Washington State Auditor's Office

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Financial Statements and Federal Single Audit Report

Public Utility District No. 1 of Jefferson County

For the period January 1, 2010 through December 31, 2012

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Washington State Auditor's Office

August 11, 2016

Board of Commissioners
Public Utility District No. 1 of Jefferson County
Port Hadlock, Washington

Report on Financial Statements and Federal Single Audit

Please find attached our report on Public Utility District No. 1 of Jefferson County's financial statements and compliance with federal laws and regulations.

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

Sincerely,

Troy X. Kelley

TROY KELLEY

STATE AUDITOR

OLYMPIA, WA

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SECTION I – SUMMARY OF AUDITOR'S RESULTS

The results of our audit of Public Utility District No. 1 of Jefferson County are summarized below in accordance with U.S. Office of Management and Budget Circular A-133.

Financial Statements

We issued an unmodified opinion on the fair presentation of the basic financial statements in accordance with accounting principles generally accepted in the United States of America (GAAP).

Internal Control over Financial Reporting:

- *Significant Deficiencies:* We identified deficiencies in the design or operation of internal control over financial reporting that we consider to be significant deficiencies.
- *Material Weaknesses:* We identified deficiencies that we consider to be material weaknesses.

We noted no instances of noncompliance that were material to the financial statements of the District.

Federal Awards

Internal Control over Major Programs:

- *Significant Deficiencies:* We reported no deficiencies in the design or operation of internal control over major federal programs that we consider to be significant deficiencies.
- *Material Weaknesses:* We identified deficiencies that we consider to be material weaknesses.

We issued an unmodified opinion on the District's compliance with requirements applicable to its major federal program.

We reported findings that are required to be disclosed under section 510(a) of OMB Circular A-133.

Identification of Major Federal Programs:

The following program was selected as a major program in our audit of compliance in accordance with OMB Circular A-133.

CFDA No.	Program or Cluster Title
66.468	Capitalization Grants for Drinking Water State Revolving Funds

The dollar threshold used to distinguish between Type A and Type B programs, as prescribed by OMB Circular A-133, was $300,000.

The District did not qualify as a low-risk auditee under OMB Circular A-133.

SECTION II – FINANCIAL STATEMENT FINDINGS

See finding 2012-001 and 2012-002.

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

See finding 2012-003.

SCHEDULE OF AUDIT FINDINGS AND RESPONSES

Public Utility District No. 1 of Jefferson County
January 1, 2010 through December 31, 2012

2012-001 The District's internal controls over financial accounting and financial statement preparation are inadequate to ensure accurate and complete reporting.

Background

It is the responsibility of District management to design and follow internal controls that provide reasonable assurance regarding the reliability of financial reporting.

Our audit identified a significant deficiency in controls that adversely affects the District's ability to produce reliable financial statements.

Description of Condition

During our audit, we identified the following deficiencies in internal controls over financial reporting that, when taken together, represent a significant deficiency:

- During the audit period, the District contracted with a Certified Public Accountant (CPA) to prepare its annual financial statements. The CPA prepare the statements based on the information provided by District staff. During this time the District experienced turnover in the Finance Director position resulting in an inconsistent process for ensuring the financial statements were complete, accurate and prepared in accordance with current Generally Accepted Accounting Principles (GAAP).

- The District relied on the contracted CPA to compile the financial statements and did not provide adequate oversight, such as reviewing the financial reporting package, to ensure the financial statements were completed accurately and timely.

- The District lacked procedures to reconcile its year-end cash balances to the bank statements and reports from the County Treasurer. Additionally, there were a lack of procedures to ensure its depreciation was calculated correctly.

Cause of Condition

The CPA used outdated information in the preparation of the financial reporting package. Additionally, turnover of key finance staff and a transition of general ledger accounting software increased difficulty in obtaining support for financial balances and resulted in delays in reporting.

Effect of Condition

The District's 2012 financial statements were not submitted to the State Auditor's Office until the auditor was on site to conduct the audit, 171 days late.

We were initially unable to obtain support from the accounting system for several balances reported in the financial statements. After extensive research and delay, the District was able to provide the documentation needed.

In addition, during our audit, we identified the following errors, which were not detected by the District:

Fiscal year 2012

- The District did not impellent Governmental Accounting Standard 63, relating to the presentation of net position when preparing its financial statements as required by the Governmental Accounting Standards Board.

- The cash and investments balance was understated by $86,192.

- The District did not include a $72,859 loan assumed as part of acquisition of a water system in its value. Capital assets and liabilities were understated by this amount.

Fiscal year 2011

- The District reported $211,932 of loan proceeds received as a revenue rather than as long-term liabilities.

Fiscal year 2010

- The District did not calculate depreciation expense for assets added during 2010 and also continued to charge depreciation expense to other assets that were fully depreciated. As a result depreciation expense was understated by a net of $51,253.

- Additional revisions were required to the presentation of the Management Discussion and Analysis and to the Notes to the Financial Statements to comply with current standards.

The District corrected all identified errors. While these errors were not material to the financial statements as a whole, deficiencies in internal controls make it reasonably possible that significant misstatements could occur and not be prevented or detected by the District.

Recommendation

We recommend the District establish and follow procedures to ensure:

- The individuals involved in the preparation of the financial reports and data supporting the financial reports are provided the necessary resources, time, training and oversight to facilitate the preparation of accurate and supported financial statements.
- An appropriate review of the financial statements is performed by a person knowledgeable of District activities and government auditing requirements.
- Financial statements are completed and submitted timely as required by state law, within 150 days of the District's fiscal year end.
- Accounts are reconciled monthly with bank statements and reports from the County Treasurer.
- Depreciation calculations are reviewed to ensure all depreciable assets are included and that fully depreciated assets are excluded from the calculation.

District's Response

We appreciate the auditor's concern for the audit period. These past few years have been monumental for our district with the citizens' initiative to acquire public power in the county. We have hired several new employees to transition the organization from a small water district to a county wide public power district. We are also in process to acquire and implement a new comprehensive accounting and billing system that is compatible with electric operations. We are redesigning all our accounting processes to improve our internal controls which will address the concerns raised by the auditor.

Auditor's Remarks

We wish to thank the District's staff and management for their cooperation and assistance during the audit. We look forward to working with the District on this issue and will follow up on it during the next audit.

Applicable Laws and Regulations

RCW 43.09.200 states in part:

> The state auditor shall formulate, prescribe, and install a system of accounting and reporting for all local governments, which shall be uniform for every public institution, and every public office, and every public account of the same class.

RCW 43.09.230 states in part:

> The state auditor shall require from every local government financial reports covering the full period of each fiscal year, in accordance with the forms and methods prescribed by the state auditor, which shall be uniform for all accounts of the same class.
>
> Such reports shall be prepared, certified, and filed with the state auditor within one hundred fifty days after the close of each fiscal year.

Budget Accounting and Reporting System Manual - Part 3, Accounting, Chapter 1, Accounting Principles and General Procedures, Section 3, Internal Control states in part:

> Controls over Financial Reporting
>
> > 3.1.3.140 This objective refers to fair presentation of financial statements and required schedules in all material respects in accordance with the stated basis of accounting.
> >
> > 3.1.3.150 In meeting this objective, the government should have controls that accomplish the following key functions:
> >
> > - Identification of financial events – Controls should ensure financial events and transactions are properly identified and recorded.
> > - Properly applying accounting standards – Controls should ensure correct criteria and methodology is applied when accounting for financial events. When the correct method of accounting for or reporting a transaction is unclear, the government should seek clarification by performing research, contracting for

accounting assistance, or communicating with the State Auditor’s Office or standard setting bodies.

- Correctly accounting for all financial events – Controls should ensure that:
- Only valid transactions are recorded and reported.
- All transactions occurred during the period are recorded and reported.
- Transactions are recorded and reported at properly valued and calculated amounts.
- Recorded and reported transactions accurately reflect legal rights and obligations.
- Transactions are recorded and reported in the account and fund to which they apply.
- Preparation of the annual report – Controls should ensure that financial statements and required schedules are properly compiled and prepared from source accounting records. Controls should also ensure correct presentation of statements and schedules.

3.1.3.160 Controls and processes should generate adequate documentation to demonstrate achievement of objectives. This is not only important for audit, oversight and public records purposes, but also to enable effective monitoring of controls over financial reporting by management.

Government Auditing Standards, July 2007 Revision – Section 5.11 provides that auditors should report material weaknesses and significant deficiencies in internal control.

The American Institute of Certified Public Accountants, Statement on Auditing Standards No. 115 defines significant deficiencies and material weaknesses as follows:

a. Significant deficiency: A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

b. Material weakness: A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Public Utility District No. 1 of Jefferson County
January 1, 2010 through December 31, 2012

2012-002 The District's internal controls were inadequate to ensure accurate and timely federal grant reporting, resulting in a missed federal audit deadline.

Background

It is the responsibility of District management to design and follow internal controls that provide reasonable assurance regarding the reliability of financial reporting.

Entities that receive federal money are required to prepare a Schedule of Expenditures of Federal Awards (SEFA) as part of their annual financial report. The SEFA should include all federal expenditures made by the District for the fiscal year, and is the basis for determining major programs audited in accordance with U.S. Office of Management and Budget (OMB) Circular A-133.

Description of Condition

Our audit identified the following deficiencies in internal controls that, when taken together, represent a material weakness:

- District personnel responsible for preparation of the SEFA did not have an adequate understanding of the OMB Circular A-133 and State Auditor's Budgeting, Accounting and Reporting System (BARS) Manual reporting requirements.
- The District's process for financial statement preparation did not include a reconciliation of reported grant expenditures to accounting records or an effective secondary review capable of detecting significant misstatements.

Cause of Condition

Historically, the District had not received many federal grants. As a result, the District did not design effective internal controls, including providing necessary training to staff, to ensure accurate and complete reporting of federal expenditures.

Effect of Condition

The District did not prepare a SEFA for 2012. However, in June 2016, the District identified the following federal expenditures which should have been reported in 2012:

- $1,625,121 for the Capitalization Grants for Drinking Water State Revolving Funds grants (CFDA 66.468), which required audit as a major program.

The material weakness in internal controls caused the District to under-report a major federal program and miss its federal reporting deadline of September 30, 2013. This also delayed the audit process and resulted in increased audit costs. Non-compliance with this requirement can put future federal funding in jeopardy.

Recommendation

We recommend the District establish and follow procedures to ensure:

- Personnel responsible for financial reporting receive adequate training regarding federal reporting requirements as outlined in OMB Circular A-133 and the *Budgeting, Accounting and Reporting System* (BARS) manual.

- The Schedule of Expenditures of Federal Awards is complete and accurate. This includes reconciliation of reported federal grant expenditures to accounting records and a secondary review by an individual knowledgeable of District grant activities and federal reporting requirements.

District's Response

The PUD will ensure that the new Chief Financial Officer and/or the Controller will have the necessary training and/or experience in State and Federal grant accounting and reporting requirements. They will be responsible for implementing and enforcing improved internal controls.

Auditor's Remarks

We thank the District for its assistance throughout the audit, and the steps it is taking to address these issues. We will review the status of the District's corrective action during our next scheduled audit.

Applicable Laws and Regulations

Budgeting, Accounting and Reporting System (BARS) Manual – Accounting, Accounting Principles and Internal Control, Internal Control states in part:

> 3.1.3.20 Internal control is a process – affected by those charged with governance, management and other personnel designed to provide reasonable assurance regarding the achievement of objectives in the following categories:
>
> - Effectiveness and efficiency of operations
> - Compliance with applicable laws and regulations
> - Reliability of financial reporting
>
> 3.1.3.30 Management and the governing body are responsible for the government's performance, compliance and financial reporting. Therefore, the adequacy of internal control to provide reasonable assurance of achieving these objectives is also the responsibility of management and the governing body. The governing body has *ultimate* responsibility for ensuring adequate controls to achieve objectives, even though *primary* responsibility has been delegated to management.

Government Auditing Standards, December 2011 Revision, paragraph 4.23 states in part:

> 4.23 When performing GAGAS financial audits, auditors should communicate in the report on internal control over financial reporting and compliance, based on the work performed, (1) significant deficiencies and material weaknesses in internal control;

The American Institute of Certified Public Accountants defines significant deficiencies and material weaknesses in its Codification of Statements on Auditing Standards, section 265, as follows:

> .07 For purposes of generally accepted auditing standards, the following terms have the meanings attributed as follows:
>
> > Material weakness. A deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the

> entity's financial statements will not be prevented, or detected and corrected, on a timely basis.
>
> Significant deficiency. A deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness yet important enough to merit attention by those charged with governance.

RCW 43.09.200 Local government accounting—Uniform system of accounting, states in part:

> The state auditor shall formulate, prescribe, and install a system of accounting and reporting for all local governments, which shall be uniform for every public institution, and every public office, and every public account of the same class.

Budgeting Accounting and Reporting System (BARS) Manual – Supplemental Schedules – Expenditures of Federal Awards (Schedule 16), states in part:

> The purpose of this schedule is to summarize federal grant expenditures as a basis for planning and conducting the single audit. It also serves to provide assurance to those agencies that award financial assistance that their programs or grants were included in the audit. It is important to prepare this schedule carefully to ensure that it is accurate and complete. Any program or grant omitted from this schedule will be considered unaudited. This schedule should be prepared on the same basis of accounting as the financial statements.

U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations,* states in part:

> Section 200:
>
> (a) Audit required. Non-federal entities that expend $300,000 ($500,000 for fiscal years ending after December 31, 2003) or more in a year in Federal awards shall have a single or program-specific audit conducted for that year in accordance with the provisions of this part. Guidance on determining Federal awards expended is provided in §___.205

Section 205:

Basis for determining Federal awards expended.

(a) Determining Federal awards expended. The determination of when an award is expended should be based on when the activity related to the award occurs. Generally, the activity pertains to events that require the non-federal entity to comply with laws, regulations, and the provisions of contracts or grant agreements, such as: expenditure/expense transactions associated with grants, cost-reimbursement contracts, cooperative agreements, and direct appropriations; the disbursement of funds passed through to subrecipients, the use of loan proceeds under loan and loan guarantee programs…

Section 300:

The auditee shall:

(a) Identify, in its accounts, all Federal awards received and expended and the Federal programs under which they are received. Federal program and award identification shall include, as applicable, the CFDA title and number, award number and year, name of the Federal agency, and the name of the pass-through entity.

(b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs.

(c) Comply with laws, regulations, and the provisions of contracts or grant agreements related to each of its major federal programs.

(d) Prepare appropriate financial statements, including the schedule of expenditures of Federal awards in accordance with §___.310

Section 310:

(a) Schedule of expenditures of federal awards. The auditee shall…prepare a schedule of expenditures of Federal awards for the period covered by the auditee’s financial statements.

SCHEDULE OF FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

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

2012-003 The District did not have adequate internal controls to ensure compliance with federal suspension and debarment requirements.

CFDA Number and Title:	66.468 – Capitalization Grants for Drinking Water State Revolving Funds
Federal Grantor Name:	Environmental Protection Agency
Federal Award/Contract Number:	N/A
Pass-through Entity Name:	Department of Commerce
Pass-through Award/Contract Number:	DM10-952-018 DM12-952-091
Questioned Cost Amount:	$0

Background

During 2012, the District expended $1,625,121 under the Capitalization Grants for Drinking Water State Revolving Funds loan program. The purpose of the program is to help public water systems finance the costs of infrastructure needed to achieve or maintain compliance with Safe Drinking Water Act (SDWA) requirements and protect the public health objectives of the Act.

Federal requirements prohibit grant recipients from contracting with or making subawards to parties that have been suspended or debarred from doing business with the federal government. The District is required to verify that all vendors receiving $25,000 or more in federal funds have not been suspended or debarred. The District can obtain a written certification from a vendor or insert a clause into the contract where the vendor states it is not suspended or debarred. Alternatively, the District may review the federal Excluded Parties List issued by the U.S. General Services Administration. This requirement must be met prior to entering into a contract with a vendor.

Description of Condition

During 2012, the District paid $1,614,360 of its loan program funding to four vendors subject to suspension and debarment requirements. The District did not have procedures in place to verify whether the vendors were suspended or debarred prior to entering into the contracts, or inform vendors of their responsibilities regarding lower-tier covered transactions.

We consider this deficiency in internal controls to be a material weakness.

Cause of Condition

The District was unaware of the requirements regarding suspension and debarment, and did not design effective internal controls to ensure compliance.

Effect of Condition and Questioned Costs

Without proper controls, the District increases the risk of awarding funds to vendors and subrecipients that are suspended or debarred from participating in federal programs. Any payments to an ineligible party are unallowable and would be subject to recovery by the funding agency.

Failure to comply with federal requirements may jeopardize the District’s eligibility for future federal assistance.

We were able to verify the vendors had not been suspended or debarred and, therefore, we are not questioning costs for the payments.

Recommendation

We recommend the District:

- Establish and follow internal controls to ensure compliance with federal suspension and debarment requirements.
- Ensure staff responsible for maintaining compliance with these requirements receive adequate training to effectively perform their duties.

District’s Response

The PUD will ensure that the new Chief Financial Officer and/or the Controller will have the necessary training and/or experience in State and Federal grant accounting and reporting requirements. They will be responsible for implementing and enforcing improved internal controls.

Auditor's Remarks

We appreciate the District's assistance during the audit and its receptiveness to our recommendations. We will review this area again during our next audit.

Applicable Laws and Regulations

U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, Section 300, states in part:

> The auditee shall:
>
> > (b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs.
> >
> > (c) Comply with laws, regulations, and the provisions of contracts or grant agreements related to each of its Federal programs.

Government Auditing Standards, December 2011 Revision, paragraph 4.23 states:

> **4.23** When performing GAGAS financial audits, auditors should communicate in the report on internal control over financial reporting and compliance, based upon the work performed, (1) significant deficiencies and material weaknesses in internal control; (2) instances of fraud and noncompliance with provisions of laws or regulations that have a material effect on the audit and any other instances that warrant the attention of those charged with governance; (3) noncompliance with provisions of contracts or grant agreements that has a material effect on the audit; and (4) abuse that has a material effect on the audit.

The American Institute of Certified Public Accountants defines significant deficiencies and material weaknesses in its *Codification of Statements on Auditing Standards*, section 935, as follows:

> **.11** For purposes of adapting GAAS to a compliance audit, the following terms have the meanings attributed as follows: ...
>
> **Deficiency in internal control over compliance.** A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow

management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance on a timely basis. A deficiency in *design* exists when *(a)* a control necessary to meet the control objective is missing, or *(b)* an existing control is not properly designed so that, even if the control operates as designed, the control objective would not be met. A deficiency in *operation* exists when a properly designed control does not operate as designed or the person performing the control does not possess the necessary authority or competence to perform the control effectively. ...

Material weakness in internal control over compliance. A deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a compliance requirement will not be prevented, or detected and corrected, on a timely basis. In this section, a reasonable possibility exists when the likelihood of the event is either reasonably possible or probable as defined as follows:

Reasonably possible. The chance of the future event or events occurring is more than remote but less than likely.

Remote. The chance of the future event or events occurring is slight.

Probable. The future event or events are likely to occur. ...

Significant deficiency in internal control over compliance. A deficiency, or a combination of deficiencies, in internal control over compliance that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance

Title 2, Code of Federal Regulations, states in part:

Section 180.220 – Are any procurement contracts included as covered transactions?

(b) …a contract for goods or services is a covered transaction if any of the following applies:

(1) The contract is awarded by a participant in a nonprocurement transaction that is covered under

§180.210, and the amount of the contract is expected to equal or exceed $25,000.

(c) A subcontract also is a covered transaction if,--

(1) It is awarded by a participant in a procurement transaction under a nonprocurement transaction of a Federal agency that extends the coverage of paragraph (b)(1) of this section to additional tiers of contracts…and

(2) The value of the subcontract is expected to equal or exceed $25,000.

Section 180.970 Nonprocurement transaction.

(a) Nonprocurement transaction means any transaction, regardless of type (except procurement contracts), including, but not limited to the following (states in part):

(1) Grants.

Section 180.300 – What must I do before I enter into a covered transaction with another person at the next lower tier?

When you enter into a covered transaction with another person at the next lower tier, you must verify the person with whom you intend to do business is not excluded or disqualified. You do this by:

(a) Checking the EPLS; or

(b) Collecting a certification from that person if allowed by this rule; or

(c) Adding a clause or condition to the covered transaction with that person.

Section 180.330 What requirements must I pass down to persons at lower tiers with whom I intend to do business?

Before entering into a covered transaction with a participant at the next lower tier, you must require the participant to—

(a) Comply with this subpart as a condition of participation in the transaction. You may do so using any method(s), unless the regulation of the Federal agency responsible for the transaction requires you to use specific methods.

(b) Pass the requirement to comply with this subpart to each person with whom the participant enters into a covered transaction at the next lower tier.

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

Public Utility District No. 1 of Jefferson County
January 1, 2010 through December 31, 2012

Board of Commissioners
Public Utility District No. 1 of Jefferson County
Port Hadlock, Washington

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of Public Utility District No. 1 of Jefferson County, Washington, as of and for the years ended December 31, 2012, 2011 and 2010, and the related notes to the financial statements, which collectively comprise the District's basic financial statements, and have issued our report thereon dated March 27, 2014. As discussed in Note 1 to the financial statements, during the year ended December 31, 2012, the District implemented Governmental Accounting Standards Board Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position*.

INTERNAL CONTROL OVER FINANCIAL REPORTING

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

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying Schedule of Audit Findings and Responses, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the District's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying Schedule of Audit Findings and Responses as Finding 2012-002 to be a material weakness.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying Schedule of Audit Findings and Responses as Finding 2012-001 to be a significant deficiency.

COMPLIANCE AND OTHER MATTERS

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

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

DISTRICT'S RESPONSE TO FINDINGS

The District's response to the findings identified in our audit is described in the accompanying Schedule of Audit Findings and Responses. The District's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the response.

PURPOSE OF THIS REPORT

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

TROY KELLEY

STATE AUDITOR

OLYMPIA, WA

March 27, 2014, except for the matters discussed in the Schedule of Audit Findings and Responses 2012-002, as to which the date is August 10, 2016.

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM AND REPORT ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

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

Board of Commissioners
Public Utility District No. 1 of Jefferson County
Port Hadlock, Washington

REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM

We have audited the compliance of Public Utility District No. 1 of Jefferson County, Jefferson County, Washington, with the types of compliance requirements described in the U.S. *Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the District's major federal programs for the year ended December 31, 2012. The District's major federal program is identified in the accompanying Schedule of Findings and Questioned Costs.

Management's Responsibility

Management is responsible for compliance with federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of the District's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the District's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. Our audit does not provide a legal determination on the District’s compliance.

Opinion on Each Major Federal Program

In our opinion, the District complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2012.

REPORT ON INTERNAL CONTROL OVER COMPLIANCE

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

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

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We identified certain deficiencies in internal control over compliance, as described in the accompanying Schedule of Federal Award Findings and Questioned Costs as Finding 2012-003 to be a material weakness.

District's Response to Findings

The District's response to the internal control over compliance findings identified in our audit is described in the accompanying Schedule of Federal Award Findings and Questioned Costs. The District's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

Purpose of this Report

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose. However, this report is a matter of public record and its distribution is not limited. It also serves to disseminate information to the public as a reporting tool to help citizens assess government operations.

Troy X. Kelley

TROY KELLEY

STATE AUDITOR

OLYMPIA, WA

August 10, 2016

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

Public Utility District No. 1 of Jefferson County
January 1, 2010 through December 31, 2012

Board of Commissioners
Public Utility District No. 1 of Jefferson County
Port Hadlock, Washington

REPORT ON THE FINANCIAL STATEMENTS

We have audited the accompanying financial statements of Public Utility District No. 1 of Jefferson County, Washington, as of and for the years ended December 31, 2012, 2011 and 2010, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed on page 33.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Public Utility District No. 1 of Jefferson County, as of December 31, 2012, 2011 and 2010, and the changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Matters of Emphasis

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

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 34 through 37 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Supplementary and Other Information

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

OTHER REPORTING REQUIRED BY GOVERNMENT AUDITING STANDARDS

In accordance with *Government Auditing Standards*, we have also issued our report dated March 27, 2014, except for the matters discussed in the Schedule of Audit Findings and Responses 2012-002, for which the date is August 10, 2016, on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control over financial reporting and compliance.

Troy X. Kelley

TROY KELLEY

STATE AUDITOR

OLYMPIA, WA

March 27, 2014, except for our report on the Schedule of Expenditures of Federal Awards, as to which the date is August 10, 2016.

FINANCIAL SECTION

Public Utility District No. 1 of Jefferson County
January 1, 2010 through December 31, 2012

REQUIRED SUPPLEMENTARY INFORMATION

BASIC FINANCIAL STATEMENTS

SUPPLEMENTARY AND OTHER INFORMATION

Public Utility District No.1 of Jefferson County
Management's Discussion and Analysis

Our discussion and analysis of the Public Utility District No.1 of Jefferson County's financial performance provides an overview of the District's financial activities for the years ended December 31, 2012, 2011 and 2010. Please read it in conjunction with the District's basic financial statements which begin on page 5. This annual financial report consists of two parts – Management's Discussion and Analysis (this section) and the Basic Financial Statements.

BASIC FINANCIAL STATEMENTS

The District's basic financial statements include four components:

Statements of Net position
Statements of Revenues, Expenses and Changes in Net Position
Statements of Cash Flows
Notes to Financial Statements

The **statements of net position** provide a basis for evaluating the capital structure of the District and assessing its liquidity and financial flexibility.

The **statements of revenues, expenses and changes in net position** present information which shows how the District's net position changed during each year. All of the year's revenues and expenses are recorded when the underlying transaction occurs, regardless of the timing of the related cash flows. The statements of revenues, expenses and changes in net position measure the success of the District's operations during the year and determine whether the District has recovered its costs through user fees and other charges.

The **statements of cash flows** provide information regarding the District's cash receipts and cash disbursements during the year. These statements report cash activity in four categories:

Operating
Noncapital financing
Capital financing
Investing

These statements differ from the statements of revenues, expenses and changes in net position by only accounting for transactions that result in cash receipts or cash disbursements.

The **notes to financial statements** provide a description of the accounting policies used to prepare the financial statements and present material disclosures required by generally accepted accounting principles that are not otherwise present in the financial statements.

FINANCIAL HIGHLIGHTS

Following is a summary of financial highlights for the Public Utility District No.1 of Jefferson County for the years ended December 31, 2012, 2011, and 2010:

CONDENSED FINANCIAL POSITION

NET POSITION

	2012	2011	2010	2009
Current and Other Assets	$ 8,965,639	$ 9,712,911	$ 10,362,785	$ 11,194,525
Capital Assets	24,187,373	22,076,375	22,096,535	22,304,657
Total Assets	33,153,012	31,789,286	32,459,320	33,499,182
Current and Other Liabilities	522,371	207,776	313,683	787,459
Current Portion of Debt	660,400	548,862	559,855	539,258
Long-term Debt	11,671,704	10,158,780	10,638,206	10,751,912
Total Liabilities	12,854,475	10,915,418	11,511,744	12,078,629
TOTAL NET POSITION	$ 20,298,537	$ 20,873,868	$ 20,947,576	$ 21,420,553

NET POSITION DETAIL

	2012	2011	2010	2009
Invested in Capital Assets, net of Debt	$ 12,130,300	$ 11,647,993	$ 10,898,474	$ 10,546,199
Restricted Assets	3,260,984	3,436,268	2,793,419	2,451,320
Unrestricted Assets	4,907,253	5,789,607	7,255,683	8,423,034
TOTAL NET POSITION	$ 20,298,537	$ 20,873,868	$ 20,947,576	$ 21,420,553

CONDENSED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

	2012	2011	2010	2009
Operating Revenues	$ 1,912,086	$ 1,768,330	$ 1,824,237	$ 1,888,076
Non-Operating Revenues	761,062	831,620	629,739	718,133
Total Revenues	2,673,148	2,599,950	2,453,976	2,606,209
Operating Expenses	2,297,446	1,827,690	1,654,239	1685658
Non-Operating Expenses	951,033	845,968	1,336,497	1123299
Total Expenses	3,248,479	2,673,658	2,990,736	2,808,957
Income (Loss)	(575,331)	(73,708)	(536,760)	(202,748)
Capital Contributions	-	-	-	-
Change in Net Position	(575,331)	(73,708)	(536,760)	(202,748)
Total Net Position, January 1	20,873,868	20,947,576	21,420,553	21,623,301
Prior period adjustment			63,783	
Total Net Position, January 1, restated	20,873,868	20,947,576	21,484,336	21,623,301
Total Net Position, December 31	$ 20,298,537	$ 20,873,868	$ 20,947,576	$ 21,420,553

Assets
Current and restricted assets have decreased by $747,272 in 2012, $649,874 in 2011, and $831,740 in 2010. This was due primarily as a result of expenditures related to preliminary costs of acquisition of an electric utility and the improvement and acquisition of water facilities. The District had capital assets in the amount of $24.2M, $22.1M, $22.1M as of December 31, 2012, 2011, and 2010, respectively. The increase in asset additions in 2012 and 2011 was offset by current year depreciation of system assets. Additionally, the District's cash and investments totaled $4.9M, $5M, and $4.8M in 2012, 2011 and 2010, respectively. Capital assets are detailed in Note 3 to the financial statements.

Liabilities
Current liabilities increased by $394,745 in 2012 primarily related to preliminary costs related to acquisition of the electric business in April 2013 and remained static in the two years prior. Long-term debt decreased by $490,419 in 2011 as there was no new debt issued and reflecting payments on existing debt and increased by $1.4M in 2012 primarily due to State Drinking Water loans related to the new water treatment plant under construction and an additional acquisition debt related to the purchase of the Kala Point Water system. Long term debt is detailed in Note 6 to the financial statements.

The District's current ratio, that is current assets divided by current liabilities, widely believed to be the best indicator of liquidity or ability to operate in the current and near term, presents a 2.3 to 1 ratio in 2012, and a ratio of 3.98 to 1 ratio in 2011 indicating that the District continues to have strong liquidity with the ability to meet its current obligations.

Net Position
Total net position decreased $573,331, $73,708, and $472,977 for 2012, 2011, and 2010, respectively. These decreases in net position are due primarily to non-operating losses related to legal and other preliminary costs of the acquisition of an electric utility which is detailed below.

Operating Revenue and Expenses
Operating revenues increased by $143,756 in 2012, decreased by $55,907 in 2011, and decreased by $63,839 in 2010 with corresponding operating expenses increasing by $469,756 in 2012, increasing by$173,451 in 2011, and decreasing by $31,419 in 2010. This resulted with a net decrease in net income of $501,623 in 2012, an increase of net income of $463,052 in 2011, and a decrease in net income by $334,012 in 2010.

Fluctuations in operating revenues were primarily due to addition of new customers or weather related. Additionally, operating expenses related to gearing up for the electric transition significantly increased in 2012 just three months prior to acquisition and operation of the electric utility. Expenses which could be directly attributed to the acquisition, such as legal and preliminary engineering were classified as non-operating "public power preliminary costs" as reflected in the statement of revenues, expenses and changes in net position found on page 6 of the following financial statements.

Overall Financial Position
The District's overall financial position continues to remain sound in 2012, 2011 and 2010. The District has maintained consistent operating net income while increasing and improving services to new and existing customers.

FUTURE PLANS FOR DEVELOPMENT AND EXPANSION

The District continues to grow in providing services to its constituents and is currently in the process of improving and initiating service to water customers including the acquisition of the Kala Point Water system and the construction of a new water filtration plant. The District has maintained stable rates for the water systems. During 2008 the voters of Jefferson County voted to authorize the District to explore the possibility of providing electric service to residents.

In May, 2010 the District entered into an agreement with Puget Sound Energy (PSE) for the purchase of PSE's electric system in eastern Jefferson County for $103 Million. The District finalized the acquisition of the electric system in March of 2013 and began providing power services on April 1, 2013. The system serves 18,000 customers in eastern Jefferson County. Total District revenues are expected to increase significantly with the operation of the electric facility. The District has obtained a long term contract with the Bonneville Power Authority (BPA) to provide its lowest cost power.

In 2013, the District acquired loan proceeds of approximately $115M from the United States Department of Agriculture Rural Utility Service to finance the acquisition of the electric system as described above plus additional improvements and transition costs. It has also obtained a line of credit from a local bank as secondary financing source for supplementary and interim financing purposes.

REQUESTS FOR INFORMATION

The basic financial statements, notes and management discussion and analysis are designed to provide a general overview of the District's finances. Questions concerning any of the information provided in this report should be directed to the District at PO Box 929, Port Hadlock, WA 98339-0929.

Public Utility District No. 1 of Jefferson County
Comparative Statement of Net Position
As of December 31, 2012 and 2011

	2012	2011
ASSETS		
Current Assets		
Cash and investments	$ 1,656,369	$ 1,601,591
Receivables (net):	-	-
Accounts	173,718	158,100
Assessments	650,000	960,000
Other current assets	6,208	5,478
TOTAL CURRENT ASSETS	2,486,295	2,725,169
Noncurrent Assets		
Long term portion of assessments receivable	3,218,361	3,551,474
Restricted assets:		
Cash	347,515	370,668
Investments	2,913,468	3,065,600
	6,479,344	6,987,742
Capital Assets		
Utility Plant	30,442,501	27,756,551
Less: Accumulated depreciation	(6,255,128)	(5,680,176)
Total Capital Assets	24,187,373	22,076,375
TOTAL NONCURRENT ASSETS	30,666,717	29,064,117
TOTAL ASSETS	$ 33,153,012	$ 31,789,286
LIABILITIES		
Current Liabilities		
Accounts payable	320,932	47,237
Accrued interest	97,658	88,146
Current portion of long-term debt	660,400	548,862
TOTAL CURRENT LIABILITIES	1,078,990	684,245
Noncurrent Liabilities		
Vacation and sick leave accrual	103,781	72,393
PWTF loans payable	4,483,599	3,071,766
Bonds payable	4,386,609	4,678,420
Notes payable	2,801,496	2,408,594
TOTAL NONCURRENT LIABILITIES	11,775,485	10,231,173
TOTAL LIABILITIES	12,854,475	10,915,418
NET POSITION		
Invested in capital assets - net of related debt	12,130,300	11,647,993
Restricted:		
For debt service	3,013,332	3,065,600
For property tax qualified expenditures	247,652	370,668
Total restricted	3,260,984	3,436,268
Unestricted	4,907,253	5,789,607
TOTAL NET POSITION	$ 20,298,537	$ 20,873,868

The accompanying notes are an integral part of these statements.

Public Utility District No. 1 of Jefferson County

Comparative Statement of Net Position

As of December 31, 2011 and 2010

	2011	2010
ASSETS		
Current Assets		
Cash and investments	$ 1,601,591	$ 2,015,109
Receivables (net):	-	-
Accounts	158,100	167,969
Assessments	960,000	1,560,000
Other current assets	5,478	5,478
TOTAL CURRENT ASSETS	2,725,169	3,748,556
Noncurrent Assets		
Long term portion of assessments receivable	3,551,474	3,820,810
Restricted assets:		
Cash	370,668	206,126
Investments	3,065,600	2,587,293
	6,987,742	6,614,229
Capital Assets		
Utility Plant	27,756,551	27,280,408
Less: Accumulated depreciation	(5,680,176)	(5,183,873)
Total Capital Assets	22,076,375	22,096,535
TOTAL NONCURRENT ASSETS	29,064,117	28,710,764
TOTAL ASSETS	$ 31,789,286	$ 32,459,320
LIABILITIES		
Current Liabilities		
Accounts payable	47,237	114,802
Accrued interest	88,146	120,914
Current portion of long-term debt	548,862	559,855
TOTAL CURRENT LIABILITIES	684,245	795,571
Noncurrent Liabilities		
Vacation and sick leave accrual	72,393	77,967
PWTF loans payable	3,071,766	3,110,533
Bonds payable	4,678,420	4,843,704
Notes payable	2,408,594	2,683,969
TOTAL NONCURRENT LIABILITIES	10,231,173	10,716,173
TOTAL LIABILITIES	10,915,418	11,511,744
NET POSITION		
Invested in capital assets - net of related debt	11,647,993	10,898,474
Restricted:		
For debt service	3,065,600	2,628,865
For property tax qualified expenditures	370,668	164,554
Total restricted	3,436,268	2,793,419
Unestricted	5,789,607	7,255,683
TOTAL NET POSITION	$ 20,873,868	$ 20,947,576

The accompanying notes are an integral part of these statements.

Public Utility District No. 1 of Jefferson County

Comparative Statement of Revenue, Expenses, and Changes in Net Position

For the years ended December 31, 2012 and 2011

	2012	2011
OPERATING REVENUES		
Water fees	$ 1,775,657	$ 1,574,624
System development fees	61,250	40,950
Other charges for services	75,179	152,756
TOTAL OPERATING REVENUES	1,912,086	1,768,330
OPERATING EXPENSES		
Personnel services	924,065	767,178
Purchase of services	118,964	97,183
Materials and supplies	221,728	139,732
Property and liability insurance	47,076	43,524
Taxes and licenses	109,246	94,083
Auto and travel	29,655	41,779
Professional fees	102,323	66,869
Office and administrative	169,437	81,039
Depreciation	574,952	496,303
TOTAL OPERATING EXPENSES	2,297,446	1,827,690
NET OPERATING INCOME (LOSS)	(385,360)	(59,360)
NONOPERATING REVENUES (EXPENSES)		
Federal and State grant revenue	-	-
Property taxes	561,551	553,611
Public power preliminary costs	(406,979)	(389,819)
Regional studies	(105,644)	(57,289)
Assessment interest income	186,574	184,195
Investment interest income	1,427	24,714
Timber harvest tax and other	11,510	69,100
Interest expense	(438,410)	(398,860)
TOTAL NONOPERATING REVENUES AND EXPENSES	(189,971)	(14,348)
CHANGE IN NET POSITION	(575,331)	(73,708)
Net Position, January 1	20,873,868	20,947,576
NET POSITION, DECEMBER 31	$ 20,298,537	$ 20,873,868

The accompanying notes are an integral part of these statements.

Public Utility District No. 1 of Jefferson County

Comparative Statement of Revenue, Expenses, and Changes in Net Position

For the years ended December 31, 2011 and 2010

	2011	2010
OPERATING REVENUES		
Water fees	$ 1,574,624	$ 1,569,426
System development fees	40,950	29,400
Other charges for services	152,756	225,411
TOTAL OPERATING REVENUES	1,768,330	1,824,237
OPERATING EXPENSES		
Personnel services	767,178	681,345
Purchase of services	97,183	159,849
Materials and supplies	139,732	147,884
Property and liability insurance	43,524	43,039
Taxes and licenses	94,083	76,606
Auto and travel	41,779	34,411
Professional fees	66,869	54,710
Office and administrative	81,039	48,864
Depreciation	496,303	407,531
TOTAL OPERATING EXPENSES	1,827,690	1,654,239
NET OPERATING INCOME (LOSS)	(59,360)	169,998
NONOPERATING REVENUES (EXPENSES)		
Federal and State grant revenue	-	13,600
Property taxes	553,611	376,227
Public power preliminary costs	(389,819)	(597,978)
Regional studies	(57,289)	(325,744)
Assessment interest income	184,195	206,670
Investment interest income	24,714	11,012
Timber harvest tax and other	69,100	22,230
Interest expense	(398,860)	(412,775)
TOTAL NONOPERATING REVENUES AND EXPENSES	(14,348)	(706,758)
CHANGE IN NET POSITION	(73,708)	(536,760)
Net Position, January 1	20,947,576	21,420,553
Prior period adjustment		63,783
Net Position, January 1 (Restated)	20,947,576	21,484,336
NET POSITION, DECEMBER 31	$ 20,873,868	$ 20,947,576

The accompanying notes are an integral part of these statements

Public Utility District No. 1 of Jefferson County

Comparative Statement of Cash Flows

For the years ended December 31, 2012 and 2011

	2012	2011
Cash flows from operating activities		
Cash received from customers	$ 1,957,718	$ 1,778,199
Cash payments for goods and services	(524,311)	(631,351)
Cash payments to employees	(955,080)	(761,604)
Net cash provided (used) by operating activities	478,327	385,244
Cash flows from noncapital financing activities		
Payments received on assessments	643,113	869,336
Net nonoperating revenues (expenses)	60,438	175,603
Net cash provided by noncapital financing activities	703,551	1,044,939
Cash flows from capital financing activities		
Proceeds on new debt	2,257,508	228,007
Principal payments on debt	(705,905)	(734,501)
Interest paid	(428,898)	(427,124)
Payments for capital acquisitions	(2,613,091)	(476,143)
Net cash provided (used) by capital financing activities	(1,490,386)	(1,409,761)
Cash flows from investing activities		
Receipts of interest	188,001	208,909
Net cash provided by investing activities	188,001	208,909
Net increase (decrease) in cash and cash equivalents	(120,507)	229,331
Cash and investments-January 1	5,037,859	4,808,528
Cash and investments-December 31	$ 4,917,352	$ 5,037,859
Cash and equivalents at year end consist of:		
Operating cash and investments	1,656,369	1,601,591
Restricted cash and investments	3,260,983	3,436,268
	$ 4,917,352	$ 5,037,859
Reconciliation of operating income to net cash provided (used) by operating activities:		
Operating income (loss)	(385,360)	(59,360)
Adjustments to reconcile operating income to net cash provided (used) by operating activities:		
Depreciation expense	574,952	496,303
(Increase) decrease in accounts receivable	(15,618)	9,869
Increase (decrease) in accounts payable	304,353	(61,568)
Net cash provided by operating activities	$ 478,327	$ 385,244

The accompanying notes are an integral part of these statements

Public Utility District No. 1 of Jefferson County

Comparative Statement of Cash Flows

For the years ended December 31, 2011 and 2010

	2011	2010
Cash flows from operating activities		
Cash received from customers	$ 1,778,199	$ 1,800,334
Cash payments for goods and services	(631,351)	(572,703)
Cash payments to employees	(761,604)	(675,348)
Net cash provided (used) by operating activities	385,244	552,283
Cash flows from noncapital financing activities		
Payments received on assessments	869,336	815,291
Net nonoperating revenues (expenses)	175,603	(525,265)
Receipt of federal and state grants	-	13,600
Net cash provided by noncapital financing activities	1,044,939	303,626
Cash flows from capital financing activities		
Proceeds on new debt	228,007	-
Principal payments on debt	(734,501)	(560,397)
Interest paid	(427,124)	(417,920)
Payments for capital acquisitions	(476,143)	(199,409)
Net cash provided (used) by capital financing activities	(1,409,761)	(1,177,726)
Cash flows from investing activities		
Receipts of interest	208,909	217,682
Net cash provided by investing activities	208,909	217,682
Net increase (decrease) in cash and cash equivalents	229,331	(104,135)
Cash and investments-January 1	4,808,528	4,912,663
Cash and investments-December 31	$ 5,037,859	$ 4,808,528
Cash and equivalents at year end consist of:		
Operating cash and investments	1,601,591	2,015,109
Restricted cash and investments	3,436,268	2,793,419
	$ 5,037,859	$ 4,808,528
Reconciliation of operating income to net cash provided (used) by operating activities:		
Operating income (loss)	(59,360)	169,998
Adjustments to reconcile operating income to net cash provided (used) by operating activities:		
Depreciation expense	496,303	407,531
(Increase) decrease in accounts receivable	9,869	(23,903)
Increase (decrease) in accounts payable	(61,568)	(1,343)
Net cash provided by operating activities	$ 385,244	$ 552,283

The accompanying notes are an integral part of these statements.

PUBLIC UTILITY DISTRICT NO. 1 OF JEFFERSON COUNTY
NOTES TO FINANCIAL STATEMENTS
For the Years Ended December 31, 2012, 2011 and 2010

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

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of Public Utility District No. 1 of Jefferson County (District) conform to generally accepted accounting principles (GAAP) as applicable to proprietary funds of governmental utilities. The following is a summary of the most significant policies (including identification of those policies which result in material departures from generally accepted accounting principles):

Reporting Entity

The District is a municipal corporation governed by an elected three member board. As required by generally accepted accounting principles, management has considered all potential component units in defining the reporting entity. The District has no component units.

Basis of Accounting and Presentation

The accounting records of the District are maintained in accordance with methods prescribed by the State Auditor under the authority of Chapter 43.09 RCW.

The District uses the Uniform System of Accounts for Class A and B Water Utilities as prescribed by the National Association of Regulatory Utility Commissioners. The District's predominant business activity is the provision of water service to the residents of unincorporated Jefferson County. The accompanying financial statements include the financial position and results of operations of all enterprise operations which the District manages. The financial statements include, as well, the assets and liabilities of all funds for which the District has a custodial or trust responsibility.

The District uses the accrual basis of accounting where revenues are recognized when earned and expenses are recognized when incurred. Capital asset purchases are capitalized and long-term liabilities are accounted for in the appropriate funds.

Unbilled utility service receivables are recorded at year end.

The District distinguishes between operating and non-operating revenues and expenses. Operating revenues and expenses are defined as related to the sale of water to customers and to other services that are usually provided under standard rate schedules or by contractual arrangements. Operating expenses for the District include the cost of sales and services, administrative expenses, utility taxes, and depreciation on capital assets. Non-operating revenues and expenses include property tax revenues, preliminary public power study costs, regional studies, assessment revenues and expenses, interest income and expense, and other items not usually directly related to the provision of water or sewer service.

The accounting policies of the District conform to generally accepted accounting principles applicable to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard setting body for establishing governmental accounting and financial reporting principles. The District has applied all applicable GASB pronouncements including GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*.

Deposits and investments

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

Cash include cash on hand, demand deposits and certain short-term investments held in the Jefferson County treasury. The Jefferson County Treasurer acts as the Treasurer of the District and as such invests cash in excess of current requirements in various interest-bearing securities which are disclosed as a part of the District's investments.

Restricted Assets

In accordance with bond resolutions, related agreements and laws, separate restricted accounts have been established. These assets are restricted for specific uses including debt service, bond reserve and capital additions, and are classified as current or noncurrent assets, as appropriated.

Because of certain bond covenants the District is required to establish and maintain prescribed amounts of resources (cash and investments) that can be used only to service outstanding debt. These required reserves are maintained by the County Treasurer in restricted funds attributable to each debt instrument.

Receivables

All receivables are reported at their gross value and where appropriate, are reduced by the estimated portion that is expected to be uncollectible. Assessments receivable represent the future amounts due on improvement district assessments. Grant receivables represent amounts due from Federal, State and other government entities regarding reimbursement for costs incurred under grant agreements

Capital Assets and Depreciation

Property, plant, and equipment is stated at cost. Assets with a useful life of more than one year and a cost of more than $1,000 are capitalized. Where cost could not be determined from available records, estimated historical cost was used to record the estimated value of the assets. Assets acquired by gift or bequest are recorded at their estimated fair market value at the date of transfer. Interest incurred for interim financing during the construction process is capitalized and included in the cost of the related asset.

Depreciation of exhaustible capital assets used by the District is charged as an expense against operations, and accumulated depreciation is reported on the balance sheet. Depreciation has been provided over the estimated useful lives using the straight-line method.

The estimated useful lives for each major class of depreciable capital assets are as follows:

Buildings	25-30 years
Equipment	5-10 years
Water & sewer systems	25-45 years
Office & computer equipment	3-7 years

Property tax revenues

Property taxes are levied and collected by the Jefferson County Treasurer. They are recognized as revenue when collected.

Vacation, sick leave and other compensated absences

District employees are entitled to certain compensated absences based on their length of employment and subject to union agreements. With minor exceptions, compensated absences either vest or accumulate when they are earned. The amounts accrued as of December 31, 2012, 2011, and 2010 were $103,781, $72,393, and $77,967, respectively.

Post-employment healthcare benefits

The District does not provide post-employment healthcare benefits except those mandated by the Consolidated Omnibus Budget Reconciliation Act (COBRA). The requirements established by COBRA are fully funded by employees who elect coverage under the Act, and no direct costs are incurred by the District.

NOTE 2 –CASH, DEPOSITS AND INVESTMENTS

All bank deposits of the District are entirely insured. The Jefferson County Treasurer acts as the Treasurer for the District and as such invests funds not needed for current operations. As of December 31, 2012, 2011 and 2010 all investments of the District were invested through the Jefferson County Treasurer's Office, primarily in the State of Washington Investment Pool. The District has no investments in derivative instruments. Investments are valued at cost which is substantially equivalent to their current market value. All investments in Certificates of Deposit have maturities of one year or less.

Risk management of investment instruments is as follows:

Interest Rate Risk – The District's exposure to fair value losses arising from increasing interest rates is managed by limiting the maturity to between six months and one year.

Credit Risk – Through its investment policy the County Treasurer manages credit risk by restricting County investments to obligations of the U.S. Treasury, U.S. Government agencies and instrumentalities, primary certificates of deposit issued by qualified public depositories designated by the Washington Public Deposit Protection Commission and the Washington State local government investment pool. Over 60% of the County Treasurer's investments are in the Washington State investment pool.

Custodial Credit Risk – Custodial credit risk is the risk that in the event of a bank failure the District's (County Treasurer's) deposits may not be recovered. As of December 31, 2012, 2011 and 2010 all investments are insured by either Federal Depository Insurance or the Washington Public Deposit Protection Commission.

NOTE 3 – CAPITAL ASSETS AND DEPRECIATION

Following is a summary of 2012, 2011 and 2010 changes in capital assets:

2012

	Balance 1/1/2012	Addtions	Transfers & Deletions	Balance 12/31/2012
Capital assets not being depreciated				
Land	$ 2,265,000			$ 2,265,000
Construction in progress	515,990	555,299		1,071,289
Capital assets being depreciated				
Buildings	225,207	12,832		238,039
Office/computer equipment	109,084	18,222		127,306
Equipment	247,184	116,558		363,742
Water and sewer systems	24,394,086	1,983,039		26,377,125
Less: accumulated depreciation	(5,680,176)	(574,952)		(6,255,128)
Totals	$ 22,076,375	$ 2,110,998	$ -	$ 24,187,373

2011

	Balance 1/1/2011	Addtions	Transfers & Deletions	Balance 12/31/2011
Capital assets not being depreciated				
Land	$ 2,265,000			$ 2,265,000
Construction in progress	60,186	459,694	3,890	515,990
Capital assets being depreciated				
Buildings	225,207			225,207
Office/computer equipment	96,780	12,304		109,084
Equipment	243,039	4,145		247,184
Water and sewer systems	24,390,196	3,890		24,394,086
Less: accumulated depreciation	(5,183,873)	(496,303)		(5,680,176)
Totals	$ 22,096,535	$ (16,270)	$ 3,890	$ 22,076,375

2010				
	Balance 1/1/2010	Addtions	Transfers & Deletions	Balance 12/31/2010
Capital assets not being depreciated				
Land	$ 2,265,000			$ 2,265,000
Construction in progress	4,575,751		4,515,565	60,186
Capital assets being depreciated				
Buildings	225,207			225,207
Office/computer equipment	96,780	12,304		96,780
Equipment	239,574	4,145		243,039
Water and sewer systems	19,678,687	3,890		24,390,196
Less: accumulated depreciation	(4,776,342)	(445,050)		(5,183,873)
Totals	$ 22,304,657	$ (424,711)	$ 4,515,565	$ 22,096,535

NOTE 4 – PENSION PLANS

Substantially all District full-time and qualifying part-time employees participate in one of the statewide retirement systems administered by the Washington State Department of Retirement Systems under cost sharing multiple-employer defined benefit public employee retirement plans. The Department of Retirement Systems, a department within the primary government of the State of Washington, issues a publicly available comprehensive annual financial report containing historical trend information and may be obtained from the Department of Retirement Systems, Administrative Services Division, P.O. Box 48380, Olympia, WA 98504.

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 combination defined benefit / defined contribution plan.

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 in national higher education retirement programs; judges of district and municipal courts; and employees of local governments. PERS participants who joined the system by September 30, 1977 are Plan 1 members. Those who joined on or after October 1, 1977 and before September 1, 2002 are Plan 2 members and those who joined on or after September 1, 2002 have the choice of Plan 2 or Plan 3.

PERS retirement benefit provisions are established in state statute and may be amended only by the State Legislature.

Plan 1 retirement benefits are vested after an employee completes five years of eligible service. Plan 1 members are eligible for retirement at any age 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 annual pension is 2 percent of the average final compensation per year of service, capped at 60 percent. The average final compensation is based on the greatest compensation during any 24 eligible consecutive compensation months.

If qualified, after reaching the age of 66 a cost-of-living allowance is granted based on years of service credit and is capped at 3 percent annually.

Plan 2 retirement benefits are vested after an employee completes five years of eligible service. Plan 2 members may retire at the age of 65 with five years of service, or at the age of 55 with 20 years of service, with an allowance of 2 percent of the average final compensation per year of service. The average final compensation is based on the greatest compensation during any eligible consecutive 60-month period. Plan 2 retirements prior to the age of 65 receive reduced benefits. If retirement is at age 55 or older with at least 30 years of service, a 3 percent per year reduction applies; otherwise an actuarial reduction will apply. There is no cap on years of service credit; and a cost-of-living allowance is granted (indexed to the Seattle Consumer Price Index), capped at 3 percent annually.

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 benefit calculated at 1 percent of the average final compensation per year of service. The average final compensation is based on the greatest compensation during any eligible consecutive 60-month period. Plan 3 members become eligible for retirement if they have: at least ten years of service; or five years including twelve months that were earned after age 54; or five service credit years earned in PERS Plan 2 prior to June 1, 2003. Plan 3 retirements prior to the age of 65 receive reduced benefits. If retirement is at age 55 or older with at least 30 years of service, a 3 percent per year reduction applies; otherwise an actuarial reduction will apply. There is no cap on years of service credit, and Plan 3 provides the same cost-of-living allowance as Plan 2.

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 Employee Retirement Benefits Board.

There are 1,169 participating employers in PERS. Membership in PERS consisted of the following as of the latest actuarial valuation date for the plans of June 30, 2011:

Retirees and beneficiaries receiving benefits	76,899
Terminated plan members entitled to but not receiving benefits	28,860
Active plan members vested	105,521
Active plan members nonvested	51,005
Total	**262,285**

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 percent for state agencies and local government unit employees, and at 7.5 percent for state government elected officers. 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. PERS Plan 3 defined contribution is a non-contributing plan for employers. Employees who participate in the defined contribution portion of PERS Plan 3 do not contribute to the defined benefit portion of PERS Plan 3. The Employee Retirement Benefits Board sets Plan 3 employee contribution rates. Six rate options are available ranging from 5 to 15 percent; two of the options are graduated rates dependent on the employee's age. The methods used to determine the contribution requirements are established under state statute in accordance with chapters 41.40 and 41.45 RCW.

The required contribution rates expressed as a percentage of current-year covered payroll, as of December 31, 2011 and 2012, were as follows:

	PERS Plan 1	PERS Plan 2	PERS Plan 3
Employer*	5.31%	5.31%	5.31%
Employee	6.00%	4.59%	***

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

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

	Employee	Employer
2010	28,024	49,378
2011	31,455	52,965
2012	33,293	56,060

Currently none of the District's employees are included in the PERS Plan 1.

NOTE 5 - SELF INSURANCE

The District is a member of the Public Utility Risk Management Services (PURMS) Self-Insurance fund. PURMS is a public entity risk pool organized December 30, 1976, pursuant to the provisions of the Revised Code of Washington, Chapter 54.16.200, and interlocal government agreements. The program's general objectives are to formulate, develop, and administer, on behalf of the member public utilities, a program of insurance, to obtain lower costs for that coverage, and to develop a comprehensive loss control program.

PURMS consists of 20 members. The risks shared by the members are defined in the Self Insurance Agreement. PURMS consists of three pools for liability, property and health and welfare coverage. The pools operate independently of one another and all members do not participate in all pools. The District participates in the liability, property and health and welfare pools.

The pools are governed by a Board of Directors comprised of one designated representative from each participating member. The administrator and elected Administrative Committee conduct the business of the pools.

The pools are fully funded by its current and former members. Members that withdraw from the fund are still responsible for their share of the assessments for occurrences while they were members. Likewise terminated members continue to receive coverage for the time they were members.

Each of PURMS Risk Pools is audited annually by the State Auditor's Office. In addition, as required by State regulations, PURMS provides quarterly financial reports to the State Risk Manager reflecting the claims and administrative expenses of the Risk Pools, and bi-annually, the State Risk Manager performs its own audit of PURMS' Risk Pools. Finally, on an annual basis, PURMS engages the services of the accounting firm of Moss Adams to perform a claims audit for each of the Risk Pools.

Liability Risk Pool

The liability risk pool has a $1 million liability coverage limit per occurrence. In addition, the fund maintains $35 million of excess general liability insurance and $35 million of professional liability insurance over the $1 million retention. A second layer of excess general liability insurance of $25 million is also maintained over the first layer of $35 million. The fund maintains $35 million in directors and officers liability coverage with a retention of $500,000. The deductible is $250.

Liability assessments are levied at the beginning of each calendar year to replenish the reserves to the designated level or at any time during the year that the actual reserves drop to $500,000 less than the designated level. The District paid assessments in 2012 totaling $6,398.91. The current designated reserve level is $3 million.

Property Risk Pool

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

The designated property pool reserve balance is $750,000. Property assessments are levied at the beginning of each calendar year to replenish the reserves to the designated level and at any time during the year that the actual reserves drop below $500,000.

Health and Welfare Risk Pool

The District participates in the PURMS Health and Welfare Risk Pool. PURMS provides health and welfare insurance coverage for the Employees of each of its Members participating in the Health & Welfare Risk Pool ("H&W Pool") in accordance with the terms of the Health &

Welfare Coverage of the SIA ("H&W Coverage") and the terms of each Member's respective Coverage Booklet provided to its Employees.

The H&W Pool's operations are financed by assessments of its participants. Each month, each Participant of the H&W Pool is assessed for: (a) the cost the H&W Pool incurred during the preceding month for the H&W Claims for such Member's Employees ("H&W Claims Costs"); and (b) for such Member's share of Shared H&W Costs. "Shared H&W Costs" consist of administrative expenses incurred by the H&W Pool, premiums for Stop-Loss Insurance, PPO Charges and Shared H&W Claims.

The exposure of each Participant is limited by two different pairs of stop-loss points. For 2012, the Individual Stop Loss Point was $225,000 per Employee and the Aggregate Stop Loss Point was $14,059,584 for the combined Claims Costs of the Employees of all Participants of the H&W Pool.

NOTE 6 – LONG TERM DEBT

Long term debt of the District as of December 31, 2012, 2011 and 2010 consists of Revenue Bonds, private debt for the purchase of property and Public Works Trust Fund & Drinking Water loans as follows:

	Issue Date	Issue Amount	Outstanding 2012	Outstanding 2011	Outstanding 2010
Revenue Bonds					
LUD 11	4/99	$ 1,090,000	$ 590,000	$ 630,000	$ 670,000
LUD 13	11/97	$ 155,000	-	10,000	20,000
LUD 14	4/09	$ 2,000,000	1,739,000	1,828,000	1,915,000
Tri-Area (USDA)	4/03	$ 3,043,250	2,718,009	2,759,282	2,798,559
	Subtotals		5,047,009	5,227,282	5,403,559
Notes Payable					
LUD 15	6/08	$ 1,053,076	549,372	764,205	963,189
Kala Point Water	10/12	$ 672,859	672,859	-	-
Peterson Lake Loan	3/06	$ 2,000,000	1,579,265	1,644,381	1,720,780
	Subtotals		2,801,496	2,408,586	2,683,969
Public Works Trust Fund & Drinking Water Loans					
PW-99-691-ELP-301	9/99	$ 97,663	35,979	41,121	21,092
PW-00-65120-008	3/03	$ 157,168	74,448	82,720	46,263
PW-02-691-066	10/02	$ 1,186,719	418,842	488,649	90,992
PW-05-691-024	5/05	$ 948,924	657,204	1,523,289	558,456
PW-05-691-025	6/06	$ 2,000,000	1,414,483	707,980	1,632,095
DM10-952-018	8/11	$ 956,857	956,857	-	761,636
DM12-952-091	11/12	$ 697,779	697,779	228,007	-
	Subtotals		4,255,592	3,071,766	3,110,534
	Totals		$12,104,097	$10,707,634	$11,198,062

Changes in Long-term Liabilities

During the years ended December 321, 2012, 2011 and 2010 the following transpired in long-term liabilities:

	Beginning Balance 1/1/2012	Additions	Reductions	Ending Balance 12/31/2012	Due Within One Year
Public Works Trust Fund Loans	$ 3,071,766	$ 2,257,508	$ 1,073,682	$ 4,255,592	$ 294,693
Notes Payable	1,445,397	1,636,048	279,949	2,801,496	191,777
Bonds Payable	6,190,471	-	1,143,462	5,047,009	173,929
Total Long-term Liabilities	$ 10,707,634	$ 3,893,556	$ 2,497,093	$ 12,104,097	$ 660,399

	Beginning Balance 1/1/2011	Additions	Reductions	Ending Balance 12/31/2011	Due Within One Year
Public Works Trust Fund Loans	$ 3,110,533	$ 228,007	$ 266,774	$ 3,071,766	$ 245,950
Notes Payable	1,720,780	-	275,383	1,445,397	122,851
Bonds Payable	6,366,748	-	176,277	6,190,471	180,061
Total Long-term Liabilities	$ 11,198,061	$ 228,007	$ 718,434	$ 10,707,634	$ 548,862

	Beginning Balance 1/1/2010	Additions	Reductions	Ending Balance 12/31/2010	Due Within One Year
Public Works Trust Fund Loans	$ 3,374,426	$ -	$ 263,893	$ 3,110,533	$ 266,774
Notes Payable	1,782,166	-	61,386	1,720,780	76,399
Bonds Payable	6,601,866	-	235,118	6,366,748	375,261
Total Long-term Liabilities	$ 11,758,458	$ -	$ 560,397	$ 11,198,061	$ 718,434

Revenues of the District are pledged to pay related debt. Additionally, all revenue bonds require a portion of retained earnings to be reserved for future debt retirement. The Jefferson County Treasurer has established sufficient reserves and the District is in compliance with all debt covenants. The District has no arbitrage liability with respect to its bond issues. The District has no capital leases as of December 31, 2012. Operating leases for office equipment represent annual obligations of $12,960.

NOTE 7 – SHORT TERM DEBT

The District did not use short term debt to finance any activities for the years ended December 31, 2012, 2011 and 2010.

NOTE 8 – CONTINGENCIES AND LITIGATION

In the opinion of the management, the District insurance policies and reserves are adequate for all known or pending claims.

The District participates in a number of federal and state assisted programs. These grants are subject to audit which could result in requests for reimbursement to the grantor agencies for disallowed expenditures. District management believes that such disallowances, if any, will be immaterial.

In 2010, the District was is the defendant in a class action lawsuit alleging that it illegally levied property tax within the city limits of Port Townsend. The judge ruled in favor of the District. The court of appeals ruled in favor of the District. Although the case could be referred to the Supreme Court, it is the opinion of council that the case is now closed.

NOTE 9 – SUBSEQUENT EVENTS

In May, 2010 the District entered into an agreement with Puget Sound Energy (PSE) for the purchase of PSE's electric system in eastern Jefferson County for $103 Million. The District took over the electric operations prior to the issuance of these financial statements in April, 2013. The system serves 18,000 customers in eastern Jefferson County.

Subsequent to year end the District has consummated the purchase of PSE assets and has received funding from the United States Department of Agriculture Rural Utility Service in the amount of $115 Million. The District has signed a power sales agreement with the Bonneville Power Administration (BPA) qualifying it for the federal agency's lowest power rates starting June 30, 2013 and receiving power from BPA as of April 1, 2013.

NOTE 10 – PARTICIPATION IN NORTHWEST OPEN ACCESS NETWORK, INC. (NoaNet)

The District, along with other Washington State public entities, is a member of Northwest Open Access Network, Inc. (DBA NoaNet), a Washington nonprofit mutual corporation. NoaNet was incorporated in February 2000 to provide a broadband communications backbone over public benefit fibers leased from BPA throughout Washington. 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%. Each member of NoaNet has entered into a Repayment Agreement to guarantee the debt of NoaNet. The District's guarantee is limited to its 0.14% interest or $15,169. In 2011 NoaNet issued refunding bonds providing a total net value savings of $1,590,000. As a member of NoaNet, the District has guaranteed certain portions of NoaNet debt based on its proportionate share.

Financial statements for NoaNet may be obtained by writing to: Northwest Open Access Network, 21507 42nd Avenue South, #J-4, SeaTac, WA 98198. Information may also be obtained from the NoaNet web site at www.noanet.net.

NOTE 11 – PRIOR PERIOD ADJUSTMENT

Adjustment of prior period errors in 2010 are recoded as a correction in beginning net position. The adjustment primarily represent errors in allocation, principal and interest, of assessments receivable.

Public Utility District #1 of Jefferson County
Schedule of Expenditures of Federal Awards
For the Year Ended December 31, 2012

Federal Agency (Pass-Through Agency)	Federal Program	CFDA Number	Other Award Number	Expenditures: From Pass-Through Awards	Expenditures: From Direct Awards	Expenditures: Total	Note
Environmental Protection Agency Office of Water (WA Department of Commerce)	Capitalization Grants for Drinking Water State Revolving Funds	66.468	DM10-952-018	789,975		789,975	1,2
Environmental Protection Agency Office of Water (WA Department of Commerce)	Capitalization Grants for Drinking Water State Revolving Funds	66.468	DM12-952-091	835,146		835,146	1,2
			Total CFDA 66.468	**1,625,121**	**0**	**1,625,121**	
			Total Federal Awards Expended:	**1,625,121**	**0**	**1,625,121**	

The accompanying notes are an integral part of these statements.

Note 1 - Basis of Presentation

The accompanying Schedule of Expenditures of Federal Awards (the Schedule) includes the federal grant activity of Public Utility District #1 of Jefferson County (the District) under programs of the federal government for the year ended December 31, 2012. The information in this Schedule is presented in accordance with the requirement of the Office of Management and Budget (OMB) Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards. Because the Schedule presents only a selected portion of the operations of the District, it is not intended to and does not present the financial position, changes in net position, or cash flows of the District.

Note 2 - Summary of Significant Accounting Policies

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

CORRECTIVE ACTION PLAN FOR FINDINGS REPORTED UNDER OMB CIRCULAR A-133

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

This schedule presents the corrective action planned by the auditee for findings reported in this report in accordance with OMB Circular A-133. The information in this schedule is the representation of the Jefferson County Public Utility District No. 1.

Finding ref number:	**Finding caption:**
2012-001	The District's internal controls over financial accounting and financial statement preparation are inadequate to ensure accurate and complete financial reporting.
Name, address, and telephone of auditee contact person: Jim Parker 310 Four Corners Road Port Townsend, WA 98368 (360) 385-8340	
Corrective action the auditee plans to take in response to the finding: *The PUD is integrating and implementing new accounting and billing software with improved control measures to provide for better financial accountability and reporting. The PUD is hiring and contracting with needed skilled individuals and is and will continue training appropriate PUD employees to ensure that accurate and supported financial statements are completed in a timely and detailed manner. Improved controls will be developed to ensure secondary review of District activities and financial reporting requirements is being done; the timely submittal of statements and schedules; accurate records are maintained; appropriate cash balance and activity reconciling are performed; and that journal entries are performed timely, are adequately supported and are properly reviewed and authorized. Capital assets are being set up in the new accounting software to allow for proper tracking and so that depreciation can be accurately calculated.*	
Anticipated date to complete the corrective action: January 2017	

Finding ref number:	**Finding caption:**
2012-002	The District's internal controls were inadequate to ensure accurate and timely federal grant reporting, resulting in a missed federal audit deadline.
Name, address, and telephone of auditee contact person: Jim Parker 310 Four Corners Road Port Townsend, WA 98368 (360) 385-8340	
Corrective action the auditee plans to take in response to the finding: *The PUD will ensure the new Chief Financial Officer and/or the Controller will have the necessary training and/or experience in State and Federal grant accounting and reporting requirements. They will be responsible for implementing and enforcing improved internal controls.*	
Anticipated date to complete the corrective action: January 2017	

Finding ref number:	**Finding caption:**
2012-003	The District did not have adequate internal controls to ensure compliance with federal suspension and debarment requirements.
Name, address, and telephone of auditee contact person: Jim Parker 310 Four Corners Road Port Townsend, WA 98368 (360) 385-8340	
Corrective action the auditee plans to take in response to the finding: *The PUD will ensure the new Chief Financial Officer and/or the Controller will have the necessary training and/or experience in State and Federal grant accounting and reporting requirements. They will be responsible for implementing and enforcing improved internal controls.*	
Anticipated date to complete the corrective action: January 2017	

ABOUT THE STATE AUDITOR'S OFFICE

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

We work with our audit clients and citizens to achieve our vision of government that works for citizens, by helping governments work better, cost less, deliver higher value, and earn greater public trust.

In fulfilling our mission to hold state and local governments accountable for the use of public resources, we also hold ourselves accountable by continually improving our audit quality and operational efficiency and developing highly engaged and committed employees.

As an elected agency, the State Auditor's Office has the independence necessary to objectively perform audits and investigations. Our audits are designed to comply with professional standards as well as to satisfy the requirements of federal, state, and local laws.

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

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

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

Contact information for the State Auditor's Office	
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