0.40%–1.75%						
Series of 2015A, serial bonds		Refunding					
	maturing annually to						
	September 1, 2025 and						
	term bonds maturing						
	September 1, 2030 and		30,570,000	—	1,135,000	29,435,000	1,180,000
	2035, interest						
	at 3.70%–5.00%						
Series of 2015B, serial bonds		Refunding					
	maturing annually to						
	September 1, 2026 and						
	term bonds maturing						
	September 1, 2022, 2030						

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Series of 2015C, serial bonds		Refunding					
maturing annually to							
September 1, 2016 and							
term bonds maturing							
September 1, 2018,							
interest at 4.654%–5.112%			1,621,593	—	805,857	815,736	815,736
		Revenue bonds					
		payable	\$ 167,311,593	—	16,875,857	150,435,736	13,080,736

The changes in long-term debt, including the portion maturing currently, for the year ended August 31, 2018 and 2017 are as follows:

Long-term debt as of August 31, 2016	\$	183,874,581
Principal payments		(16,562,988)
Issuance of bonds		—
Defeasance of debt		—
Long-term debt as of August 31, 2017		167,311,593
Principal payments		(16,875,857)
Long-term debt as of August 31, 2018	\$	150,435,736

In 2004, the board authorized an intersystem loan, in the form of a revolving note (Note) for the purpose of funding the cost of relicensing the Wells Project. Under the terms of the Note, the Project was allowed to take semiannual draws from the Electric Distribution System’s Wells Relicensing Fund. The interest rate for each draw was established at the time of the draw and was equal to the yield on U.S. Treasury bonds maturing in May 2018, plus 100 basis points. Amounts borrowed under the Note were to be due upon the expiration of the current Wells Project license and any subsequent annual FERC licenses issued to the District. On May 31, 2012, the original Wells Project license expired and FERC issued an annual license that allowed the District to continue operating the Wells Project until a new long-term license could be issued. Under the terms of the Note the District had the option, by election prior to maturity, to extend the maturity date such that principal would be amortized over the life of the new FERC license, with interest payable semi-annually. In May 2012, the District Commission, in anticipation of receiving a new long-term license, chose to utilize this option. On November 9, 2012, FERC issued to the District a new 40-year license to operate and maintain the Wells Project. Repayment of the Note was amortized over the new license period at an interest rate equal to the 30-year US Treasury bond yield at November 1, 2012, the effective date of the new license, plus 100 basis points. The note was reclassified to a long-term liability in 2014.

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Following is a summary of future debt service requirements for Wells Project revenue bonds outstanding at August 31, 2018:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2019	13,080,736	7,172,253	20,252,989
2020	4,970,000	6,857,580	11,827,580
2021	5,060,000	6,652,086	11,712,086
2022	5,265,000	6,425,702	11,690,702
2023	5,475,000	6,189,535	11,664,535
2024–28	30,950,000	26,992,060	57,942,060
2029–33	35,185,000	18,940,939	54,125,939
2034–38	33,825,000	8,357,529	42,182,529
2039–41	16,625,000	3,031,877	19,656,877
\$	<u>150,435,736</u>	<u>90,619,561</u>	<u>241,055,297</u>

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 year 2018 and 2017.

Following is a summary of the debt service requirements for the intra-district note payable at August 31, 2018.

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2019	\$ 132,500	349,051	481,551
2020	137,500	343,805	481,305
2021	142,500	338,367	480,867
2022	147,500	332,736	480,236
2023	152,500	326,913	479,413
2024–28	857,500	1,539,086	2,396,586
2029–33	1,040,000	1,355,200	2,395,200
2034–38	1,252,500	1,133,103	2,385,603
2039–43	1,512,500	865,288	2,377,788
2044–48	1,825,000	541,888	2,366,888
2049–52	\$ 1,965,000	156,454	2,121,454
	<u>9,165,000</u>	<u>7,281,891</u>	<u>16,446,891</u>



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***Advance Debt Refunding***

In August 2012, the Wells Project issued its Wells Hydroelectric Revenue and Refunding Bonds, Series 2012 (Taxable) (the 2012 Bonds), in the total par amount of \$43,360,000. The 2012 Bonds were issued at par. A portion of the 2012 Bonds refinanced and legally defeased \$6,560,000 of the outstanding 2003A Bonds, \$1,790,000 of the outstanding 2003B Bonds, and \$31,905,000 of the outstanding 2003C Bonds. This refinancing resulted in a reduction of \$2,998,000 in total Wells Project debt service over the succeeding seven years and an economic gain (difference between the present values of the old and new debt service requirements) of \$3,176,000.

In June 2015, the Wells Project issued its Wells Hydroelectric Revenue and Refunding Bonds, Series 2015A, 2015B, and 2015C (the 2015 Bonds), in the total combined par amount of \$58,249,581. The 2015 Bonds were issued at par. A portion of the 2015 Bonds refinanced and legally defeased \$67,075,000 of the outstanding 2005 Series Bonds. This refinancing resulted in a reduction of \$1,058,000 in total Wells Project debt service over the succeeding 24 years and an economic gain (difference between the present values of the old and new debt service requirements) of \$443,469.

Debt service on all outstanding Wells Project bonds, which have been refinanced and legally defeased is met by cash and investments held in irrevocable trust with escrow agents. As of August 31, 2018 and 2017, the escrow agent was holding cash and investments of \$4,301,201 and \$12,488,434, which are expected to fully fund debt service on all outstanding Wells Project legally defeased bonds. The trust account assets and the liability for the corresponding refunded bonds are not included in the Project's financial statements.

**(5) Other Commitments and Contingencies**

***(a) Plan Species Account***

In accordance with the Tributary Conservation Plan, formed under the HCP, a plan species account was established to fund projects for the protection and restoration of plan species habitat. The HCP requires a Tributary Committee, composed of one representative of each party to the HCP, to select the projects and approve the project budgets from the plan species account for purposes of implementing the Tributary Conservation Plan. All budget and spending decisions must be made by unanimous vote of the Tributary Committee members. The HCP requires the District to make monetary contributions to the plan species account. In 2018 and 2017, the Project made payments of \$275,968 and \$267,772 to the plan species account. Funds paid into the plan species account are to be spent on only HCP related activities. The activity in this account is recorded as an expense for the Project.

***(b) Relicensing***

On November 9, 2012, FERC issued to the District a new long-term license for the Wells Project. The new license was issued for a period of 40 years, effective November 1, 2012.

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**(c) Generator and Turbine Refurbishment**

A generator and turbine refurbishment project is in progress at the Project and will continue for several years until all 10 units are refurbished. Cost of the refurbishment has been financed through the issuance of revenue bonds. Toshiba America Energy Systems has substantially completed the first two units is now underway on the third. The first unit was completed behind schedule and the contract provides liquidated damages, of which \$3.5 million has been withheld from payments.

**(d) Chief Joseph Dam Encroachment**

The Project’s pool encroaches on the Chief Joseph Dam tailrace. Chief Joseph Dam is a federal hydroelectric project operated by the United States Army Corps of Engineers. Under an agreement signed in 2014, and in full effect for the term of the Project’s FERC license, the Project delivers replacement power to the Federal Transmission System at no cost to the United States as compensation for power loss due to the Project’s encroachment.

**(6) Pension Plans, Deferred Compensation Plans**

The following table represents the aggregate pension amounts for all plans subject to the requirements of GASB 68 for the year 2018 and 2017:

<b>Aggregate Pension Amounts - PERS Plans 1/2/3</b>						
					<b>2018</b>	<b>2017</b>
Net pension liabilities*				\$	4,653,072	6,633,902
Pension assets						—
Deferred outflows of resources					417,786	547,090
Deferred inflows of resources					2,106,070	1,358,664
Pension expense					(1,103,469)	(768,768)
* The current portion of the net pension liability of \$1,198,388 and \$1,133,341 for 2018 and 2017, respectively, is included in accounts payable in the accompanying statement of net position.						

Substantially, all Project full-time and qualifying part-time employees participate in one of the following statewide retirement systems administered by the Washington State Department of Retirement Systems, under cost-sharing multiple-employer public employee defined benefit and defined contribution retirement plans. The Department of Retirement Systems (DRS), a department within the primary government of the State of Washington, issues a publicly available comprehensive annual financial report (CAFR) that includes financial statements and required supplementary information for each plan. The DRS CAFR may be obtained by writing to Department of Retirement Systems, Communications Unit, P.O. Box 48380, Olympia, WA 98504-8380; or it may be downloaded from the DRS Web site at [www.drs.wa.gov](http://www.drs.wa.gov). The following disclosures are made pursuant to GASB Statement No. 68.

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

**Plan Description**

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

Membership in the system includes: elected officials; state employees; employees of the Supreme, Appeals, and Superior courts (other than judges currently in a judicial retirement system); employees of legislative committees; community and technical colleges, college and university employees not participating in national higher education retirement programs; judges of district and municipal courts; and employees of local governments.

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

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

PERS Plan 1 and Plan 2 defined benefit retirement benefits are financed from a combination of investment earnings and employer and employee contributions. PERS retirement benefit provisions are established in Chapters 41.34 and 41.40 RCW and may be amended only by the State Legislature.

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PERS Plan 1 members are vested after the completion of five years of eligible service. Plan 1 members are eligible for retirement after 30 years of service, or at the age of 60 with five years of service, or at the age of 55 with 25 years of service. The monthly benefit is 2% of the average final compensation (AFC) per year of service. (AFC is the monthly average of the 24 consecutive highest-paid service credit months.) The retirement benefit may not exceed 60% of AFC. The monthly benefit is subject to a minimum for PERS Plan 1 retirees who have 25 years of service and have been retired 20 years, or who have 20 years of service and have been retired 25 years. Plan 1 members retiring from inactive status prior to the age of 65 may receive actuarially reduced benefits. If a survivor option is chosen, the benefit is further reduced. Plan 1 members may elect to receive an optional COLA that provides an automatic annual adjustment based on the Consumer Price Index. The adjustment is capped at 3% annually. To offset the cost of this annual adjustment, the benefit is reduced.

PERS Plan 1 provides duty and nonduty disability benefits. Duty disability retirement benefits for disablement prior to the age of 60 consist of a temporary life annuity payable to the age of 60. The allowance amount is \$350 a month, or two-thirds of the monthly AFC, whichever is less. The benefit is reduced by any workers' compensation benefit and is payable as long as the member remains disabled or until the member attains the age of 60. A member with five years of covered employment is eligible for nonduty disability retirement. Prior to the age of 55, the allowance amount is 2% of the AFC for each year of service reduced by 2% for each year that the member's age is less than 55. The total benefit is limited to 60% of the AFC and is actuarially reduced to reflect the choice of a survivor option. A cost-of-living allowance is granted at age 66 based upon years of service times the COLA amount. This benefit was eliminated by the Legislature, effective July 1, 2011. Plan 1 members may elect to receive an optional COLA that provides an automatic annual adjustment based on the Consumer Price Index. The adjustment is capped at 3% annually. To offset the cost of this annual adjustment, the benefit is reduced.

PERS Plan 1 members can receive credit for military service. Members can also purchase up to 24 months of service credit lost because of an on-the-job injury.

PERS Plan 2 members are vested after the completion of five years of eligible service. Plan 2 members are eligible for normal retirement at the age of 65 with five years of service. The monthly benefit is 2% of the AFC per year of service. (AFC is the monthly average of the 60 consecutive highest-paid service months.)

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

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

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

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PERS Plan 2 retirement benefits are also actuarially reduced to reflect the choice, if made, of a survivor option. There is no cap on years of service credit; and a cost-of-living allowance is granted (based on the Consumer Price Index), capped at 3% annually.

The surviving spouse or eligible child or children of a PERS Plan 2 member who dies after leaving eligible employment having earned 10 years of service credit may request a refund of the member's accumulated contributions.

PERS Plan 3 has a dual benefit structure. Employer contributions finance a defined benefit component and member contributions finance a defined contribution component. The defined benefit portion provides a monthly benefit that is 1% of the AFC per year of service. (AFC is the monthly average of the 60 consecutive highest-paid service months.)

Effective June 7, 2006, PERS Plan 3 members are vested in the defined benefit portion of their Plan after 10 years of service; or after five years of service, if 12 months of that service are earned after age 44; or after five service credit years earned in PERS Plan 2 prior to June 1, 2003. Plan 3 members are immediately vested in the defined contribution portion of their plan.

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

- If they have at least 10 service credit years and are 55 years old, the benefit is reduced by an ERF that varies with age, for each year before age 65.
- If they have 30 service credit years and are at least 55 years old, they have the choice of a benefit that is reduced by 3% for each year before age 65; or a benefit with a smaller (or no) reduction factor (depending on age) that imposes stricter return-to-work rules.

PERS Plan 3 defined benefit retirement benefits are also actuarially reduced to reflect the choice, if made, of a survivor option. There is no cap on years of service credit and Plan 3 provides the same cost-of-living allowance as Plan 2.

PERS Plan 3 defined contribution retirement benefits are solely dependent upon contributions and the results of investment activities.

The defined contribution portion can be distributed in accordance with an option selected by the member, either as a lump sum or pursuant to other options authorized by the Director of the Department of Retirement Systems.

PERS Plan 2 and Plan 3 provide disability benefits. There is no minimum amount of service credit required for eligibility. The Plan 2 monthly benefit amount is 2% of the AFC per year of service. For Plan 3, the monthly benefit amount is 1% of the AFC per year of service.

These disability benefit amounts are actuarially reduced for each year that the member's age is less than 65, and to reflect the choice of a survivor option. There is no cap on years of service credit, and a cost-of-living allowance is granted (based on the Consumer Price Index) capped at 3% annually.

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PERS Plan 2 and Plan 3 members may have up to 10 years of interruptive military service credit; five years at no cost and five years that may be purchased by paying the required contributions. Effective July 24, 2005, a member who becomes totally incapacitated for continued employment while serving the uniformed services, or a surviving spouse or eligible children, may apply for interruptive military service credit. Additionally, PERS Plan 2 and Plan 3 members can also purchase up to 24 months of service credit lost because of an on-the-job injury.

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

Beneficiaries of a PERS Plan 2 or Plan 3 member with 10 years of service who is killed in the course of employment receive retirement benefits without actuarial reduction, if the member was not at normal retirement age at death. This provision applies to any member killed in the course of employment, on or after June 10, 2004, if found eligible by the Department of Labor and Industries.

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

**Funding Policy**

Each biennium, the state Pension Funding Council adopts Plan 1 employer contribution rates, Plan 2 employer and employee contribution rates, and Plan 3 employer contribution rates. Employee contribution rates for Plan 1 are established by statute at 6% for state agencies and local government unit employees, and at 7.5% for state government elected officials. The Plan 2/3 employer rates include a component to address the PERS Plan 1 UAAL and an administrative expense that is currently set at 0.18%. The employer and employee contribution rates for Plan 2 and the employer contribution rate for Plan 3 are developed by the Office of the State Actuary to fully fund Plan 2 and the defined benefit portion of Plan 3. All employers are required to contribute at the level established by the Legislature. Under PERS Plan 3, employer contributions finance the defined benefit portion of the Plan and member contributions finance the defined contribution portion. The Director of the Department of Retirement Systems sets Plan 3 employee contribution rates. Six rate options are available ranging from 5% to 15%; two of the options are graduated rates dependent on the employee's age. As a result of the implementation of the Judicial Benefit Multiplier Program in January 2007, a second tier of employer and employee rates was developed to fund, along with investment earnings, the increased retirement benefits of those justices and judges that participate in the program. The methods used to determine the contribution requirements are established under state statute in accordance with Chapters 41.40 and 41.45 RCW.

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The required contribution rates expressed as a percentage of current year covered payroll, as of August 31, 2018 and 2017, are as follows:

<b>2018</b>				<b>PERS Plan 1</b>	<b>PERS Plan 2</b>	<b>PERS Plan 3</b>
Employer				12.70%	12.70%	12.70%
Employee				6.00	7.38	*
<b>2017</b>				<b>PERS Plan 1</b>	<b>PERS Plan 2</b>	<b>PERS Plan 3</b>
Employer				11.18%	11.18%	11.18%
Employee				6.00	6.12	*

\* Variable from 5% minimum to 15% maximum based on rate selected by the PERS 3 member.

The Project and the employees made the required contributions. The Project's required contribution for the year ended August 31, 2018 and 2017 was \$1,162,482 and \$1,127,131.

**Actuarial Assumptions**

The total pension liability (TPL) for each of the DRS plans was determined using the most recent actuarial valuation completed in 2018 with a valuation date of June 30, 2018. The actuarial assumptions used in the valuation were based on the results of the Office of the State Actuary's (OSA) *2007-2012 Experience Study*.

Additional assumptions for subsequent events and law changes are current as of the 2018 actuarial valuation report. The TPL was calculated as of the valuation date and rolled forward to the measurement date of June 30, 2018. Plan liabilities were rolled forward from June 30, 2017 to June 30, 2018, reflecting each plan's normal cost (using the entry-age cost method), assumed interest and actual benefit payments.

- **Inflation:** 2.75% total economic inflation; 3.50% salary inflation
- **Salary increases:** In addition to the base 3.50% salary inflation assumption, salaries are also expected to grow by promotions and longevity.
- **Investment rate of return:** 7.4%

Mortality rates were based on the RP-2000 report's Combined Healthy Table and Combined Disabled Table, published by the Society of Actuaries. OSA applied offsets to the base table and recognized future improvements in mortality by projecting the mortality rates using 100% Scale BB. Mortality rates are applied on a generational basis; meaning, each member is assumed to receive additional mortality improvements in each future year throughout his or her lifetime.

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**Discount Rate**

The discount rate used to measure the total pension liability for all DRS plans was 7.4%.

To determine that rate, an asset sufficiency test included an assumed 7.5% long-term discount rate to determine funding liabilities for calculating future contribution rate requirements. Consistent with the long-term expected rate of return, a 7.4% future investment rate of return on invested assets was assumed for the test. Contributions from plan members and employers are assumed to continue being made at contractually required rates (including PERS 2/3, whose rates include a component for the PERS 1). Based on these assumptions, the pension plans' fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return of 7.4% was used to determine the total liability.

**Long-Term Expected Rate of Return**

The long-term expected rate of return on DRS pension plan investments of 7.4% was determined using a building-block-method. The Washington State Investment Board (WSIB) used a best estimate of expected future rates of return (expected returns, net of pension plan investment expense, including inflation) to develop each major asset class. Those expected returns make up one component of WSIB's capital market assumptions. WSIB uses the capital market assumptions and their target asset allocation to simulate future investment returns at various future times. The long-term expected rate of return of 7.4% approximately equals the median of the simulated investment returns over a 50-year time horizon.

**Estimated Rates of Return by Asset Class**

Best estimates of arithmetic real rates of return for each major asset class included in the pension plan's target asset allocation as of June 30, 2018 and 2017 are summarized in the table below. The inflation component used to create the table is 2.2% and represents WSIB's most recent long-term estimate of broad economic inflation.

<b>Asset class</b>	<b>Target allocation</b>	<b>Percentage long-term expected real rate of return arithmetic</b>
Fixed income	20%	1.70%
Tangible assets	7	4.90
Real estate	18	5.80
Global equity	32	6.30
Private equity	23	9.30
	<u>100%</u>	



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**Sensitivity of NPL**

The table below presents the Project's proportionate share of the net pension liability as of June 30, 2018 calculated using the discount rate of 7.4%, as well as what the Project's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage point lower (6.4%) or 1-percentage point higher (8.4%) than the current rate.

	<b>1% Decrease (6.4%)</b>	<b>Current discount rate (7.4%)</b>	<b>1% Increase (8.4%)</b>
PERS 1	\$ 3,835,930	3,121,338	2,502,357
PERS 2/3	7,006,188	1,531,734	(2,956,707)

The table below presents the Project's proportionate share of the net pension liability as of June 30, 2017 calculated using the discount rate of 7.5%, as well as what the Project's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage point lower (6.5%) or 1-percentage point higher (8.5%) than the current rate.

	<b>1% Decrease (6.5%)</b>	<b>Current discount rate (7.5%)</b>	<b>1% Increase (8.5%)</b>
PERS 1	\$ 4,182,878	3,416,295	7,652,435
PERS 2/3	10,375,519	3,217,608	(2,276,777)

**Pension Plan Fiduciary Net Position**

Detailed information about the State's pension plans' fiduciary net position is available in the separately issued DRS financial report.

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**Pension Liabilities (Assets), Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions**

At August 31, 2018 and 2017, the Project reported a liability of \$4,653,072 and \$6,633,903 for its proportionate share of the net pension liabilities as follows:

		Net pension liability	
		2018	2017
PERS 1	\$	3,121,338	3,416,295
PERS 2/3		1,531,734	3,217,608

The net pension liability was measured as of June 30, 2018 and 2017 and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of those dates. At June 30, the Project's proportionate share of the collective net pension liabilities was as follows:

	Proportionate share June 30, 2017	Proportionate share June 30, 2018	Change in proportion
PERS 1	0.138455%	0.134405%	0.004050%
PERS 2/3	0.178088	0.172521	0.005567

Employer contribution transmittals received and processed by DRS for the fiscal year ended June 30 are used as the basis for determining each employer's proportionate share of the collective pension amounts reported by DRS in the Schedules of Employer and Non-employer Allocations for all plans.

**Pension Expense, Deferred Outflows and Deferred Inflows**

For the year ended August 31, 2018, the Project recognized pension expense of \$1,103,469. At August 31, 2018, the Project reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

PERS Plan 1	Deferred outflows of resources	Deferred inflows of resources
Differences between expected and actual experience	\$ —	—
Net difference between projected and actual investment earnings on pension plan investments	—	(124,040)
Changes of assumptions	—	—
Changes in proportion and differences between contributions and proportionate share of contributions	—	—
Contributions subsequent to the measurement date	84,011	—
Total	\$ 84,011	(124,040)

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<b>PERS Plan 2/3</b>	<b>Deferred outflows of resources</b>	<b>Deferred inflows of resources</b>
Differences between expected and actual experience	\$ 187,751	(268,179)
Net difference between projected and actual investment earnings on pension plan investments	—	(939,943)
Changes of assumptions	17,919	(435,919)
Changes in proportion and differences between contributions and proportionate share of contributions	—	(337,989)
Contributions subsequent to the measurement date	128,105	—
Total	<u>\$ 333,775</u>	<u>(1,982,030)</u>

For the year ended August 31, 2017, the Project recognized pension expense of \$768,768. At August 31, 2017, the Project reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

<b>PERS Plan 1</b>	<b>Deferred outflows of resources</b>	<b>Deferred inflows of resources</b>
Differences between expected and actual experience	\$ —	—
Net difference between projected and actual investment earnings on pension plan investments	—	(127,486)
Changes of assumptions	—	—
Changes in proportion and differences between contributions and proportionate share of contributions	—	—
Contributions subsequent to the measurement date	75,345	—
Total	<u>\$ 75,345</u>	<u>(127,486)</u>

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Notes to Financial Statements

August 31, 2018 and 2017

<b>PERS Plan 2/3</b>	<b>Deferred outflows of resources</b>	<b>Deferred inflows of resources</b>
Differences between expected and actual experience	\$ 326,019	(105,822)
Net difference between projected and actual investment earnings on pension plan investments	—	(857,737)
Changes of assumptions	34,177	—
Changes in proportion and differences between contributions and proportionate share of contributions	—	(267,619)
Contributions subsequent to the measurement date	111,547	—
Total	<u>\$ 471,743</u>	<u>(1,231,178)</u>

Deferred outflows of resources related to pensions resulting from the Project's contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended August 31, 2018. Other amounts reported as deferred outflows and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

	<b>PERS Plan 1</b>	<b>PERS Plan 2/3</b>
Year ended August 31:		
2019	5,427	(212,536)
2020	(27,116)	(361,579)
2021	(81,367)	(615,793)
2022	\$ (20,984)	(253,511)
Thereafter	—	(213,622)
Total	<u>\$ (124,040)</u>	<u>(1,776,360)</u>

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August 31, 2018 and 2017

Other amounts reported as deferred outflows and deferred inflows of resources related to pensions were recognized in pension expense for the reporting year ended August 31, 2017, as follows:

	<u>PERS Plan 1</u>	<u>PERS Plan 2/3</u>
Year ended August 31:		
2018	\$ (34,179)	(412,011)
2019	99,483	40,404
2020	62,182	(113,823)
2021	—	(376,489)
2022	—	(2,517)
Thereafter	—	(6,546)
Total	<u>\$ 127,486</u>	<u>(870,982)</u>

**Deferred Compensation Plans**

The Project 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 Project provides a 50% match of employee contributions capped at 2% of regular straight-time wages. 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.

**(7) Deferred Outflows, Inflows of Resources and Regulatory Assets**

The Wells Hydroelectric Project had deferred outflows of \$575,790 and \$1,000,870 at August 31, 2018 and 2017. Deferred outflows consist of unamortized losses on reacquired debt related to the sale of bonds and pension related estimated costs. The Project had deferred inflows of \$2,479,594 and \$1,754,160 at August 31, 2018 and 2017. Deferred inflows consist of unamortized gains on reacquired debt related to the sale of bonds and pension related gains.

The Wells Hydroelectric Project had regulatory assets of \$2,421,291 and \$5,603,168 as of August 31, 2018 and 2017. Those balances are net of accumulated amortization of \$55,233,114 in 2018 and \$52,039,425 in 2017. Regulatory assets amortized by the Project consist of the following: improvements to recreational facilities, repair and maintenance costs, miscellaneous fish improvements, preliminary survey and investigation, legal settlement charges, and miscellaneous clearing accounts. Regulatory assets are amortized using the sinking fund method (6% rate).

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**(8) Related-Party Transactions**

As discussed in note (1), the Project represents only one department of the District. Related-party transactions occur when the Project and the District's electric distribution system share facilities, employees, equipment or other resources, often making it necessary for one department to reimburse the other for use of the shared resource. Related-party transactions for the year ended August 31, 2018 include building expenses, salary costs, network costs, travel costs, and other miscellaneous items and are as follows:

	<u>2018</u>	<u>2017</u>
Received from the distribution system	\$ 3,957,798	\$ 7,835,627
Paid to the distribution system	23,503,577	17,516,082

**(9) Subsequent events**

**(a) Power Sales Contract**

The Wells Project's legacy Power Sales Contracts with four Pacific Northwest investor-owned utilities expired on August 31, 2018. The District negotiated new 10-year contracts with Puget Sound Energy, Portland General Electric, and Avista Corporation. Under the new agreements, the Wells' output is sold at cost to the District's Distribution System; however, previous obligations (share of output) to the Colville Tribes and Okanogan County PUD remain in place.

**(b) Change in Reporting Periods**

Historically, the Project has reported annual results as of August 31; however, beginning in 2019, the Project will report its financial results on a calendar year basis. This will necessitate a 4-month interim reporting period from September 1, 2018 to December 31, 2018.

**REQUIRED SUPPLEMENTARY INFORMATION**

**REQUIRED SUPPLEMENTARY INFORMATION**

Public Utility District No. 1 of Douglas County  
 Schedule of Proportionate Share of the Net Pension Liability  
 PERS Plan 1  
 As of June 30, 2018  
 Last 10 Measurement Years

		<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>
<u>Employer's proportion of the net pension liability (asset)</u>	%	0.162184%	0.154055%	0.138455%	0.134405%
<u>Employer's proportionate share of the net pension liability</u>	\$	<u>8,483,732</u>	<u>8,273,479</u>	<u>6,569,798</u>	<u>6,002,573</u>
TOTAL	\$	8,483,732	8,273,479	6,569,798	6,002,573
<u>Employer's covered employee payroll</u>	\$	15,584,452	17,173,115	17,359,459	17,355,869
<u>Employer's proportionate share of the net pension liability as a percentage of covered employee payroll</u>	%	54.44%	48.18%	37.85%	34.59%
<u>Plan fiduciary net position as a percentage of the total pension liability</u>	%	59.10%	57.03%	61.24%	63.22%

Notes to Schedule:

*There are no factors that significantly affect trends in the amounts reported above.*



**REQUIRED SUPPLEMENTARY INFORMATION**

Public Utility District No. 1 of Douglas County  
Schedule of Employer Contributions  
PERS Plan 1  
As of June 30, 2018  
Last 10 Fiscal Years

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	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>
<u>Contractually required contributions</u>	\$ 745,396	856,049	832,842	898,395
<u>Contributions in relation to the contractually required contributions</u>	\$ (745,396)	(856,049)	(832,842)	(898,395)
<u>Contribution deficiency (excess)</u>	\$ -	-	-	-
<u>Covered Employer Payroll</u>	\$ 17,173,115	17,359,459	17,355,869	18,646,736
<u>Contributions as a percentage of covered employee payroll</u>	% 4.34%	4.93%	4.80%	4.82%

Notes to Schedule:

*There are no factors that significantly affect trends in the amounts reported above.*

**REQUIRED SUPPLEMENTARY INFORMATION**

Public Utility District No. 1 of Douglas County  
 Schedule of Proportionate Share of the Net Pension Liability  
 PERS Plan 2 & 3  
 As of June 30, 2018  
 Last 10 Fiscal Years

		<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>
<u>Employer's proportion of the net pension liability (asset)</u>	%	0.191162%	0.185707%	0.178088%	0.172521%
<u>Employer's proportionate share of the net pension liability</u>	\$	<u>6,830,329</u>	<u>6,635,419</u>	<u>6,187,707</u>	<u>2,945,643</u>
TOTAL	\$	6,830,329	6,635,419	6,187,707	2,945,643
<u>Employer's covered employee payroll</u>	\$	15,584,452	17,173,115	17,359,459	17,355,869
<u>Employer's proportionate share of the net pension liability as a percentage of covered employee payroll</u>	%	43.83%	38.64%	35.64%	16.97%
<u>Plan fiduciary net position as a percentage of the total pension liability</u>	%	89.20%	85.82%	90.97%	95.63%

Notes to Schedule:

*There are no factors that significantly affect trends in the amounts reported above.*

**REQUIRED SUPPLEMENTARY INFORMATION**

Public Utility District No. 1 of Douglas County  
Schedule of Employer Contributions  
PERS Plan 2 & 3  
As of June 30, 2018  
Last 10 Fiscal Years

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	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>
<u>Contractually required contributions</u>	\$ 851,534	1,072,067	1,087,742	1,331,196
<u>Contributions in relation to the contractually required contributions</u>	\$ (851,534)	(1,072,067)	(1,087,742)	(1,331,196)
<u>Contribution deficiency (excess)</u>	\$ -	-	-	-
<u>Covered Employer Payroll</u>	\$ 17,173,115	17,359,459	17,355,869	18,646,736
<u>Contributions as a percentage of covered employee payroll</u>	% 4.96%	6.18%	6.27%	7.14%

Notes to Schedule:

*There are no factors that significantly affect trends in the amounts reported above.*