Washington State Auditor's Office

Financial Statements Audit Report

Public Utility District No. 1 of Franklin County

Audit Period
January 1, 2007 through December 31, 2007

Report No. 74434

Issue Date
April 21, 2008

WASHINGTON
BRIAN SONNTAG
STATE AUDITOR

Washington State Auditor
Brian Sonntag

April 21, 2008

Board of Commissioners
Public Utility District No. 1 of Franklin County
Pasco, Washington

Report on Financial Statements

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

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

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

Sincerely,

BRIAN SONNTAG, CGFM
STATE AUDITOR

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January 1, 2007 through December 31, 2007

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

Public Utility District No. 1 of Franklin County
January 1, 2007 through December 31, 2007

Board of Commissioners
Public Utility District No. 1 of Franklin County
Pasco, Washington

We have audited the basic financial statements of Public Utility District No. 1 of Franklin County, Washington, as of and for the years ended December 31, 2007 and 2006, and have issued our report thereon dated April 10, 2008.

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

INTERNAL CONTROL OVER FINANCIAL REPORTING

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

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the District's ability to initiate, authorize, record, process or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the District's financial statements that is more than inconsequential will not be prevented or detected by the District's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

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

COMPLIANCE AND OTHER MATTERS

As part of obtaining reasonable assurance about whether the District's financial statements are free of material misstatement, we performed tests of 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*.

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

BRIAN SONNTAG, CGFM
STATE AUDITOR

April 10, 2008

Independent Auditor's Report on Financial Statements

Public Utility District No. 1 of Franklin County
January 1, 2007 through December 31, 2007

Board of Commissioners
Public Utility District No. 1 of Franklin County
Pasco, Washington

We have audited the accompanying basic financial statements of Public Utility District No. 1 of Franklin County, Washington, as of and for the years ended December 31, 2007 and 2006, as listed on page 5. These financial statements are the responsibility of the District's management. Our responsibility is to express opinions on these financial statements based on our 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Public Utility District No. 1 of Franklin County, as of December 31, 2007 and 2006, and the changes in financial position and, where applicable, cash flows thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

The management's discussion and analysis on pages 6 through 9 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

BRIAN SONNTAG, CGFM
STATE AUDITOR

April 10, 2008

Financial Section

Public Utility District No. 1 of Franklin County
January 1, 2007 through December 31, 2007

REQUIRED SUPPLEMENTAL INFORMATION

BASIC FINANCIAL STATEMENTS

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion and analysis of the financial results of Public Utility District No.1 of Franklin County (the District) provide an overview of the utility's financial activities for the year ended December 31, 2007. This discussion is designed to be used in conjunction with the financial statements and notes, which follow this section.

FINANCIAL HIGHLIGHTS

- The District continues to experience robust growth in retail loads in 2007. With a 5% rate decrease effective January 1, 2007, the expectation would be that retail revenues would decrease; however, because of the growth retail revenues increased by approximately $50,000.

- Natural gas sales decreased by approximately $1.7 million. Gas sales are subject to market conditions related to both price and the type of hedging instrument used to minimize exposure to risk. In 2007 the District's hedging strategy shifted from buying and selling physical gas to the utilization of financial hedging instruments, which often times is not settled with a physical sale or purchase.

- Combustion turbine O&M expense increased by approximately $1 million in 2007. In 2007 the District made a one time payment to assign the remaining term of a 15 year gas capacity contract. This permanent assignment will save the District approximately $800 thousand per year.

- Interest income increased more than $600,000 due to the higher investment balances maintained throughout the year.

- On the balance sheet side the increase in current assets of approximately $7.5 million and the corresponding increase in long-term liabilities is the result of a new bond issue that provided $12.8 million in bond proceeds. The bond proceeds were earmarked for the rebuild of an outdated transmission line and an automated meter reading system for the District.

OVERVIEW OF THE FINANCIAL STATEMENTS

This section of the annual report consists of basic financial statements and the notes to the financial statements.

Basic Financial Statements

The financial statements of the District are designed to provide readers with a broad overview of the District's finances similar to a private-sector business. They are prepared using the accrual basis of accounting in accordance with generally accepted accounting principles. Under this basis of accounting, revenues are recognized in the period in which they are earned and expenses are recognized in the period in which they are incurred, regardless of the timing of related cash flows. These statements offer short and long-term financial information about District activities.

The ***Balance Sheet*** presents the District's assets and liabilities, with the difference between the two reported as Net Assets (Equity). The Balance Sheet provides information about the nature and amount of investments in resources (assets), and the obligations to creditors (liabilities). Equity increases when revenues exceed expenses.

The ***Statement of Revenues, Expenses, and Changes in Net Assets*** reports the revenues and expenses during the periods indicated. The ***Statement of Cash Flows*** provides information about the District's cash receipts and payments for operations, as well as funds provided and used in investing and financing activities.

Notes to the Financial Statements

The notes to the financial statements provide additional information that is essential to gain a full understanding of the figures provided in the financial statements.

FINANCIAL ANALYSIS OF THE DISTRICT AS A WHOLE

One of the most important questions asked about the District's finances is, "Is the District, as a whole, better off or worse off as a result of the year's activities?" The Balance Sheet and the Statement of Revenues, Expenses, and Net Assets report information about the District's activities in a way that helps answer this question. These two statements report the net assets of the District and the changes in them. The District's Net Assets – the differences between assets and liabilities – is one way to measure financial health or financial position. Over time, increases or decreases in the District's net assets are one indicator of whether its financial health is improving or deteriorating. However, other non-financial factors such as changes in economic conditions, customer growth, and legislative mandates should also be considered.

In 2007, the overall financial position of the District improved. The District's total net assets increased last year by approximately $11.2 million. The analysis below focuses on the District's net assets and changes in net assets during the year.

No restrictions or commitments affect the availability of future funding.

Net Assets

	2007	2006	2005	2006 to 2007 Change
Current and Other Assets	$ 50,547,847	$ 42,541,647	$ 39,255,204	18.82%
Capital Assets	$ 154,466,031	$ 139,074,790	$ 130,402,842	11.07%
Accumulated Depreciation	$ (48,189,839)	$ (44,111,778)	$ (39,588,417)	9.24%
Total Assets	$ 156,824,039	$ 137,504,659	$ 130,069,629	14.05%
Long-Term Liabilities	$ 65,542,133	$ 57,337,514	$ 60,413,630	14.31%
Other Liabilities	$ 17,218,341	$ 17,320,368	$ 19,289,154	-0.59%
Total Liabilities	$ 82,760,474	$ 74,657,882	$ 79,702,784	10.85%
Invested in Capital Assets, Net of Debt	$ 39,591,633	$ 35,818,758	$ 29,464,425	10.53%
Restricted	$ 1,994,029	$ 1,995,932	$ 1,898,499	-0.10%
Unrestricted	$ 32,477,903	$ 25,032,087	$ 19,003,921	29.75%
Total Net Assets	$ 74,063,565	$ 62,846,777	$ 50,366,845	17.85%

The key factors relating to the approximately $7.5 million increase in Current Assets are an increase in investments of approximately $9.5 million combined with a $1 million decrease in accounts receivable.

As stated in the financial highlight section, the increase in investments was primarily due to strong retail sales and new bond proceeds of $12.8 million. The decrease in accounts receivable balance is attributable to increased collection efforts on the part of the District.

The increase in Capital Assets Net of Debt is due to the increased expenditures in capital in 2007, which is primarily driven by the growth of our service territory. For the fourth year in a row, Franklin County is the fastest growing county in the state.

On the liability side the $8.2 million increase in long-term liabilities is due to the bond proceeds noted in the financial highlights section.

Changes in the District's net assets can be determined by reviewing the following condensed Statement of Revenues, Expenses, and Changes in Net Assets for the year.

Statement of Revenues, Expenses, and Changes in Net Assets

	2007	2006	2005	2006 to 2007 Change
Operating Revenues:				
Retail Energy Sales	$57,534,021	$57,484,180	$55,231,005	0.09%
Natural Gas Sales	$596,171	$2,288,082	$5,980,502	-73.94%
CT Gas Sales	$6,750	$0	$0	0.00%
Broadband Revenue	$298,544	$273,812	$228,758	9.03%
Transmission Sales	$88	$2,841	$1,293	-96.90%
Other Electric Revenue	$14,749,829	$14,989,527	$9,257,002	-1.60%
Other Operating Revenues	$4,485,515	$4,536,468	$4,287,119	-1.12%
Total Operating Revenues	$77,670,918	$79,574,910	$74,985,679	-2.39%
Nonoperating Revenues:				
Interest income	$1,701,420	$1,063,731	$533,095	59.95%
Debt Premium and Expense Amortization	($53,186)	$45,540	$45,540	-216.79%
Total Nonoperating Revenues	$1,648,234	$1,109,271	$578,635	48.59%
Total Revenues	$79,319,152	$80,684,181	$75,564,314	-1.69%
Operating Expenses:				
Purchased Power	$48,160,311	$48,806,613	$49,437,313	-1.32%
Distribution Operations and Maintenance	$2,381,531	$2,589,028	$2,420,626	-8.01%
Combustion Turbine Operations and Maintenance	$1,655,179	$728,930	$680,142	127.07%
Broadband Operations and Maintenance	$266,199	$296,997	$362,220	-10.37%
Customer Accounting & Information	$1,474,157	$1,401,862	$1,307,704	5.16%
Conservation	$630,231	$366,736	$296,223	71.85%
Administration & General	$4,650,721	$4,309,722	$3,632,092	7.91%
Taxes	$4,154,383	$4,206,328	$4,149,236	-1.23%
Depreciation	$4,100,476	$4,530,948	$4,070,784	-9.50%
Total Operating Expenses	$67,473,188	$67,237,164	$66,356,340	0.35%
Nonoperating Expenses (Revenue)	$3,027,091	$3,116,405	$3,019,192	-2.87%
Total Expenses	$70,500,279	$70,353,569	$69,375,532	0.21%
	$8,818,873	$10,330,612	$6,188,782	-14.63%
Capital Contributions	$2,397,915	$2,149,320	$2,274,108	11.57%
Change in Net assets	$11,216,788	$12,479,932	$8,462,890	-10.12%
Beginning Net assets	$62,846,777	$50,366,845	$41,903,955	24.78%
Ending Net assets	$74,063,565	$62,846,777	$50,366,845	17.85%

- As indicated in the financial highlights section, the District implemented a 5% rate decrease effective January 1, 2007, the expectation would be that retail revenues would decrease; however, because of the residential and commercial growth in the area, retail revenues increased by approximately $50,000.

- Natural gas sales decreased by approximately $1.7 million. Gas sales are subject to market conditions related to both price and the type of hedging instrument used to minimize exposure to risk. In 2007 the District's hedging strategy shifted from buying and selling physical gas to the utilization of financial hedging instruments, which often times is not settled with a physical sale or purchase.

- As noted in the financial highlights section, Interest income increased more than $600,000 due to the higher investment balances maintained throughout the year.

- On the expense side, Combustion turbine O&M expense increased by approximately $1 million in 2007. In 2007 the District made a one time payment to assign the remaining term of a 15 year gas capacity contract. This permanent assignment will save the District approximately $800 thousand per year.

Capital Assets

The district experienced an overall increase of approximately $15.4 million in Capital Assets, including Construction in Progress. This is primarily a result of the rapid growth in the Pasco area. The following is a summary of the major projects in 2007:

- In 2007 the District spent $251,498 to connect new broadband customers.
- The cost of connecting new customers to the distribution system in 2007 was $4.4 million.
- Approximately $3 million was spent to make the District's system more reliable.
- During 2007, the District embarked on some major capital projects that were still in progress at the end of 2007. Construction in Progress increased approximately $7 million. These ongoing projects consist of a new substation, remodeling of the District's administrative building, and a major transformer purchase.

A summary of utility plant in service at December 31, 2007 is reflected in the following schedule:

Land	**$ 645,285**
Construction Work in Progress	**10,810,519**
Broadband	**10,952,282**
Transmission	**3,989,639**
Distribution	**96,642,357**
General Plant	**13,293,591**
Production	**18,132,358**
	$ 154,466,031

See Note 2 of the notes to the financial statements for more detailed information regarding capital assets.

Liabilities

Our long-term debt balance increased by approximately $8.2 million which is primarily due to the combination of new bond proceeds of $12.8 million, the defeasance of portions of outstanding bond issues, and the principal payment on our existing bonds in accordance with our bond repayment schedule. See Note 5 in the notes to the financial statements for further explanation.

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 Franklin PUD at PO Box 2407, Pasco, WA 99302

PUBLIC UTILITY DISTRICT NO.1 OF FRANKLIN COUNTY
BALANCE SHEET
DECEMBER 31, 2007 AND 2006

ASSETS	**2007**	**2006**
CURRENT ASSETS		
Cash (Note 4)	2,075,323	1,943,619
Working funds and other deposits	684,648	767,897
Investments (Note 4)	28,408,144	18,908,212
Bond Sinking funds and reserves	1,994,029	1,995,932
Accounts Receivable (net)	10,643,299	11,650,667
Inventory and supplies	3,232,344	3,878,323
Prepayments	84,817	86,044
Clearing accounts	1,044	2,048
Deferred power costs	1,147,711	1,597,230
Deferred regulatory charge	374,743	272,915
Total current assets	48,646,102	41,102,887
LONG TERM ASSETS		
Unamortized debt expense	$ 1,850,675	1,293,260
Investment in Joint Ventures (Note 14)	51,070	145,500
UTILITY PLANT (Note 2)		
Electric Plant In Service	143,655,512	$ 135,274,884
Construction Work in Progress	10,810,519	3,799,906
Accumulated Depreciation	(48,189,839)	(44,111,778)
Net Utility Plant	106,276,192	94,963,012
Total long term assets	108,177,937	96,401,772
TOTAL ASSETS	$ 156,824,039	$ 137,504,659

NET ASSETS AND LIABILITIES		
CURRENT LIABILITIES		
Warrants payable	2,310,247	990,104
Accounts payable	285,618	317,378
Customer deposits	1,248,488	1,081,271
Accrued taxes payable	1,931,829	1,943,785
Accrued interest payable	1,003,024	962,599
Other current liabilities	6,139,317	7,145,300
Current portion of Long Term Debt	2,993,101	3,100,000
Miscellaneous deferred credits (Note 1)	1,306,717	1,779,931
Total current liabilities	17,218,341	17,320,368
LONG TERM LIABILITIES		
Outstanding revenue bonds (Note 5)	63,300,000	55,530,000
Unamortized premium and discount and loss on refunding	2,135,042	1,668,347
Other long term liabilities	107,091	139,167
Total long term liabilities	65,542,133	57,337,514
TOTAL LIABILITIES	82,760,474	74,657,882
NET ASSETS		
Invested in capital assets, net of related debt	$ 39,591,633	$ 35,818,758
Restricted for debt service	1,994,029	1,995,932
Unrestricted	32,477,903	25,032,087
Total Net Assets	74,063,565	62,846,777
TOTAL NET ASSETS AND LIABILITIES	$ 156,824,039	$ 137,504,659

The accompanying notes are an integral part of this statement.

PUBLIC UTILITY DISTRICT NO.1 OF FRANKLIN COUNTY
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS
FOR THE YEARS ENDED DECEMBER 31, 2007 AND 2006

OPERATING REVENUES	**2007**	**2006**	**Change**
Retail Energy Sales (Note 11)	57,534,021	57,484,180	0.1%
Natural Gas Sales	596,171	2,288,082	-73.9%
CT Gas Sales	6,750		
Broadband Revenue	298,544	273,812	9.0%
Transmission Sales	88	2,841	-96.9%
Other Electric Revenue	14,749,829	14,989,527	-1.6%
Other Operating Revenues	4,485,515	4,536,468	-1.1%
TOTAL OPERATING REVENUES	77,670,918	79,574,910	-2.4%
OPERATING EXPENSES			
Purchased Power	48,160,311	48,806,613	-1.3%
Distribution Operations and Maintenance	2,381,531	2,589,028	-8.0%
Combustion Turbine Operations and Maintenance	1,655,179	728,930	127.1%
Broadband Operations and Maintenance	266,199	296,997	-10.4%
Customer Accounting & Information	1,474,157	1,401,862	5.2%
Conservation	630,231	366,736	71.8%
Administration & General	4,650,721	4,309,722	7.9%
Taxes	4,154,383	4,206,328	-1.2%
Depreciation	4,100,476	4,530,948	-9.5%
TOTAL OPERATING EXPENSES	67,473,188	67,237,164	0.4%
OPERATING INCOME	10,197,730	12,337,746	-17.3%
NONOPERATING REVENUES AND EXPENSES			
Interest income	1,701,420	1,063,731	59.9%
Interest expense	(2,975,267)	(2,979,592)	-0.1%
Debt premium and expense amortization	(53,186)	45,540	-216.8%
Other nonoperating revenue (expense)	(51,824)	(136,813)	-62.1%
TOTAL NONOPERATING REVENUES AND EXPENSES	(1,378,857)	(2,007,134)	-31.3%
INCOME (LOSS) BEFORE CAPITAL CONTRIBUTIONS AND EXTRAORDINARY ITEMS	8,818,873	10,330,612	-14.6%
Capital Contributions	2,397,915	2,149,320	11.6%
CHANGE IN NET ASSETS	11,216,788	12,479,932	-10.1%
TOTAL NET ASSETS, BEGINNING OF PERIOD	62,846,777	50,366,845	24.8%
TOTAL NET ASSETS, END OF PERIOD	$ 74,063,565	$ 62,846,777	17.8%

The accompanying notes are an integral part of this statement.

PUBLIC UTILITY DISTRICT NO.1 OF FRANKLIN COUNTY
STATEMENT OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2007 AND 2006

	2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from Customers	81,800,651	82,573,109
Cash paid to suppliers and counterparties	(56,505,779)	(59,293,813)
Cash paid to employees	(6,165,838)	(5,582,458)
Taxes Paid	(3,762,574)	(3,806,084)
Other receipts	684,806	437,016
Net cash provided (used) by operating activities	16,051,266	14,327,770
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisition and Construction of Capital Assets	(15,407,510)	(8,512,519)
Bond Proceeds	13,535,122	-
Bond issuance Costs	(735,122)	
Defeasance of 1996 and 2002 Bonds	(2,744,547)	
Interest Paid on Long-Term Debt	(2,897,878)	(3,072,927)
Principal Paid on Long-Term Debt	(2,640,000)	(2,720,000)
Contributions in Aid of Construction	2,397,915	2,149,320
Proceeds from sale of plant	17,600	10,328
Net cash provided (used) by capital and related financing activities	(8,474,420)	(12,145,798)
CASH FLOWS FROM INVESTING ACTIVITIES		
Investment Purchases	(31,989,343)	(16,276,063)
Investment Sales and Maturities	23,160,219	12,104,506
Interest on Investments	1,383,980	1,037,007
Net cash provided (used) by investing activities	(7,445,144)	(3,134,550)
Net increase (decrease) in cash	131,702	(952,578)
Cash balance, beginning of year	1,943,621	2,896,199
Cash balance, end of year	$ 2,075,323	$ 1,943,621
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating Income	10,197,730	12,337,746
Adjustments to reconcile operating income to net Cash provided (used) by operating activities		
Depreciation and amortization	4,100,476	4,530,948
(Increase) decrease in working funds	83,249	223,241
(Increase) decrease in accounts receivables (Net)	1,385,831	(910,696)
(Increase) decrease in plant supplies	645,979	(1,466,933)
(Increase) decrease prepaids	1,227	(2,587)
(Increase) decrease in other receivables	(378,466)	(191,164)
(Increase) decrease in clearing accounts	1,004	(2,048)
(Increase) decrease in deferred power costs	557,492	710,732
(Increase) decrease in deferred regulatory charge	(101,828)	1,325,700
(Increase) decrease in deferred GST	(107,973)	98,136
(Decrease) increase in payables	139,759	(311,391)
(Decrease) increase in deferred credits	(473,214)	(2,013,914)
Net cash provided by operating activities	$ 16,051,266	$ 14,327,770

NONCASH INVESTING, CAPITAL AND FINANCING ACTIVITIES

During 2007, the District issued $39,790,240 of Electric Refunding bonds and retired various outstanding bond issues (see Note 5).

The accompanying notes are an integral part of this statement.

PUBLIC UTILITY DISTRICT NO. 1 OF FRANKLIN COUNTY
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2007 AND 2006

NOTE 1 - SUMMARY OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the Public Utility District No. 1 of Franklin County conform to generally accepted accounting principles (GAAP) as applicable to proprietary funds of governments. The District elects to apply Financial Accounting Standards Board (FASB) guidance issued after November 30, 1989 to the extent that it does not conflict or contradict guidance of the Governmental Accounting Standards Board (GASB). GASB is the accepted standard setting body for establishing governmental accounting and financial reporting principles. In June 1999, GASB approved Statement 34, *Basic Financial Statements–and Management Discussion and Analysis-for State and Local Governments*. This and consecutive statements are reflected in the accompanying financial statements (including notes to financial statements). The following is a summary of the most significant policies (including identification of those policies which result in departures from generally accepted accounting principles).

A. Reporting Entity
Pubic Utility District No. 1 of Franklin County was established in 1938 and purchases, generates, transmits, distributes and sells electric energy. In addition, the District is authorized under state law to provide wholesale telecommunications services. The District's service area is approximately 435 square miles in Franklin County, including approximately 80 percent of the County's population. The District has 93 employees and serves approximately 22,062 customers. The District has revenues in excess of $81 million and total assets of over $156 million. An elected three-member Board of Commissioners administers the District.

As required by generally accepted accounting principles and GASB Statement 14 *The Reporting Entity* and GASB Statement 39 *Determining Whether Certain Organizations Are Component Units*, management has considered all potential component units in defining the reporting entity. The District has determined it has one component unit and includes that unit in its financial statements. Refer to Note 18 – Rural Economic Development Fund.

B. Basis of Accounting and Presentation
The accounting and reporting policies of the District are regulated by the Washington State Auditor's Office and are based on the Uniform System of Accounts prescribed for public utilities and licensees by the Federal Energy Regulatory Commission (FERC). The District uses the full accrual basis of accounting where revenues are recognized when earned and expenses are recognized when incurred. Revenues and expenses related to the District's principal operations are considered to be operating revenues and expenses; while revenues and expenses related to financing and investing activities are considered to be non-operating revenues and expenses. Unbilled utility service revenues are recorded at year end.

C. Utility Plant and Depreciation
Refer to Note 2 – Utility Plant and Depreciation.

D. Restricted Funds
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. The District's cash and investment balances as of December 31, 2007 and 2006 include the following funds restricted for debt service:

Debt Service Funds:	2007	2006
Restricted for Bond interest payments	$1,002,362	$962,600
Restricted for Bond principal payments	991,667	1,033,332
Total Funds Restricted for Debt Service	**$1,994,029**	**$1,995,932**

In addition to funds restricted for debt service, the District's cash and investment balances as of December 31, 2007 and 2006 include the following funds that are restricted:

	2007	2006
Customer deposits – cash	$298,488	$406,271
Customer deposits – investments	950,000	650,000
Cash held by Rural Economic Development Fund	318,760	294,226
Other miscellaneous deposits	67,400	67,400
Total Restricted Cash and Investments	**$1,634,648**	**$1,417,897**

The District has reserve account surety policies with Ambac Assurance Corporation and MBIA Insurance Corporation to meet the Reserve Account requirements for the 1998, 2001, 2002, and 2003 outstanding bonds. A new surety policy was purchased from Ambac in 2007 to meet Reserve Account requirement for 2007 bonds.

E. Cash and Cash Equivalents

The District considers all highly liquid investments (including restricted assets) with a maturity of three months or less to be cash equivalents.

F. Accounts Receivable

The District uses the percentage-of-receivables method to record amounts estimated to be uncollectible based on the prior years write offs. Uncollected accounts over 60 days, except those with special arrangements, are approved monthly for write off by the Board of Commissioners.

G. Inventories

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

H. Investments

Refer to Note 4 – Deposits and Investments.

I. Derivative Instruments

The District has adopted FASB SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended by SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities* and SFAS No. 149. The District has reviewed its various contractual arrangements to determine applicability of these standards. Certain of the District's contracts to purchase and sell natural gas and power supplies, as well as certain options and financial swaps for gas and electricity, are considered to be derivatives under SFAS No. 133, 138 and 149 criteria. More specifically, purchases and sales of forward electricity, natural gas and option contracts that require physical delivery and which are expected to be used or sold by the reporting entity in the normal course of business are generally considered "normal purchases and normal sales" under SFAS No. 133. These transactions are excluded under SFAS 133 and therefore are not required to be fair valued in the financial statements. Certain put and call options, and financial swaps for electricity and natural gas, are considered to be derivatives under SFAS No. 133, but do not generally meet the "normal purchases and normal sales" criteria under SFAS No. 133. The fair value of the District's derivative instruments that were not considered "normal purchases and normal sales" was $1,246,013 and $1,701,678 as of December 31, 2007 and 2006, respectively.

The District has adopted GASB Technical Bulletin (TB) 2003-01, *Disclosure Requirements for Derivatives Not Reported at Fair Value on the Statement of Net Assets*, effective for 2003. The following disclosures are provided in conformity with this guidance.

Objective & Strategies:

The District enters into derivative energy transactions to hedge its known or expected positions within its approved risk management policy. Decisions are made to enter into forward transactions to protect its financial position, specifically to deal with expected long and short positions as determined by projected load and resource balance positions. Generally, several strategies are employed to hedge the District's resource portfolio, including:

Combustion Turbines – The District purchases gas for future periods to generate electricity when the plant is economically viable on a marginal basis for that period based on parameters set by the Risk Management

Committee. If load projections indicate that the District does not require the electricity to serve its customers, an equivalent quantity of power will concurrently be sold or otherwise hedged for the same period.

Surplus Purchased Power Resources – The District hedges projected surpluses in future periods by selling power or by purchasing put options. Surplus power is generally sold forward at a fixed-price, either physically or financially, when the probability of surplus is very high; surplus power is hedged through the purchase of physical or financial put options when the projected surplus is less certain, but nevertheless expected to be available under expected scenarios.

Deficit Power Resources – The District hedges projected power resource deficits in future periods by purchasing power or by purchasing power call options (or if the Frederickson Project (see Note 12) is economically viable for the period, by buying gas or gas call options). Power is generally purchased to cover projected deficits at a fixed price, either physically or financially, when the probability of the deficit position is very high; such deficit positions are hedged through the purchase of physical or financial call options when the projected deficits are less certain, but nevertheless expected under the approved planning conditions.

Derivatives authorized under the Risk Management Policy and employed by the District include:

- Physical power and natural gas forward purchases and sales
- Monthly and daily power and gas physical calls and puts
- Power and natural gas fixed for floating swaps
- Currency swaps relating to managing US/Canadian exchange rate risk resulting from transactions denominated in Canadian dollars
- Monthly financial Asian power and gas put and call options
- Financial daily power and gas put and call options
- Monthly power and natural gas swaptions

There is no associated debt for these instruments at December 31, 2007 or 2006.

GASB TB 2003-01 mandates disclosures for six different types of risk that can arise in connection with derivatives to the extent these risks are actually present.

Credit Risk

The District developed a credit policy that establishes guidelines for setting credit limits and monitoring credit exposure on a continuous basis. The policy addresses frequency of counterparty credit evaluations, credit limits per specific counterparty and counterparty credit concentration limits.

Commodity transactions, both physical and financial, are entered into only with counterparties approved by the Risk Management Committee for creditworthiness. The District had 42 counterparties with BBB- to AA+ credit ratings, or secured by guarantors with BBB- to AA+ credit ratings, that have approved credit limits for power sales and purchases as of December 31, 2007. As of December 31, 2006 the District had 35 investment-grade counterparties. For investment-grade counterparties, the maximum credit extended to any one counterparty is $1.5 million; however, the average credit extended to the 42 investment-grade counterparties is $900,000. In addition, the District approved credit limits with 5 counterparties that are not rated or have credit ratings below BBB-; all have unsecured limits of $50,000 or less, and transactions with such counterparties are short-term in nature (hourly or daily). Credit concentration limits based on market conditions and available qualified counterparties are established by the Risk Management Committee.

The District entered into master enabling agreements with various counterparties, which enable hedging transactions. Such agreements include the Western Systems Power Pool (WSPP) form of agreement for physical power transactions, various forms of enabling agreements for physical gas transactions and International Swap Dealers Association Agreements (ISDA) for financial transactions. All of the enabling agreements have provisions addressing credit exposure and provide for various remedies to assure financial performance, including the ability to call on additional collateral as conditions warrant, generally as determined by the exposed party. The District also uses netting provisions in the agreements to diffuse a portion of the risk.

Transactions under the physical enabling agreements are used to deal with long and short physical positions under the direction of the Risk Management Committee and pursuant to the risk management policy. Transactions under the ISDA agreements are used to financially hedge long or short positions so that the District will pay or receive the equivalent of a fixed or known price for energy purchased or sold. The agreements also permit the District to hedge the risk of an underlying physical position by using call options, or put options.

Basis Risk

The District proactively works to eliminate or minimize basis risk on energy transactions by entering into derivative transactions that settle pursuant to an index derived from market transactions at the point physical delivery is expected to take place. At December 31, 2007 and 2006, there are no derivative transactions outstanding that carry basis risk. As applicable, all power related transactions are to be settled on the relevant Mid-Columbia index and all gas transactions are to be settled on the relevant Sumas/Huntingdon index. The District has ready access to electric transmission and natural gas transportation capacity at those respective trading points.

Termination Risk

As of December 31, 2007 and 2006, no termination events have occurred and there are no outstanding transactions with material termination risk. None of the outstanding transactions have early termination provisions except in the event of default by either counterparty. Events of default are generally related to (i) failure to make payments when due, (ii) failure to provide and maintain suitable credit assurances as required, (iii) bankruptcy or other evidence of insolvency, or (iv) failure to perform under any material provision of the agreement. Failure to provide or receive energy or natural gas under physical commodity transactions does generally not fall under the events of default provisions, unless the non-performing party fails to pay the resulting liquidated damages as they come due.

There is no rollover, interest rate, or market access risk for these derivative products at December 31, 2007 and 2006.

J. Deferred Regulatory Charges and Credits

The Board of Commissioners establishes rates for the District designed to recover the costs of providing services. As a result, the District qualifies for the application of SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*, which allows for the deferral of unrecognized gains or losses. As of December 31, 2007 and 2006, unrealized losses of $374,743 and $272,915, in the fair value of derivative instruments have been deferred. All other power supply contracts are considered to be normal purchases and sales under SFAS Nos. 133 and 138 and, as such, were not subject to the fair value recording requirements of these statements.

Deferred charges and deferred credits as of December 31, 2007 and 2006 were as follows:

Deferred Charges	**2007**	**2006**
Unamortized Debt Expense	$ 1,850,675	$ 1,293,260
Clearing accounts	1,044	2,048
Deferred regulatory charges	374,743	272,915
Deferred power costs	1,147,711	1,597,230
Total Deferred Charges	$3,374,173	$ 3,165,453

Deferred Credits	**2007**	**2006**
Miscellaneous deferred credits:		
Deferred Regulatory credit	$ 820,895	$ 1,383,763
Other deferred credits	58,880	74,240
Extended sick leave	52,199	49,013
Derivative Liability	374,743	272,915
Total Deferred Credits	$1,306,717	$ 1,779,931

Extended sick leave is sick leave accrued by employees (@30%) prior to April 1, 1993, adjusted to actual as of December 31, 2007 and 2006. This total is no longer current sick leave, but instead is used, at the employee's option, to supplement the District sponsored short-term disability plan. The amount also represents the portion of leave that may be used upon retirement towards health insurance.

K. Debt Premium, Discount and Expense

Original issue and reacquired bond premiums, discounts and expenses relating to revenue bonds are amortized over the lives of the related bonds using the straight-line method. Losses on debt refunding have been deferred and amortized over the shorter of the remaining life of the old or new debt.

L. Contributed Capital

GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, was adopted by the District effective January 1, 2001. The statement requires that nonexchange transactions, such as contributed capital, be recognized as revenue in the current year. Capital contributions of $2,397,915 and $2,149,320 are reported for 2007 and 2006, respectively, on the statement of revenues, expenses and changes in fund net assets as a result of the adoption of this statement. The District does not amortize contributed capital.

M. Compensated Absences

Compensated absences are absences for which employees will be paid, such as vacation and sick leave.
The district records unpaid leave for compensated absences as an expense and liability when incurred. Personal leave may accumulate to a maximum of 1200 hours, and is payable upon separation of service, retirement, or death. Changes in compensated absences during the current fiscal period are as follows:

Outstanding compensated absences, December 31, 2006	$1,183,232
Compensated absences accrued during 2007	895,928
Compensated absences used during 2007	(862,432)
Outstanding compensated absences, December 31, 2007	$1,216,728

These are included in Other Current Liabilities on the District's Balance Sheet. The District estimates a minimum of $178,261 in compensated absences will be paid within one year.

N. Use of Estimates

The preparation of the financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results may differ from those estimates.

O. Construction Financing

Capital expenditures in 2007 were made using 73% from bond proceeds, 16% from contributions in aid to construction, and 11% from rate revenue.

P. Purchase Commitments

Refer to Note 12 for contracts with Energy Northwest, Bonneville Power Administration, and others for future power supply.

Q. Reclassification

Certain amounts reported within the 2006 financial statements have been reclassified to conform to the 2007 presentation. The 2006 Unamortized debt expense was recategorized from current assets to long term assets. This had no effect on previously reported operations and cash flows.

NOTE 2 – UTILITY PLANT AND DEPRECIATION

Major expenses for utility plant and major repairs that increase useful lives are capitalized. The District capitalizes all assets costing over $1,000. Maintenance, repairs and minor renewals are accounted for as expenses when incurred.

Utility plant in service and other capital assets are recorded at cost where the historical cost is known. Where historical cost is not known, assets are recorded at estimated cost. Contributions by developers and customers are recorded at contract price or cost as contributions in aid of construction. The District records depreciation on assets acquired by contributions.

Utility Plant Activity for the year ended December 31, 2007 was as follows:

Utility Plant	Balance, 12/31/2006	Increase	Decrease	Balance, 12/31/2007
Assets subject to depreciation:				
Intangible				
Broadband	$10,700,784	251,498		$10,952,282
Transmission	3,883,238	106,401		3,989,639
Distribution	89,611,525	7,189,527	(158,695)	96,642,357
General Plant	12,391,457	970,663	(68,529)	13,293,591
Production	18,132,358			18,132,358
Less Accumulated Depreciation	(44,111,778)	(4,243,008)	164,947	(48,189,839)
Subtotal	90,607,584	4,275,081	(62,277)	94,820,388
Assets not subject to depreciation:				
Land	555,522	89,763		645,285
Construction Work in Progress	3,799,906	15,620,998	(8,610,385)	10,810,519
Net Utility Plant	$ 94,963,012	19,985,842	(8,672,662)	106,276,192

Utility Plant Activity for the year ended December 31, 2006 was as follows:

Utility Plant	Balance, 12/31/2005	Increase	Decrease	Balance, 12/31/2006
Assets subject to depreciation:				
Intangible				
Broadband	$10,414,951	285,833		$10,700,784
Transmission	3,852,217	31,021		3,883,238
Distribution	82,337,365	7,274,160		89,611,525
General Plant	12,152,944	238,513		12,391,457
Production	18,132,358			18,132,358
Less Accumulated Depreciation	(39,588,417)	(4,925,561)	402,200	(44,111,778)
Subtotal	87,301,418	2,903,966	402,200	90,607,584
Assets not subject to depreciation:				
Land	551,215	4,307		555,522
Construction Work in Progress	2,961,792	8,600,287	(7,762,173)	3,799,906
Net Utility Plant	$ 90,814,425	11,508,560	(7,359,973)	$ 94,963,012

Capital assets are depreciated using the straight-line method over the following estimated useful lives for major asset classes:

Broadband	5 -15 years
Transmission	33 – 50 years
Distribution	15 – 50 years
General Plant	5 – 40 years
Production	20 years

Initial depreciation on utility plant is recorded in the year subsequent to purchase or project completion.

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

The estimated original cost of operating property retired or otherwise disposed of and the cost of removal, less salvage, is charged to accumulated depreciation. However, in the case of the sale of a significant operating unit or system, the original cost is removed from the utility plant accounts, accumulated depreciation is charged with the accumulated depreciation related to the property sold, and the net gain or loss on disposition is credited or charged to income. There were no sales of significant units or systems in 2007.

NOTE 3 – CONSTRUCTION IN PROGRESS

Construction in progress represents expenditures to date on projects whose authorizations total $14,769,920.

Construction in Progress at December 31, 2007 is composed of the following:

Project Description	Amount Authorized	Expended through 12/31/07	Amount Committed	Required Future Financing
Underground Cable Replacements	$ 439,920	$ 538,948	$ 0	$ -
Broadband System	310,000	239,769	0	-
Information Handling Projects	372,200	270,243	0	-
Major Projects	6,078,000	3,304,981	2,773,019	-
System Construction – New Customers [1]	3,450,000	5,129,595	0	-
System Construction – Reliability and Overloads	3,085,500	4,618,136	0	-
Other Miscellaneous Projects	1,034,300	1,224,904	0	-
Totals	$ 14,769,920	$15,326,576	2,773,019	$ 0

[1] It is the District's policy that new customers incur the cost of providing service to new construction through Contributions in Aid of Construction. In 2007, the District received $2,397,915 in Contributions in Aid of Construction. No future financing is required to complete the remaining capital projects for 2007.

NOTE 4 – DEPOSITS AND INVESTMENTS

Deposits: The District's deposits and certificates of deposits are entirely covered by federal depository insurance (FDIC and FSLIC) or by collateral held in a multiple financial institution collateral pool administered by the Washington Public Deposit Protection Commission (PDPC). Deposit accounts are reconciled to the District's accounting records at year end, and the book balance of these accounts does not materially differ from the bank balance.

Investments: As required by state law, all investments of the District's funds are obligations of the U.S. Government or government agencies, deposits with Washington state banks and savings and loan institutions, the Washington State Treasurer's Investment Pool, or other investments allowed by Chapter 39.59 RCW. The District does not have a formally adopted investment policy at this time.

Interest income of $1,701,420 and $1,063,731 for 2007 and 2006, respectively, was recorded on the statement of revenues, expenses, and changes in fund net assets. Current market value of District's investments is estimated to be $30,780,933 as of December 31, 2007, and $21,258,370 as of December 31, 2006. Of these amounts, $368,760 and $294,226, respectively, were held in a money market account by the Rural Economic Development Fund. All investments are stated at cost and approximate market value. Management holds time deposits and securities until maturity; therefore, temporary declines in market value are not reflected in the financial statements. As of December 31, 2007, $30,412,173 of the District's investments were held with the Washington State Treasurer's Local Government Investment Pool (LGIP).The LGIP is governed by the State Finance Committee and is administered by the State Treasurer.

The LGIP is an un-rated 2a-7 like pool, as defined by GASB 31. Accordingly, participants' balances in the LGIP are not subject to interest rate risk, as the weighted average maturity of the portfolio will not exceed 90 days. Per GASB 40 guidelines the balances are also not subject to custodial credit risk. The credit risk of the LGIP is limited as most investments are either obligations of the US government, government sponsored enterprises, or insured demand deposit accounts and certificates of deposit. Investments or deposits held by the LGIP are all classified as category 1 risk level investments. They are either insured or held by a third-party custody provider in the LGIP's name.

NOTE 5 – LONG TERM DEBT

A. Revenue Bonds Outstanding

During the year ended December 31, 2007, the following changes occurred in long term debt:

Issue	Original Issue Amount	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
1996 Electric Revenue & Refunding Bonds, interest rates ranging 5.0% - 5.5%, maturing in 2012	5,100,000	4,245,000		(4,245,000)	-	-
1998 Electric Revenue & Refunding Bonds, interest rates ranging 4.0% - 5.0%, maturing in 2018	12,750,000	4,795,000		(4,475,000)	320,000	320,000
2001 Electric Revenue & Refunding Bonds – interest rates ranging 3.75% - 5.625%, maturing in 2021	19,460,000	17,870,000		(12,745,000)	5,125,000	875,000
2002 Electric Revenue & Refunding Bonds – interest rates ranging 4.0% - 5.625%, maturing in 2022	21,705,000	21,705,000		(20,110,000)	1,595,000	
2003 Electric Revenue & Refunding Bonds – interest rates ranging 2.0% - 3.25%, maturing in 2014	14,630,000	10,015,000		(1,495,000)	8,520,000	1,520,000
2007 Electric Revenue & Refunding Bonds – interest rates ranging 4.0% - 5.0%, maturing in 2032	50,715,000	-	50,715,000		50,715,000	260,000
Subtotal		58,630,000	50,715,000	(43,070,000)	66,275,000	2,975,000
Plus: Unamortized discount & premium		1,668,347	1,340,327	(144,230)	2,864,444	-
Less: Unamortized loss on refundings		-	(796,785)	67,383	(729,402)	-
Total Long-Term Debt		**$60,298,347**	**$51,258,542**	**($43,146,847)**	**$68,410,042**	**$2,975,000**

During the year ended December 31, 2006, the following changes occurred in long term debt:

Issue	Original Issue Amount	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
1996 Electric Revenue & Refunding Bonds, interest rates ranging 5.0% - 5.5%, maturing in 2012	5,100,000	4,690,000		(445,000)	4,245,000	460,000
1998 Electric Revenue & Refunding Bonds, interest rates ranging 4.0% - 5.0%, maturing in 2018	12,750,000	5,090,000		(295,000)	4,795,000	305,000
2001 Electric Revenue & Refunding Bonds – interest rates ranging 3.75% - 5.625%, maturing in 2021	19,460,000	18,680,000		(810,000)	17,870,000	840,000
2002 Electric Revenue & Refunding Bonds – interest rates ranging 4.0% - 5.625%, maturing in 2022	21,705,000	21,705,000			21,705,000	-
2003 Electric Revenue & Refunding Bonds – interest rates ranging 2.0% - 3.25%, maturing in 2014	14,630,000	11,185,000		(1,170,000)	10,015,000	1,495,000
Subtotal		61,350,000	-	(2,720,000)	58,630,000	3,100,000
Plus: Unamortized discount & premium		1,783,630	5,756	(121,039)	1,668,347	-
Total Long-Term Debt		**$63,133,630**	**$5,756**	**($2,841,039)**	**60,298,347**	**$3,100,000**

Future Debt Service on these bonds are as follows:

Year	Principal	Interest	Total
2008	$2,975,000	$3,007,092	$5,982,092
2009	3,050,004	2,910,936	$5,960,940
2010	3,129,996	2,768,880	$5,898,876
2011	3,264,996	2,652,000	$5,916,996
2012	3,435,000	2,527,392	$5,962,392
2013-2017	18,424,992	10,292,412	$28,717,404
2018-2022	19,785,000	5,495,412	$25,280,412
2023-2027	5,480,004	2,126,436	$7,606,440
2028-2032	6,730,008	881,865	$7,611,873
Total	$66,275,000	$32,662,425	$98,937,425

In March 2007, the District issued the Franklin Public Utility District Electric Revenue and Refunding Bonds, Series 2007 in the amount of $ 50,715,000. The Bonds mature from September 1, 2007 through September 1, 2032 with interest yields ranging from 3.36% to 4.43%. The Bonds were issued to finance a transmission line, an automated meter reading system, and other capital improvements to the District; to refund certain Outstanding Electric Revenue and Refunding Bonds series 1996, 1998, 2001, and 2002; to acquire a surety policy to fund the Reserve Account; and to pay costs of issuance of the Bonds. The District used $2,744,547 of reserves to cash defease portions of Electric Revenue Refunding Bonds, Series 1996 and 2002. This advance refunding was undertaken to reduce debt service payments over the next ten years by $1,908,645 and recognize total present value savings of $2,122,687. The economic loss of $796,785 due to this refunding is the difference between the present value of the two debt service streams (refunding debt and refunded debt) and is included within the balance sheet as unamortized loss on refunding.

Debt service on the refunded bonds is met by cash and investments held by the refunding trustee. As of December 31, 2007, the trustee was holding cash and investments of $38,045,006 which are expected to fund debt service fully. These refunded bonds constitute a contingent liability of the district but are appropriately excluded from the financial statements.

At December 31, 2007 and 2006, there was $1,994,029 and $1,995,932, respectively, in restricted assets related to bonded debt of the District. This represents sinking funds as required by the bond resolutions. There are a number of other limitations and restrictions contained in the various bond resolutions. The District is in compliance with all significant limitations and restrictions, including those regarding federal arbitrage.

<u>Other Long Term Liabilities</u>
The District has an installment purchase agreement in the amount of $125,192 with Big Bend Electric Cooperative, Inc to purchase a portion of the Broadmoor Substation. The long term portion of $107,091 is reflected as Other Long Term Liabilities on the Balance Sheet. The installments are payable over 10 years at an interest rate of 6.35%. Of the amount outstanding, $18,101 is due within one year and is included in Current Portion of Long Term Debt.

<u>Lines of Credit</u>
The District has a renewable $1 million line of credit with Bank of the West. This line of credit expires July 31, 2008. As of December 31, 2007, no draws had been taken on this line of credit. The District does not anticipate any draws on the line of credit in 2008.

In August 2006 the District established a standby irrevocable letter of credit with Bank of the West in favor of BPA in the amount of $2.2 million. This letter of credit is a component of the Flexible PF Agreement between the District and BPA and expires on September 30, 2009. The Agreement allows BPA to draw on the letter of credit to meet unexpected costs and lower cash reserve requirements at BPA, resulting in lower power costs for the District. The costs covered through the letter of credit are then credited back to the District through its BPA power bill. It is not expected that the letter of credit will be called upon during the current three year BPA rate period.

NOTE 6 – PENSION PLANS

Substantially all full-time and qualifying part-time employees participate in one of the following statewide retirement systems administered by the Washington State Department of Retirement Systems, under cost-sharing multiple-employer public employee defined benefit and defined contribution retirement plans. The Department of Retirement Systems (DRS), a department within the primary government of the State of Washington, issues a publicly available comprehensive annual financial report (CAFR) that includes financial statements and required supplementary information for each plan. The DRS CAFR may be obtained by writing to: Department of Retirement Systems, Communications Unit, P.O. Box 48380, Olympia, WA 98504-8380. The following disclosures are made pursuant to GASB Statement 27, *Accounting for Pensions by State and Local Government Employers*.

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

Plan Description

PERS is a cost-sharing multiple-employer retirement system comprised of three separate plans for membership purposes: Plans 1 and 2 are defined benefit plans and Plan 3 is a defined benefit plan with a defined contribution component. Membership in the system includes: elected officials; state employees; employees of the Supreme, Appeals, and Superior courts (other than judges currently in a judicial retirement system); employees of legislative committees; community and technical colleges, college and university employees not participating in national higher education retirement programs; judges of district and municipal courts; and employees of local governments. PERS participants who joined the system by September 30, 1977, are Plan 1 members. Those who joined on or after October 1, 1977 and by either, February 28, 2002 for state and higher education employees, or August 31, 2002 for local government employees, are Plan 2 members unless they exercise an option to transfer their membership to Plan 3. PERS participants joining the system on or after March 1, 2002 for state and higher education employees, or September 1, 2002 for local government employees have the irrevocable option of choosing membership in either PERS Plan 2 or PERS Plan 3. The option must be exercised within 90 days of employment. An employee is reported in Plan 2 until a choice is made. Employees who fail to choose within 90 days default to PERS Plan 3. PERS defined benefit retirement benefits are financed from a combination of investment earnings and employer and employee contributions. 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 benefit 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. Plan 1 retirements from inactive status prior to the age of 65 may receive actuarially reduced benefits. The benefit is actuarially reduced to reflect the choice of a survivor option. A cost-of-living allowance (COLA) is granted at age 66 based upon years of service times the COLA amount, increased by 3 percent annually. Plan 1 members may also elect to receive an additional COLA amount (indexed to the Seattle Consumer Price Index), capped at 3 percent annually. To offset the cost of this annual adjustment, the benefit is reduced.

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. The benefit is also actuarially reduced to reflect the choice of a survivor option. There is no cap on years of service credit; and a cost-of-living allowance is granted (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. Effective June 7, 2006, Plan 3 members are vested in the defined benefit portion of their plan after ten years of service; or after five years if twelve months of that service are earned after age 44; or after five service credit years earned in PERS Plan 2 prior to June 1, 2003. Plan 3 members are immediately vested in the defined contribution portion of their plan. Vested Plan 3 members are eligible to retire with full benefits at age 65, or at age 55 with 10 years of service. 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. The benefit is also actuarially reduced to reflect the choice of a survivor option. There is no cap on years of service credit; and Plan 3 provides the same cost-of-living allowance as Plan 2.

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 1,188 participating employers in PERS. Membership in PERS consisted of the following as of the latest actuarial valuation date for the plans of September 30, 2006:

Retirees and Beneficiaries Receiving Benefits	70,201
Terminated Plan Members Entitled to But Not Yet Receiving Benefits	25,610
Active Plan Members Vested	105,215
Active Plan Members Nonvested	49,812
Total	**250,838**

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. Under PERS Plan 3, employer contributions finance the defined benefit portion of the plan, and member contributions finance the defined contribution portion. 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, 2007, were as follows:

	PERS Plan 1	**PERS Plan 2**	**PERS Plan 3**
Employer[1]	6.13%[2]	6.13%[2]	6.13%[4]
Employee	6.00%[3]	4.15%[3]	[5]

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

	PERS Plan 1	**PERS Plan 2**	**PERS Plan 3**
2007	$ 42,110	$ 287,604	$ 15,748
2006	$ 22 977	$ 142,437	$ 6,444
2005	$ 13,878	$ 78,365	$ 6,423

NOTE 7 – DEFERRED COMPENSATION PLANS

In addition to the pension benefits described in Note 6, the District offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. This plan is with International City Management Association (ICMA). The plan, available to all employees, permits them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement,

1 The employer rates include the employer administrative expense fee currently set at 0.16%.
2 The employer rate for state elected officials is 9.12% for Plan 1 and 6.13% for Plan 2 and Plan 3.
3 The employee rate for state elected officials is 7.50% for Plan 1 and 4.15% for Plan 2.
4 Plan 3 defined benefit portion only.
5 Variable from 5.0% minimum to 15.0% maximum based on rate selected by the PERS 3 member.

death, or unforeseeable emergency. All plan assets are held in trust for the exclusive benefit of participants and their beneficiaries and therefore are not included in the District's financial statements.

The District makes matching contributions to either the Section 457 deferred compensation plan or the 401(a) defined contribution plan (employee's choice) for eligible employees in an amount equal to 50% of the employee's contribution contributed as a salary deferral. The District match is capped at 2.0% based on straight-time employee wages for the pay period. The District made matching contributions of $96,256 in 2007. Employees made contributions of $554,732 to the 457 and 401(a) plans in 2007.

Effective August 1, 2005, the District contributes 0.5% of an employee's regular straight-time wages each pay period into a health reimbursement arrangement (HRA). Employees that choose to participate in a District provided Wellness Program receive an additional 1% contribution of an employee's regular straight-time wages each pay period into an HRA. The HRA assets are held in trust for plan participants. Effective August 2006, the District makes annual contributions to employee HRA accounts for those employees who joined the District's high deductible medical plan.

NOTE 8- OTHER POST EMPLOYMENT BENEFITS (OPEB)

Effective August 1, 2005, in accordance with the collective bargaining agreement, the District pays a portion of the medical insurance premiums for eligible employees retiring between August 1, 2005 and July 31, 2015. Eligibility requires a retired employee must have worked in a PERS –eligible position while actively employed, must enroll in medical insurance from the Central Washington Unified Public Employees Trust (see Note 10) within the enrollment period following retirement and must remain continuously enrolled in medical insurance from the Trust. Employees who retired between August 1, 2005 and July 31, 2006 had monthly contributions equal to the lesser of actual medical premiums or ten dollars for each year of PERS-eligible service at the District paid toward their medical insurance premium during the time they are between the ages of 60 through 64 for each month they remain enrolled in medical insurance from CWPU UIP. For each successive year ending July 31, the dollar amount per month for each year of service will be reduced by one dollar until it reaches zero on August 1, 2015. The District made OPEB medical insurance premium contributions of $6,528 in 2007.

NOTE 9 - CENTRAL WASHINGTON PUBLIC UTILITIES (CWPU)

The District, along with six other utilities, participates in CWPU for the purpose of labor relations and collective bargaining activities. The District pays all CWPU costs and is reimbursed for CWPU costs on a proportionate basis from the other utilities. The District's share of CWPU costs is expensed. CWPU costs and reimbursements are handled through a clearing account. The balance of this account at December 31, 2007, was $1,044.

NOTE 10 - CENTRAL WASHINGTON PUBLIC UTILITIES UNIFIED INSURANCE PROGRAM (UIP)

The District, along with six other utilities, participates in the CWPU Unified Insurance Program to provide medical, dental, life, accidental death and dismemberment and long-term disability insurance to its employees. Insurance premiums are paid to the UIP trust account. The trust was formed to provide uniform administration of the group insurance program.

NOTE 11 - UNBILLED REVENUES AND EXPENSES

Unbilled Revenues and Expenses have been accrued as follows:

	Unadjusted Year-to-date	2006 Year End Accrual	2007 Year End Accrual	Adjusted Year-to-Date
Residential Sales	$ 22,024,684	(1,015,854)	1,464,797	$ 22,473,627
General Sales	27,894,189	(1,267,490)	779,276	27,405,975
Street Lighting Sales	314,540	(13,851)	16,329	317,018
Security Lighting Sales	72,730	(3,550)	3,070	72,250

The amounts used for statistical data reporting are the unadjusted year to date before accrual figure. These are used because KWH's are not adjusted and to include year-end accrual of revenues and expenses could be misleading.

NOTE 12- POWER SUPPLY

A. Bonneville Power Administration (Bonneville)

The District obtains power from the Bonneville Power Administration under a long-term power purchase agreement. The District's Bonneville power is supplied under a 10-year Block and Slice Power Sale Agreement, which extends from October 1, 2001 through September 30, 2011. This contract provides federal power in the form of two products: Block and Slice. The Block product provided power in monthly amounts ranging between 23 aMW to 34 aMW for the first five-year term. On October 1, 2006, the start of the second five-year term, the monthly Block entitlements increased to a range of 42 aMW to 61 aMW. Monthly Block purchase amounts are fixed, but generally are shaped to the District's monthly power requirements. The Slice product provides the District 0.7851% of the output of the Federal System and requires the District to pay that same percentage of the actual costs of the Federal System. The District's share of the Slice product is expected to be 75 average megawatts (aMW) in an average year, but may vary considerably based on water conditions within the Northwest. Depending upon hydroelectric generating conditions and market prices, the District expects to procure between 85% and 95% of its total energy resources from Bonneville.

Bonneville is required by federal law to recover all of its costs through the rates it charges its customers. Bonneville makes various filings with FERC to confirm that rates are sufficient to cover costs. Under Bonneville's adopted power and transmission rate provisions, its rates are subject to revision in order to enable Bonneville to recover its actual costs of service.

The power rate provisions for the Block and Slice products are different. The rate provisions for the Block product include a cost recovery adjustment clause (CRAC) and a dividend distribution clause (DDC). Either may be triggered if certain thresholds are met. The CRAC, including a special fish related adjustment and emergency fish related surcharge, allows Bonneville to raise rates to collect sufficient funds to pay costs. The DDC results in dollars being returned to customers, in the form of future power rate decreases, if excess dollars are collected.

Pursuant to the Slice product rate provisions, the District is subject to additional charges or credits from Bonneville if Bonneville's actual costs deviate from budgeted amounts. The Slice product is not subject to the CRAC or DDC; but rather, the District pays its share of cost increases or receives its share of cost decreases through an annual true-up mechanism. The District's share of the 2007 true-up was a credit of approximately $270,000; and based on Bonneville's budget and rate setting processes, the District expects true-ups for 2008 through 2009, if any, will be minimal.

The District also entered into a contract with Bonneville for transmission service effective May 31, 1997, which provides adequate transmission capacity to meet the District's annual system peak load. The transmission contract extends through September 30, 2031.

B. Energy Northwest

The District is a member of Energy Northwest (formerly the Washington Public Power Supply System) and a participant in Nuclear Project Nos. 1 and 3, Columbia Generating Station (formerly Project No. 2), the Packwood Project and the Nine Canyon Wind Project. Columbia Generating Station, the Packwood Project and the Nine Canyon Wind Project are operating, Project Nos. 1 and 3 have been terminated. Energy Northwest is a municipal corporation and a joint operating agency of the State of Washington. It has the authority to acquire, construct and operate works, plants, and facilities for the generation and transmission of electric power and energy. The membership of Energy Northwest consists of seventeen public utility districts, including the District, and three cities, all located in the State of Washington.

The District, Energy Northwest and Bonneville have entered into separate "net billing agreements" with respect to Energy Northwest's Project No. 1, Project No. 2 (now Columbia Generating Station) and 70% ownership share of Project No. 3. Under terms of these agreements, the District has purchased from Energy Northwest and, in turn, assigned to Bonneville a maximum of 1.330%, 2.370%, and 1.151% of the capability of the Project No. 1, Columbia Generating Station and Energy Northwest's ownership share of Project No. 3, respectively. Bonneville is unconditionally obligated to pay the District and the District is unconditionally obligated to pay Energy Northwest, the pro rata share of the total annual costs of each project, whether or not the projects are completed, operable or operating and notwithstanding the suspension, reduction or curtailment of the projects' output. The District's respective shares may be increased by not more than 25% upon default of other public agency participants.

C. Packwood Lake Hydroelectric Project

The Packwood Lake Hydroelectric Project is an Energy Northwest hydroelectric generating project in western Washington with a nameplate rating of 27.5 MW. In 1961 the District executed a contract with Energy Northwest which expires upon payment or the making of provision for payment of Energy Northwest's revenue bonds issued in conjunction with the Packwood Project (scheduled for final payment on March 1, 2012) or when Energy Northwest discontinues operation of the Packwood Project, or, upon the election of the District, 24 months prior to any scheduled termination date. Under the terms of this contract, the District, as a member-purchaser is obligated to purchase 10.5% of the capability of the Packwood Project, and is unconditionally obligated to pay 10.5% of the annual costs of the Project including outstanding bond debt. At the end of 2007, Energy Northwest had approximately $1.9 million in bond debt outstanding for the Packwood Project.

In 2007 Energy Northwest borrowed $600,000 on a line of credit to pay for repairs caused by flooding in November 2006. Some of the costs of the emergency repairs to stabilize a pipeline where a slide occurred may be reimbursed by the Federal Emergency Management Agency.

Since November 1, 2002, the firm output of 7 aMW, as well as any secondary, or nonfirm, energy, has been sold by Energy Northwest to the District and Benton PUD ("Purchasers") under a separate Power Sales Agreement. The latest amendment to this agreement extended the contract term through September 2008. The District receives 43% of the output and Benton PUD receives the remainder. For the firm energy, the two PUDs currently pay Energy Northwest Bonneville's monthly Priority Firm rate minus $2 per MWh. The Purchasers pay Energy Northwest the Dow Jones Mid-Columbia Daily Index price, minus $1 per MWh, for any nonfirm energy. Revenues from power sales are credited to each of the member-purchasers in proportion to their ownership shares. If the amount so credited is less than the member-purchasers' share of the annual costs, they must pay the balance due. If the amount credited exceeds the annual costs, the excess will be paid to the member-purchasers. The District's records show that the Packwood Project credits have exceeded costs since 1981.

In conjunction with the purchase of the Packwood Project output the District was required by Bonneville to displace an equivalent amount of Block power from Bonneville resulting in a modest savings to the District. The Purchasers and Energy Northwest are not obligated to continue the current arrangement beyond September 2008 and neither have declared their intent either to extend or end the arrangement.

D. Nine Canyon Wind Project

The Nine Canyon Wind Project is another Energy Northwest generation project. It is located in the Horse Heaven Hills area southwest of Kennewick. Phase I, which commenced commercial operation in September 2002, consists of 37 wind turbines with an aggregate generating capacity of approximately 48 MW. Phase II commenced commercial operation in December 2003 and consists of an additional 12 wind turbines with an aggregate generating capacity of approximately 15.6 MW. Phase III of the Project consists of an additional 14 wind turbines with an aggregate generating capacity of approximately 32 MW. The first unit of Phase III became operational in December 2007, and Phase III will commence commercial operation by March 2008.

The District took over a 2.01 MW (capacity) share of Phase I from Columbia Generating Station on February 1, 2006. With a capacity factor of 31.2 percent, the energy delivered should be approximately 0.63 aMW. The District has also contracted for a share of Phase III of 8 MW (capacity), or about 2.5 aMW of energy. The total Nine Canyon capacity contracted by the District is 10.01 MW, which should result in energy deliveries of approximately 3.1 aMW.

The citizens of Washington State passed Initiative 937 in November, 2006, known as the Clean Energy Initiative, which mandates renewable energy and conservation targets for the State's utilities. While the requirements of the Initiative do not currently apply to the District, the Nine Canyon and White Creek contracts will provide some of the renewable energy the District will need to comply with the Initiative's targets in the future.

E. White Creek Wind Project

In 2007 the District contracted for the output from 10 MW of capacity in the White Creek Wind Project (the Project) from Lakeview Light & Power. The Project is located in the Columbia River Gorge approximately 21 miles east of Goldendale in Klickitat County, Washington. Four Washington state consumer-owned utilities—Public Utility District No. 1 of Cowlitz County (Cowlitz), Public Utility District No. 1 of Klickitat County (Klickitat), Lakeview Light and Power (Lakeview), and Tanner Electric Cooperative (Tanner) (collectively, the Utilities)—developed the Project, which was commissioned in November 2007.

The Project is comprised of 89 2.3-MW Siemens wind turbines with an installed capacity of 205 MW. Based on a 33% capacity factor, the projected annual energy output is estimated to be 68 aMW. In December 2006 the Project was sold to White Creek Wind I, an investment group comprised of affiliates of Prudential Capital Group, Lehman Brothers and Summit Power. The Utilities entered into 20-year power purchase agreements with White Creek Wind I. The Utilities' shares of the Project are as follows: Cowlitz – 46%; Klickitat – 26%; Lakeview – 26%; and Tanner – 2%.

The District entered into a 20-year Energy and Environmental Attributes Purchase Agreement with LL&P Wind Energy, Inc., a wholly-owned subsidiary of Lakeview. The District purchases all of the energy and associated environmental attributes produced from 10 MW of the Project's capacity, which equates to a 4.89% share of the installed Project capacity. During the first contract year (2008) the price of energy delivered to the District is $51.97 per MWH; and the price will increase by 2% annually during the term of the contract. The environmental attributes included in that price includes any and all credits, benefits, emissions reductions, offset and allowances attributable to the Project as a renewable energy resource. The environmental attributes have value in the marketplace or can be used to satisfy Initiative 937's renewable energy requirements when they are applicable to the District.

F. Frederickson Project

On March 27, 2001, the District entered into an agreement with Frederickson Power, L.P. for the purchase of 30 MW of contract capacity from the 249 MW Frederickson combined-cycle natural gas-fired combustion turbine project station near Tacoma, Washington. Deliveries began when the plant reached commercial operation on September 1, 2002. The agreement expires September 1, 2022. The District is able to economically dispatch the plant each day based on spot market power and gas prices. Power costs include a capacity charge and fixed and variable operation and maintenance charges indexed to performance and escalation factors. Frederickson Power provides a guaranteed heat rate of 7,100 Btu/kWh during the term of the agreement. The District is responsible for supplying natural gas to Frederickson Power, L.P. at Huntingdon, British Columbia on days that the plant is generating power.

G. Pasco Combustion Turbine Generating Station

The District and Grays Harbor PUD jointly constructed a four-unit, 44 megawatt (MW), simple-cycle gas-turbine generating station located in the District's service area. Commercial operation commenced in August 2002. The PUDs jointly own certain common facilities and individually own specific facilities; i.e., the turbines and SCR outfitted exhaust systems. The District's 22 MW of capacity is planned for use during periods of peak system load, low Slice generation and/or high market prices.

H. Natural Gas Transportation

Natural gas is supplied to the Frederickson Project via Northwest Pipeline. Frederickson Power, L.P. holds sufficient firm transportation rights on Northwest Pipeline to meet 100 percent of the proportionate fuel requirements of the plant for the term of its agreement with the District. A proportionate share of the cost of this transportation is passed-through to the District each month. The District held long-term firm transportation rights on Westcoast Energy's pipeline system between Compressor Station No. 2 in northern British Columbia and the Sumas/Huntingdon trading hub at the U.S./Canadian border. The contracted pipeline capacity was sufficient to meet 100 percent of the daily natural gas requirements of the District's shares of Frederickson and Pasco generating projects. The District determined the capacity benefit was not expected to exceed costs over the remaining term of the contract, and permanently assigned the contract to Terasen Gas Inc. effective November 1, 2007. The District made payments to Terasen of approximately $1.5 million, and is thereafter relieved of future transportation costs of approximately $1.7 million per year at current rates.

The District relies on short-term transportation capacity purchases on Northwest Pipeline to provide natural gas to the Pasco Generating Station. The heat rate of the Pasco Generating Station is expected to keep the annual capacity factor low for at least the next several years, which makes long-term firm transportation uneconomical.

I. Conservation / Energy Services

The District's existing wholesale power supply contract with Bonneville provides a 0.5 mill per kWh discount on wholesale power purchases from Bonneville as a funding source for conservation and renewable resource activities. The Conservation Rate Credit ("CRC") (previously called the Conservation and Renewables Discount) has an annual value of approximately $428,000, which will be used for conservation measures and renewable power purchases. The District offers low-interest residential loans and rebates for energy efficient weatherization, heat pumps, and appliances. Through CRC the District also offered financial incentives to commercial, industrial, and irrigation customers for efficiency projects in 2007.

NOTE 13 - RISK MANAGEMENT

The District maintains insurance with Federated Rural Electric Insurance Exchange for the following coverage:

Coverage	Limit
Buildings and Personal Property	55,741,600
General Liability	2,000,000
Electromagnetic Field Liability	1,000,000
Umbrella Liability	15,000,000
Directors, Officers & Mgrs. Liability	10,000,000

In addition, the District has $10,000,000 boiler and machinery coverage with CNA for the Pasco combustion turbine generating station.

The District has not paid insurance settlements in excess of coverage in any of the past three years.

NOTE 14 – JOINT VENTURES

GRAYS HARBOR FRANKLIN BENTON, LLP (GHFB)

GHFB is a Limited Liability Partnership formed under RCW 25.05.500 pursuant to an interlocal cooperation agreement and began doing business under the name GHFB, LLP on July 1, 2006.

The proceeds from the sale of certain assets of Power Resource Managers (PRM) to The Energy Authority (TEA) on June 30, 2006 were retained as start up funds for GHFB. GHFB's primary purpose at this time is to fund services previously performed by PRM but not being performed by TEA, for example, receiving and analyzing information related to federal legislation that may impact the three partner PUDs. As of December 31, 2007 and 2006, the District's equity interest in GHFB, LLP was $51,070 and $145,500, respectively.

Financial statements for GHFB may be obtained by writing to: Franklin PUD, P.O. Box 2407, Pasco, WA 99302.

NOTE 15 – PARTICIPATION IN NORTHWEST OPEN ACCESS NETWORK, INC. d.b.a. NOANET

The District, along with 13 other Washington State Public Utility Districts and Energy Northwest, is a member of NoaNet, a Washington nonprofit mutual corporation. NoaNet was incorporated in February 2000 to provide a broadband communications backbone, over Public Benefit Fibers leased from Bonneville Power Administration, throughout the Pacific Northwest for assisting its members in the efficient management of load, conservation and acquisition of electric energy as well as other purposes. The network began commercial operation in January 2001.

As a member of NoaNet, the District has guaranteed certain portions of NoaNet debt based on its proportionate share. The management of NoaNet anticipates meeting debt obligations through profitable operations; however, there is no assurance NoaNet's plan will be achieved. During the start-up phase, NoaNet assessed its members to cover operating deficits. The District expensed assessments of $196,385 and $196,335 for 2007 and 2006, respectively.

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 are due beginning in December 2003 through December 2016 with interest due semi-annually at rates ranging from 5.05% to 7.09%. The amount of outstanding bonds was $20,065,000 and $21,675,000 at December 31, 2007 and 2006, respectively.

Each member of NoaNet has entered into a Repayment Agreement to guarantee the debt of NoaNet.

Under the Repayment Agreement, each Member acknowledges and agrees that it is a guarantor of the payment of principal and interest on the Bonds and is liable by assessment or otherwise to repay NoaNet for amounts due and owing with respect to such principal and interest up to each Member's Percentage Interest. The District's guarantee is based on its 6.39% interest, or $1,282,154 and $1,385,033 as of December 31, 2007 and 2006, respectively.

In January 2003, NoaNet opened a $5 million line of credit (Note) with Bank of America to fund capital expenditures, and opened a second $5 million line of credit in June 2006. Combined balances of $4,034,835 and $5,500,000 were outstanding on the Notes as of December 31, 2007 and 2006, respectively. NoaNet may assess its Members for their percentage share of principal and interest on the Note to the extent that NoaNet does not have sufficient funds to pay the Note.

NoaNet recorded a decrease of net assets of $1,767,002 (unaudited) and $2,046,529 for 2007 and 2006, respectively. The District's proportionate share of these losses is $112,911 for 2007 and $130,773 for 2006. In accordance with Accounting Principles Board Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*, as well as a position statement issued by the Washington State Auditor concerning the appropriate accounting treatment for NoaNet, a proportionate share of these losses has not been recorded by the District since NoaNet had negative net assets of $12,483,384 as of December 31, 2007 (unaudited) and $13,789,700 as of December 31, 2006.

Financial statements for NoaNet may be obtained by writing to: Northwest Open Access Network, 616 State St., Centralia, WA 98351.

NOTE 16 – TELECOMMUNICATIONS SERVICES

The District installed and continues to build a fiber optic backbone system in its service area for internal use by the electric system. The District connected its fiber optic system to NoaNet's fiber optic communications system in 2001 and makes excess capacity available at wholesale rates to Internet and telecom retail service providers. These service providers are in turn offering end users access to the District's fiber for Internet and point-to-point interconnections on a retail basis. Broadband coverage is also being extended through the development of a wireless network to deliver high-speed Internet service. Based on GASB Statement 34, segment information is not required for the District's telecommunications services.

The following is a summary of Broadband activities for 2007 and 2006:

Telecommunications Services	**2007**	**2006**
Operating Revenues		
Drop Fees	$23,269	$20,167
Fiber Transport charges	206,196	180,721
Port charges	0	12,395
WiFi Transport	5,305	5,844
Collocation Rental	40,351	32,515
Miscellaneous Broadband Services	23,423	22,170
Total Operating Revenues	$298,544	$273,812
Operating Expenses		
Labor and Benefits	$31,840	$30,360
Supplies	77	1,684
Professional Services	4,455	27,266
Other Charges	7,517	12,389
Hardware and Fiber Maintenance	25,925	28,963
Noanet Assessment	196,385	196,335
Depreciation	627,726	626,106
Total Operating Expenses	$893,925	$923,103
Capital Investment		
Current	251,498	285,833
Cumulative (since 2000)	10,952,282	10,700,784

NOTE 17 – OTHER COMMITMENTS AND CONTINGENT LIABILITIES

The District has no pending claims that materially affect the financial status of the District.

NOTE 18 – RURAL ECONOMIC DEVELOPMENT FUND (REDF)

The District created and maintains a Rural Economic Development Fund (REDF) pursuant to the terms and conditions as outlined in RCW 82.16.0491. The REDF is partially funded through a reimbursement of the state public utility tax imposed upon the utility and is utilized to assist new or expanding businesses within Franklin County. The funds used in this program are a combination of funds from the District and public utility tax credits earned. The District has contributed $50,000 per year since 2000 and received $25,000 public utility tax credit in each of those years for contributing. The District will continue to contribute $50,000 with a public utility tax credit of $25,000 in years 2007 through 2011 for a fund total of $600,000. A Board of Directors was established for the REDF, two of which are District staff members. The responsibility for implementation and administration of this fund is the Rural Economic Development Fund Board of Directors. The Board has the authority to determine all criteria and conditions for the expenditures and repayment of all funds from the REDF. The District's Board of Commissioners provides final approval of the REDF Board's recommendations for funding of projects.

The REDF began taking applications for loans in 2004. Two loans were disbursed in 2006. According to GASB 14 *The Reporting Entity* and GASB 39 *Determining Whether Certain Organizations Are Component Units,* the District has determined the REDF to be a component unit. Based on these standards the REDF is reported using a blended presentation and accordingly includes accounts receivable, investment, and corresponding liability for the loans in the District's financial statements.

NOTE 19 – SUBSEQUENT EVENTS

On March 11, 2008, the District's Board of Commissioners approved a 4% decrease of the District's electric rates. The rate decrease is effective May 1, 2008, and applies to all rate classes served by the District.

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.

Our mission is to work in cooperation with our audit clients and citizens as an advocate for government accountability. 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.

The State Auditor's Office has 300 employees who are located around the state to deliver our services effectively and efficiently. Approximately 65 percent of our staff are certified public accountants or hold other certifications and advanced degrees.

Our regular 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. We also perform fraud and whistleblower investigations. In addition, we have the authority to conduct performance audits of state agencies and local governments.

The results of our audits are widely distributed through a variety of reports, which are available on our Web site. We continue to refine our reporting efforts to ensure the results of our audits are useful and understandable.

We take our role as partners in accountability seriously. We provide training and technical assistance to governments and have an extensive program to coordinate audit efficiency and to ensure high-quality audits.

State Auditor	**Brian Sonntag, CGFM**
Chief of Staff	**Ted Rutt**
Chief Policy Advisor	**Jerry Pugnetti**
Director of Administration	**Doug Cochran**
Director of Audit	**Chuck Pfeil, CPA**
Director of Performance Audit	**Linda Long, CPA, CGFM**
Director of Special Investigations	**Jim Brittain, CPA**
Director for Legal Affairs	**Jan Jutte**
Local Government Liaison	**Mike Murphy**
Communications Director	**Mindy Chambers**
Public Records Officer	**Mary Leider**
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