Washington State Auditor's Office

Financial Statements and Federal Single Audit Report

Public Utility District No. 1 of Kitsap County

Audit Period
January 1, 2012 through December 31, 2012

Report No. 1010564

Issue Date
September 27, 2013

Washington
Troy Kelley
State Auditor

Washington State Auditor
Troy Kelley

September 27, 2013

Board of Commissioners
Public Utility District No. 1 of Kitsap County
Poulsbo, Washington

Report on Financial Statements and Federal Single Audit

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

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

Sincerely,

Troy X. Kelley

TROY KELLEY
STATE AUDITOR

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

Federal Summary

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

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

FINANCIAL STATEMENTS

An unmodified opinion was issued on the basic financial statements.

Internal Control Over Financial Reporting:

- ***Significant Deficiencies:*** We reported no deficiencies in the design or operation of internal control over financial reporting that we consider to be significant deficiencies.

- ***Material Weaknesses:*** We identified no deficiencies that we consider to be material weaknesses.

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

FEDERAL AWARDS

Internal Control Over Major Programs:

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

- ***Material Weaknesses:*** We identified no deficiencies that we consider to be material weaknesses.

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

We reported no findings that are required to be disclosed under section 510(a) of OMB Circular A-133.

Identification of Major Programs:

The following was a major program during the period under audit:

CFDA No.	Program Title
11.557	ARRA - Broadband Technology Opportunities Program (Recovery Act)

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

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

Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

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

Board of Commissioners
Public Utility District No. 1 of Kitsap County
Poulsbo, Washington

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of Public Utility District No. 1 of Kitsap County, Washington, as of and for the years ended December 31, 2012 and 2011, and the related notes to the financial statements, which collectively comprise the District's basic financial statements, and have issued our report thereon dated September 11, 2013. During the year ended December 31, 2012, the District implemented Governmental Accounting Standards Board Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position*.

INTERNAL CONTROL OVER FINANCIAL REPORTING

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

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

COMPLIANCE AND OTHER MATTERS

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

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

PURPOSE OF THIS REPORT

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

Troy X. Kelley

TROY KELLEY
STATE AUDITOR

September 11, 2013

Independent Auditor's Report on Compliance For Each Major Federal Program and on Internal Control Over Compliance in Accordance with OMB Circular A-133

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

Board of Commissioners
Public Utility District No. 1 of Kitsap County
Poulsbo, Washington

REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM

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

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts and grants applicable to its federal programs.

Auditor's Responsibility

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

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

Opinion on Each Major Federal Program

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

REPORT ON INTERNAL CONTROL OVER COMPLIANCE

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

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

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

PURPOSE OF THIS REPORT

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

Troy X. Kelley

TROY KELLEY
STATE AUDITOR

September 11, 2013

Independent Auditor's Report on Financial Statements

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

Board of Commissioners
Public Utility District No. 1 of Kitsap County
Poulsbo, Washington

REPORT ON THE FINANCIAL STATEMENTS

We have audited the accompanying financial statements of Public Utility District No. 1 of Kitsap County, Washington, as of and for the years ended December 31, 2012 and 2011, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed on page 11.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

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

Matters of Emphasis

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

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 12 through 16 and information on postemployment benefits other than pensions on page 46 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Supplementary and Other Information

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

OTHER REPORTING REQUIRED BY GOVERNMENT AUDITING STANDARDS

In accordance with *Government Auditing Standards*, we have also issued our report dated September 11, 2013 on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control over financial reporting and compliance.

Troy X. Kelley

TROY KELLEY
STATE AUDITOR

September 11, 2013

Financial Section

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

PUBLIC UTILITY DISTRICT #1 OF KITSAP COUNTY

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Management's Discussion and Analysis

This section provides an overview and analysis of key data presented in the basic financial statements for the years ended December 31, 2012 and 2011, with additional comparative data for 2010. Information within this section should be used in conjunction with the basic financial statements and accompanying notes.

Overview of the Financial Statements

Public Utility District No. 1 of Kitsap County (KPUD or District) accounts for financial activities within its Proprietary Fund for its Utility System. The Utility System provides wholesale water and telecommunications service as well as retail water service and regional water resource activities to support the System.

In accordance with requirements set forth by the Governmental Accounting Standards Board, the District's financial statements employ the accrual basis of accounting in recognizing increases and decreases in economic resources. Accrual accounting recognizes all revenues and expenses during the year, regardless of when cash is received or paid.

The basic financial statements, presented on a comparative format for the years ended December 31, 2012 and 2011, are comprised of:

- Statement of Net Position: The District presents its Statement of Net Position using the balance sheet format. The Statement of Net Position reflects the assets, liabilities and net position (equity) of the District at year-end. The net position sections of the Statement of Net Position are separated into three categories: net investment in capital assets; restricted for debt service; and unrestricted. The District had $238,388 in restricted for debt service as of December 31, 2012 and 2011.

- Statements of Revenues, Expenses, and Changes in Fund Net Position: These statements reflect the transactions and events that have increased or decreased the District's total economic resources during the period. Revenues are presented net of allowances and are summarized by major source. Revenues and expenses are classified as operating or non-operating based on the nature of the transaction.

Management's Discussion and Analysis (continued)

- Statements of Cash Flows: The Statements of Cash Flows reflect the sources and uses of cash separated into four categories of activities: operating, non-capital financing activities, capital and related financing, and investing.

The notes to the financial statements, presented at the end of the basic financial statements, are considered an integral part of the District's presentation of financial position, results of operations, and changes in cash flows.

Financial Analysis

The poor state of the economy affected almost all sectors and jurisdictions in 2012. The District was no exception. That said, the District's overall financial position and results of operations continued to be positive. The District's net position increased by $1,122,157 in 2012.

Provided below is a year-over-year analysis of the change in net position by major component of income, with a primary focus on changes between 2012 and 2011.

Operating Revenues

From 2011 to 2012, total operating revenues increased by $ 394,111 (6.85%). From 2010 to 2011, total operating revenues increased $371,273 (6.90%).

Operating Expenses

From 2011 to 2012, District operating expenses decreased by $ 402,386 (5.51%). From 2010 to 2011, District operating expenses decreased by $37,584 (.51%). Depreciation and amortization expense accounted for 25.54% of total operating expenses in 2012. This figure was 23.32% in 2011 and 22.5% in 2010.

Depreciation and amortization increased by 3.48% from 2011 to 2012 after an increase of 2.9% from 2010 to 2011.

Other Income & Expense

During 2012, property tax revenue increased $27,670. Interest income decreased due to decreasing cash and investment balances. Interest expense also decreased due to the refunding bonds issued in late 2010.

Management's Discussion and Analysis (continued)

Capital Contributions
During 2012, Capital Contributions were $787,794, a decrease of $53,602 from the $841,396 in 2011. Capital Contributions in 2010 were $718,934.

Summary of Financial Position
The overall financial position of the District remained reasonably strong during 2012 with an increase in net position of $1,122,157. The increase in net position follows an increase of $597,092 in 2011.

District management's financial policies require that financial plans be developed to maintain minimum cash and investment balances contained within unrestricted accounts sufficient to: 1) provide funding for 45 days of operating expenses based on the planned year's operating budget, and 2) provide funding for unanticipated infrastructure replacement based on 1% of total net plant. The District's unrestricted cash and cash equivalents totaled $4.9 million and $6.3 million at December 31, 2012 and 2011, respectively. Actual balances exceeded the minimum required level for each year.

In accordance with District financial policies and covenants established within the District's bond resolutions, the District is required to maintain and collect rates and charges sufficient to provide Net Revenues (defined as net income less depreciation, amortization, and interest expense) in each fiscal year in an amount at least equal to 1.25 the Annual Debt Service. For the years ended 2012, 2011 and 2010, the District's debt service coverage was 2.01, 1.66 and 1.69, respectively.

Capital Asset and Long Term Debt Activity
The District continues to have a strong rating in the market. Moody's Investor Services has assigned an underlying rating of A1 to the District on its last revenue bond issue. The District issued approximately $10.8 million in debt in 2010. The new debt was used to retire old debt and make improvements to the District's infrastructure assets. The District's 2004 and 2005 revenue bonds were rated by Standard & Poors and were assigned an insured rating of AA-. The District does not anticipate going to the market in the near future.

The District continues to develop regional infrastructure for both wholesale water supply and wholesale telecommunications service. In August 2010, PUD was awarded $3.1 million in grants from the Broadband Technology Opportunities Program. This 3-year program includes various service obligations and projects with an estimated cost of $8.5 million. The district incurred $572,688 of costs related to the federal project in 2012 and received $403,373 in reimbursements for these costs in 2012.

Debt service payments totaled $2.3 million and $2.2 million in 2012 and 2011, respectively.

Management's Discussion and Analysis (continued)

Additional information about the District's capital assets and long-term debt is presented in the following report and notes.

Condensed Comparative Financial Information

Condensed Statement of Net Position

	Dec. 31, 2012	Dec. 31, 2011	Dec. 31, 2010	$ Change '12-'11	% Change '12-'11
Assets					
Current assets	$ 6,301,125	$ 7,564,539	$ 8,921,920	$(1,263,414)	-16.70%
Utility plant	62,135,653	59,358,343	57,161,125	2,777,310	4.68%
Accumulated depreciation	(24,143,974)	(22,631,489)	(21,104,330)	(1,512,485)	6.68%
Noncurrent assets	1,243,052	1,380,007	1,531,096	(136,955)	-9.92%
Total assets	45,535,856	45,671,400	46,509,811	(135,544)	-0.30%
Deferred Outflows of Resources					
Deferred loss on refunding	101,916	113,453	124,991	(11,537)	-10.17%
Total assets and deferred outflows of resources	$45,637,772	$45,784,853	$46,634,802	$ (147,081)	-0.32%
Liabilities					
Current liabilities	2,162,275	2,054,902	2,071,398	107,373	5.23%
Long-term liabilities	13,865,825	15,242,436	16,672,981	(1,376,611)	-9.03%
Total liabilities	16,028,100	17,297,338	18,744,379	(1,269,238)	-7.34%
Net Position					
Net investment in capital assets	23,630,462	20,848,485	18,679,040	2,781,977	13.34%
Restricted	238,388	238,388	238,388	-	0.00%
Unrestricted	5,740,822	7,400,642	8,972,995	(1,659,820)	-22.43%
Total net position	29,609,672	28,487,515	27,890,423	1,122,157	3.94%
Total liabilities and net position	$45,637,772	$45,784,853	$46,634,802	$ (147,081)	-0.32%

PUBLIC UTILITY DISTRICT #1 OF KITSAP COUNTY

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Management's Discussion and Analysis (continued)

Condensed Revenues, Expenses and Changes in Net Position

	2012	2011	2010	$ Change '12-'11	% Change '12-'11
Operating Revenue					
Water Sales	$ 4,629,929	$ 4,406,849	$ 4,201,066	$ 223,080	5.06%
Telecom Sales	1,164,128	1,023,458	963,718	140,670	13.74%
Other	352,973	322,612	216,862	30,361	9.41%
Total Operating Revenue	6,147,030	5,752,919	5,381,646	394,111	6.85%
Nonoperating Revenue					
Property tax income	2,124,004	2,096,334	2,073,303	27,670	1.32%
Other income	940,599	558,407	365,912	382,192	68.44%
Total Nonoperating Revenue	3,064,603	2,654,741	2,439,215	409,862	15.44%
Total Revenue	9,211,633	8,407,660	7,820,861	803,973	9.56%
Operating Expenses	(6,903,017)	(7,305,403)	(7,342,987)	402,386	-5.51%
Nonoperating Expenses	(1,974,253)	(1,346,561)	(1,267,840)	(627,692)	46.61%
Total Expenses	(8,877,270)	(8,651,964)	(8,610,827)	(225,306)	2.60%
Income (Loss) Before Contributions	334,363	(244,304)	(789,966)	578,667	-236.86%
Capital Contributions	787,794	841,396	718,934	(53,602)	-6.37%
Change in net position	1,122,157	597,092	(71,032)	525,065	
Net position, beginning	28,487,515	27,890,423	27,961,455		
Net position, ending	$29,609,672	$ 28,487,515	$ 27,890,423		

PUBLIC UTILITY DISTRICT #1 OF KITSAP COUNTY, WASHINGTON
STATEMENT OF NET POSITION
DECEMBER 31, 2012 AND 2011

ASSETS AND DEFERRED OUTFLOWS OF RESOURCES

	DECEMBER 31,	
	2012	2011
CURRENT ASSETS		
Cash and cash equivalents	$ 4,952,125	$ 6,334,896
Accounts receivable	921,067	857,738
Property taxes receivable	114,182	123,183
Inventory materials and supplies	76,208	88,826
Short-term assessments receivable	211,058	142,813
Other current assets	26,485	17,083
Total current assets	6,301,125	7,564,539
NONCURRENT ASSETS		
Restricted cash and cash equivalents	238,388	238,388
Intangible assets, net of related amortization	361,730	403,250
Long-term notes and assessments receivable	642,934	738,369
Capital Assets Not Being Depreciated		
Land	1,180,127	1,148,698
Construction work in progress	1,551,936	862,477
Capital Assets Being Depreciated		
Utility plant in service	59,154,544	57,098,122
Utility plant acquisition adjustment	249,046	249,046
Accumulated depreciation and amortization	(24,143,974)	(22,631,489)
Net utility plant	37,991,679	36,726,854
Total noncurrent assets	39,234,731	38,106,861
Total Assets	45,535,856	45,671,400
DEFERRED OUTFLOWS OF RESOURCES		
Deferred loss on refunding	101,916	113,453
TOTAL ASSETS AND DEFERRED OUTFLOWS OF RESOURCES	$ 45,637,772	$ 45,784,853

See accompanying notes to the financial statements.

PUBLIC UTILITY DISTRICT #1 OF KITSAP COUNTY, WASHINGTON

STATEMENT OF NET POSITION

DECEMBER 31, 2012 AND 2011

LIABILITIES AND NET POSITION

	DECEMBER 31, 2012	DECEMBER 31, 2011
CURRENT LIABILITIES		
Accounts payable	$ 331,615	$ 177,577
Taxes payable	32,634	17,688
Interest payable	48,798	52,034
Retainage payable	24,811	16,372
Unamortized bond premium payable	248,420	262,543
Current portion of long-term debt	1,475,997	1,528,688
Total current liabilities	2,162,275	2,054,902
NONCURRENT LIABILITIES		
Revenue bonds	9,495,000	10,440,000
General obligation bonds	4,565,000	5,015,000
Other noncurrent debt	403,134	536,822
Accrued compensated absences (see Note 14)	358,598	414,337
Other post employment benefits liability	520,090	364,965
Less: current portion	(1,475,997)	(1,528,688)
Total noncurrent liabilities, net of current portion	13,865,825	15,242,436
Total liabilities	16,028,100	17,297,338
NET POSITION		
Net Investment in Capital Assets	23,630,462	20,848,485
Restricted for debt service	238,388	238,388
Unrestricted	5,740,822	7,400,642
Total net position	29,609,672	28,487,515
TOTAL LIABILITIES AND NET POSITION	$ 45,637,772	$ 45,784,853

See accompanying notes to the financial statements.

PUBLIC UTILITY DISTRICT #1 OF KITSAP COUNTY, WASHINGTON
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
FOR YEARS ENDED DECEMBER 31, 2012 AND 2011

	FOR YEARS ENDED DECEMBER 31, 2012	2011
OPERATING REVENUE		
Metered water sales	$ 4,623,862	$ 4,400,695
Wholesale water sales	6,067	6,154
Wholesale telecom sales	1,164,128	1,023,458
Street light revenue	51,715	50,773
Miscellaneous operating revenues	301,258	271,839
Total operating revenue	6,147,030	5,752,919
OPERATING EXPENSES		
Operations and maintenance	4,640,018	5,122,187
Administration	233,625	233,866
Depreciation and amortization	1,762,947	1,703,625
Business taxes	266,427	245,725
Total operating expenses	6,903,017	7,305,403
OPERATING LOSS	(755,987)	(1,552,484)
NONOPERATING REVENUES (EXPENSES)		
Property taxes	2,124,004	2,096,334
Grant income	460,544	20,000
Interest income	88,397	118,368
Gain (loss) on disposal of assets	(7,530)	9,169
Interest expense	(608,132)	(661,313)
Nonoperating program expenses	(1,366,121)	(685,248)
Contract revenue	399,188	410,870
Total nonoperating revenues (expenses)	1,090,350	1,308,180
INCOME (LOSS) BEFORE CONTRIBUTIONS	334,363	(244,304)
CAPITAL CONTRIBUTIONS	787,794	841,396
CHANGE IN NET POSITION	1,122,157	597,092
TOTAL NET POSITION, BEGINNING OF YEAR	$ 28,487,515	$ 27,890,423
TOTAL NET POSITION, END OF YEAR	$ 29,609,672	$ 28,487,515

See accompanying notes to the financial statements.

PUBLIC UTILITY DISTRICT #1 OF KITSAP COUNTY, WASHINGTON
STATEMENT OF CASH FLOWS
FOR YEARS ENDED DECEMBER 31, 2012 AND 2011

	FOR YEARS ENDED DECEMBER 31, 2012	FOR YEARS ENDED DECEMBER 31, 2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from customers	$ 6,083,701	$ 5,620,201
Payments to contractors, suppliers and employees	(4,617,006)	(5,243,147)
Taxes paid	(251,481)	(244,420)
Net cash provided by (used in) operating activities	1,215,214	132,634
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Contract revenue	399,188	410,870
Property taxes received	2,133,005	2,098,027
Other receipts (payments) for nonoperating program expenses	(1,366,117)	(685,247)
Net cash provided by (used in) noncapital financing activities	1,166,076	1,823,650
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Additions to utility plant and construction work in progress	(2,785,237)	(1,814,767)
Proceeds from disposition of assets	4,278	10,986
Proceeds from grants	460,544	20,000
Principal paid on debt	(1,528,688)	(1,510,924)
Interest paid on debt	(613,954)	(671,242)
Cash received from notes and assessments	27,190	99,774
Capital contributions	583,409	318,500
Net cash provided by (used in) capital and related financing activities	(3,852,458)	(3,547,673)
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest income on investments	88,397	118,368
Net cash provided by (used in) investing activities	88,397	118,368
Net increase (decrease) in cash and cash equivalents	(1,382,771)	(1,473,021)
Cash and cash equivalents, beginning of year	$ 6,573,284	$ 8,046,305
Cash and cash equivalents, end of year	$ 5,190,513	$ 6,573,284

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES:
During 2012 and 2011 the District received non-cash capital contributions of $204,385 and $522,896 respectively.

See accompanying notes to the financial statements.

PUBLIC UTILITY DISTRICT #1 OF KITSAP COUNTY, WASHINGTON

STATEMENT OF CASH FLOWS

FOR YEARS ENDED DECEMBER 31, 2012 AND 2011

	FOR YEARS ENDED DECEMBER 31, 2012	FOR YEARS ENDED DECEMBER 31, 2011
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES		
Operating loss	$ (755,987)	$ (1,552,484)
Adjustments to reconcile operating loss to net cash provided by (used in) operating activities:		
Depreciation and amortization expense	1,762,947	1,703,625
Change in assets and liabilities:		
Decrease (increase) in accounts receivable	(63,329)	(132,717)
Decrease (increase) in inventory materials and supplies	12,618	(2,352)
Decrease (increase) in other current assets	(9,402)	27,386
(Decrease) increase in taxes payable	14,946	1,305
(Decrease) increase in accounts payable	154,035	(10,269)
(Decrease) increase in other accrueds	99,386	98,140
Net cash provided by (used in) operating activities	$ 1,215,214	$ 132,634

See accompanying notes to the financial statements.

NOTE 1 - SUMMARY OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES

Kitsap Public Utility District (KPUD or District) is a municipal corporation in Washington State with incorporated boundaries the same as Kitsap County. The District is governed by an elected board of commissioners. Its purpose is to preserve and protect the water resources of Kitsap County for the benefit of the people, and to supply public utility service. KPUD has broad authority and responsibility under Chapter 54, Revised Code of Washington.

KPUD was formed at the general election of 1940 by a vote of the county's electorate to explore providing electrical service as a public special purpose District instead of a private company. U.S. entry into World War II and rapid growth in and around the naval shipyard at Bremerton initially delayed and eventually precluded assumption of electric service in Kitsap County by KPUD. In 1959, the District initiated several actions to study regional water resources in Kitsap County. In 1963, KPUD's Board recognized the necessity for long-range water supply plans to avert future shortages. Regional resource plans, studies, and assessments have taken on increasing importance.

Kitsap Public Utility District strives to provide quality water and wholesale telecommunication utility services to citizens of Kitsap County. KPUD provides safe, reliable drinking water to over 13,400 customers throughout Kitsap County. The wholesale telecommunication service expands communication choices for Kitsap County residents, businesses and public agencies from Port Orchard to Bainbridge Island.

The accounting policies of Public Utility District #1 of Kitsap County, Washington (The District) conform to generally accepted accounting principles as applicable to proprietary funds of governments. 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 more significant policies:

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

Basis of accounting and presentation – The accounting records of the District are maintained in accordance with methods prescribed by the State Auditor under the authority of Chapter 43.09 RCW. The District uses the Uniform System of Accounts for Class A Water Utilities.

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

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Unbilled District utility service receivables are recorded at year-end.

The District distinguishes operating revenues and expenses from non-operating ones. Operating revenues and expenses result from providing services and producing and delivering goods in connection with the District's principal ongoing operations. The principal operating revenues of the District are charges to customers for water and telecom services. The District also recognizes as operating revenue street light revenues and other miscellaneous operating revenues. Operating expenses for the District include costs to operate and maintain the water and telecom systems, customer service, marketing, administration, depreciation and business taxes. All revenues and expenses not meeting this definition are reported as non-operating revenues and expense.

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

Utility Plant and Depreciation – Capital assets are defined by the District as assets with initial individual cost of more than $500 and an estimated useful life in excess of 1 year.

Major expenses for capital assets, including capital leases and major repairs that increase useful lives, are capitalized. Maintenance, repairs, and minor renewals are accounted for as expenses when incurred.

Utility plant in service and other capital assets are recorded at cost. Donations by developers and customers are recorded at the contract price and donor cost.

The original cost of operating property retired or otherwise disposed of and the cost of installation, less salvage, is charged to income.

Depreciation is computed on the straight-line method with the following useful lives:

Buildings and improvements	40 - 50 years
Water storage, transportation and treatment	25 - 80 years
Transportation equipment	5 - 7 years
General equipment	5 - 10 years

See Note 4 for a detail schedule of assets and depreciation.

Restricted funds – The District obtained a Municipal Bond Insurance Policy from Financial Security Assurance Inc. The Policy guarantees the scheduled payment of principal and interest on bonds issued in 2004, 2005, and 2010.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

In accordance with bond resolutions (and certain related agreements) separate restricted funds are required to be established for bonds issued in 2010. The assets held in these funds are restricted for specific uses, including debt service and other special reserve requirements. Restricted funds include $238,388 in cash as of December 31, 2012 and 2011.

Receivables - Receivables are written off in the year that they are deemed to be uncollectible.

Inventories - Inventories are valued at cost, which approximates the market value. The District uses specific identification to determine inventory costs.

Investments – All investments of the District's funds are obligations of the U.S. Government, the Kitsap County Treasurer's Investment Pool, banker's acceptances, or deposits with Washington State banks and savings and loan institutions pursuant to the requirements of Chapter 39.58 RCW.

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 be accumulated up to 1,040 hours. However, a maximum of 520 hours is payable upon resignation, retirement or death.

Unamortized debt expenses – Costs relating to the sale of bonds are deferred and amortized over the lives of the various bond issues.

Deferred Inflows & Outflows of Resources – The District recognizes deferred losses on refunding of bonds as a deferred outflow of resource.

Capital Contributions – Capital contributions for the District consist mainly of connection fees and developer extensions.

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.

Reclassifications – Certain 2011 balances have been reclassified to conform to 2012 presentation.

NOTE 2 - DEPOSITS AND INVESTMENTS

As required by state law, all investments of the District's funds are obligations of the U.S. Government, the Kitsap County Treasurer's Investment Pool, banker's acceptances, or deposits with Washington State banks and savings and loan institutions. The District does not have a formally adopted investment policy at this time.

Investments –
As of December 31, 2012, the district had the following investments:

Investment type	Maturities	Fair Value
Kitsap County Treasurer's Investment Pool	50 days Avg	$ 4,063,717

As of December 31, 2011, the district had the following investments:

Investment type	Maturities	Fair Value
Kitsap County Treasurer's Investment Pool	50 days Avg	$ 6,042,815

All investments are listed at cost and approximate fair market value. Management intends to hold the time deposits and securities until maturity; therefore, temporary declines in market value are not reflected in the financial statements. The District's investments were all held with the Kitsap County Treasurer's Investment Pool, and are therefore not subject to risk categorization. The investment pool is administered by the Kitsap County Treasurer.

Custodial credit risk – Deposits. For a deposit, this is the risk that in the event of a bank failure, the District's deposits may not be returned to it. The District's deposits are entirely covered by the Federal Deposit Insurance Corporation (FDIC) or by collateral held in a multiple financial institution collateral pool administered by the PDPC. Under state law, public depositories under the PDPC may be assessed on a prorated basis if the pool's collateral is insufficient to cover a loss. As a result, deposits covered by collateral held in the multiple financial institution collateral pool are considered to be insured. State law requires that deposits may be made only with institutions that are approved by the PDPC.

NOTE 3 – OPERATING LEASES

The District is committed under various leases for facilities to house water and telecommunications equipment. These leases are considered operating leases for accounting purposes. Lease expenses for the years ending December 31, 2012 and 2011 amounted to $48,541 and $47,378, respectively. Future minimum lease commitments for these leases are:

Fiscal Year Ending December 31:	
2013	$ 49,501
2014	49,877
2015	50,210
2016	50,564
2017	48,455
Total	$ 248,607

NOTE 4 – UTILITY PLANT AND DEPRECIATION

Utility plant activity for the years ended December 31, 2012 was as follows:

	12/31/2011	Increase	Decrease	12/31/2012
Capital assets not being depreciated				
Land and land rights	$ 1,148,698	$ 31,429	$ -	$ 1,180,127
Construction work in progress	862,477	689,459		1,551,936
Total capital assets not being depreciated	2,011,175	720,888	-	2,732,063
Capital assets being depreciated				
Wells	5,664,326	108,917		5,773,243
Supply mains	21,783,111	912,674		22,695,785
Water treatment equipment	674,412	-		674,412
Pumping plant	4,276,216	370,265		4,646,481
Water storage	5,632,298	43,004		5,675,302
Water system comprehensive plan	741,177	1,230		742,407
Services	4,253,377	62,006		4,315,383
Hydrants	1,254,235	58,082		1,312,317
Communication equipment	70,400	95,116	20,924	144,592
Office building	988,618	26,520		1,015,138
Databases	2,299	26,173		28,472
Plant buildings	71,077	-		71,077
Office furniture and equipment	173,881	605	9,669	164,817
Vehicles	686,301	19,831	36,778	669,354
Utility equipment	467,876	7,191	61,207	413,860
Computer equipment	170,027	13,096	9,777	173,346
Telemetry equipment	320,227	5,446	4,757	320,916
Computer software	125,830	8,101	9,152	124,779
Leasehold improvements	31,247	-		31,247
Maintenance building and improv	993,201	8,623		1,001,824
Utility plant adjustment account	249,046	-		249,046
Electronic equipment - telecom	1,156,606	75,518	61,428	1,170,696
Poles, towers & fixtures - telecom	109,422	38,197	1,761	145,858
Fiber systems - telecom	6,752,800	341,759		7,094,559
Services - telecom	346,807	49,440	3,568	392,679
Plant building - telecom	249,053	-		249,053
Communication equipment - telecom	69,190	-	745	68,445
Computers - telecom	34,108	5,377	983	38,502
Total capital assets being depreciated	57,347,168	2,277,171	220,749	59,403,590
Depreciation and amortization				
Accumulated depreciation	22,382,720	1,721,150	208,942	23,894,928
Accumulated amortization (UPAA)	248,769	277		249,046
Total accum. depreciation and amort.	22,631,489	1,721,427	208,942	24,143,974
Total utility plant being depreciated, net	34,715,679			35,259,616
Net Utility Plant	$ 36,726,854			$ 37,991,679
Intangible assets				
Unamortized debt disc. & exp.	$ 820,065	$ -	$ -	$ 820,065
Accumulated amortization (Bond Costs)	416,815	41,520		458,335
Intangible assets, net of amortization	$ 403,250	$ 41,520	$ -	$ 361,730

NOTE 4 – UTILITY PLANT AND DEPRECIATION (continued)

Utility plant activity for the years ended December 31, 2011 was as follows:

	12/31/2010	Increase	Decrease	12/31/2011
Capital assets not being depreciated				
Land and land rights	$ 1,139,548	$ 9,150	$ -	$ 1,148,698
Construction work in progress	188,550	673,927		862,477
Total capital assets not being depreciated	1,328,098	683,077	-	2,011,175
Capital assets being depreciated				
Wells	5,566,965	97,361		5,664,326
Supply mains	21,160,385	622,726		21,783,111
Water treatment equipment	671,124	3,288		674,412
Pumping plant	4,227,756	48,460		4,276,216
Water storage	5,627,873	4,425		5,632,298
Water system comprehensive plan	678,549	62,628		741,177
Services	4,133,597	119,780		4,253,377
Hydrants	1,181,250	72,985		1,254,235
Communication equipment	62,090	9,500	1,190	70,400
Office building	954,177	34,441		988,618
Databases	2,299	-		2,299
Plant buildings	70,305	772		71,077
Office furniture and equipment	181,949	2,810	10,878	173,881
Vehicles	672,665	84,908	71,272	686,301
Utility equipment	423,472	44,404		467,876
Computer equipment	192,965	23,023	45,961	170,027
Telemetry equipment	308,037	12,190		320,227
Computer software	125,330	500		125,830
Leasehold improvements	31,247	-		31,247
Maintenance building and improv	992,665	536		993,201
Utility plant adjustment account	249,046	-		249,046
Electronic equipment - telecom	1,072,102	89,562	5,058	1,156,606
Poles, towers & fixtures - telecom	109,422	-		109,422
Fiber systems - telecom	6,495,008	257,792		6,752,800
Services - telecom	335,994	10,813		346,807
Plant building - telecom	249,053	-		249,053
Communication equipment - telecom	28,696	40,494		69,190
Computers - telecom	29,006	7,361	2,259	34,108
Total capital assets being depreciated	55,833,027	1,650,759	136,618	57,347,168
Depreciation and amortization				
Accumulated depreciation	20,857,280	1,660,240	134,800	22,382,720
Accumulated amortization (UPAA)	247,050	1,719		248,769
Total accum. depreciation and amort.	21,104,330	1,661,959	134,800	22,631,489
Total utility plant being depreciated, net	34,728,697			34,715,679
Net Utility Plant	$ 36,056,795			$ 36,726,854
Intangible assets				
Unamortized debt disc. & exp.	$ 820,065	$ -	$ -	$ 820,065
Accumulated amortization (Bond Costs)	375,150	41,665		416,815
Intangible assets, net of amortization	$ 444,915	$ 41,665	$ -	$ 403,250

NOTE 5 - CONSTRUCTION IN PROGRESS

Construction in progress represents expenses to date on projects for which authorizations total $7,589,738 and $7,274,533 in 2012 and 2011, respectively.

NOTE 6 - LONG-TERM DEBT

During the year ended December 31, 2012, the following changes occurred in long-term debt:

Revenue Bonds	BEGINNING BALANCE	ADDITIONS	REDUCTIONS	ENDING BALANCE	DUE WITHIN ONE YEAR
2002 Revenue Bonds - Serial bonds $80,000-$225,000 due through December 1, 2021. Interest at 1.60% to 4.95%	$ 150,000		$ 150,000	$ -	$ -
2004(B) Revenue Bonds - Serial bonds $25,000-$135,000 due through December 1, 2023. Interest at 3.00% to 4.90%	1,315,000		85,000	1,230,000	90,000
2005 Revenue Bonds - Serial bonds $65,000-$320,000 due through December 1, 2025. Interest at 4.00% to 4.20%	3,490,000		195,000	3,295,000	200,000
2010 Revenue Bonds - Serial bonds $160,000-$590,000 due through December 1, 2030. Interest at 2.00% to 4.50%.	5,485,000		515,000	4,970,000	590,000
Total revenue bonds	$ 10,440,000	$ -	$ 945,000	$ 9,495,000	$ 880,000
General Obligation Bonds					
2001(B) G/O Bonds - Serial bonds $60,000-$420,000 due through December 1, 2019. Interest at 4.95%	700,000		-	700,000	-
2010(A) G/O Bonds - Serial Bonds $80,000-$420,000 due through December 1, 2030. Interest at 0.87% to 6.20%.	3,915,000		390,000	3,525,000	395,000
2010(B) G/0 Bonds - Serial Bonds $65,000-$75,000 due through December 1, 2017. Interest at 2.00% to 3.00%.	400,000		60,000	340,000	65,000
Total general obligation bonds	$ 5,015,000	$ -	$ 450,000	$ 4,565,000	$ 460,000
Long Term Debt					
Note Payable: Public Works Trust Fund - Annual payments $92,763 plus interest due through July, 2015, interest at 1.00%	$ 371,052		$ 92,763	$ 278,289	$ 92,763
Note Payable: Frog Pond Waters, Inc. - Monthly p&i payments $4,085 due through September, 2014, interest at 5.50%	165,770		40,925	124,845	43,234
Total other long term debt	$ 536,822	$ -	$ 133,688	$ 403,134	$ 135,997
Other Long Term Liability					
OPEB Payable	$ 364,965	$ 155,125	$ -	$ 520,090	$ -

NOTE 6 - LONG-TERM DEBT (continued)

During the year ended December 31, 2011, the following changes occurred in long-term debt:

Revenue Bonds	BEGINNING BALANCE	ADDITIONS	REDUCTIONS	ENDING BALANCE	DUE WITHIN ONE YEAR
2002 Revenue Bonds - Serial bonds $80,000-$225,000 due through December 1, 2021. Interest at 1.60% to 4.95%	$ 295,000		$ 145,000	$ 150,000	$ 150,000
2004(B) Revenue Bonds - Serial bonds $25,000-$135,000 due through December 1, 2023. Interest at 3.00% to 4.90%	1,395,000		80,000	1,315,000	85,000
2005 Revenue Bonds - Serial bonds $65,000-$320,000 due through December 1, 2025. Interest at 4.00% to 4.20%	3,640,000		150,000	3,490,000	195,000
2010 Revenue Bonds - Serial bonds $160,000-$590,000 due through December 1, 2030. Interest at 2.00% to 4.50%.	6,015,000		530,000	5,485,000	515,000
Total revenue bonds	$ 11,345,000	$ -	$ 905,000	$ 10,440,000	$ 945,000

General Obligation Bonds					
2001(B) G/O Bonds - Serial bonds $60,000-$420,000 due through December 1, 2019. Interest at 4.95%	$ 700,000	$ -	$ -	$ 700,000	$ -
2010(A) G/O Bonds - Serial Bonds $80,000-$420,000 due through December 1, 2030. Interest at 0.87% to 6.20%.	4,300,000		385,000	3,915,000	390,000
2010(B) G/0 Bonds - Serial Bonds $65,000-$75,000 due through December 1, 2017. Interest at 2.00% to 3.00%.	465,000		65,000	400,000	60,000
Total general obligation bonds	$ 5,465,000	$ -	$ 450,000	$ 5,015,000	$ 450,000

Long Term Debt					
Note Payable: Public Works Trust Fund - Annual payments $5,162 plus interest due through July, 2011, interest at 1.00%	$ 5,162	$ -	$ 5,162	$ -	$ -
Note Payable: Public Works Trust Fund - Annual payments $92,763 plus interest due through July, 2015, interest at 1.00%	463,816		92,764	371,052	92,763
Note Payable: Frog Pond Waters, Inc. - Monthly p&i payments $4,085 due through September, 2014, interest at 5.50%	204,510		38,740	165,770	40,925
Note Payable: Sanderson & Associates - Semi annual p&i payments $19,836 due through January, 2011, interest at 6.00%	19,258		19,258	-	-
Total other long term debt	$ 692,746	$ -	$ 155,924	$ 536,822	$ 133,688

Other Long Term Liability					
OPEB Payable	$ 252,923	$ 112,042	$ -	$ 364,965	$ -

NOTE 6 - LONG-TERM DEBT (continued)

The annual requirements to amortize all debts outstanding as of December 31, 2012 and 2011, including interest, are as follows.

Fiscal Year Ending December 31,	Principal	Interest	Total
2011	$ 1,510,924	$ 671,243	$ 2,182,167
2012	1,528,688	613,952	2,142,640
2013	1,475,997	577,454	2,053,451
2014	1,208,436	538,093	1,746,529
2015	1,213,701	505,125	1,718,826
2016	1,115,000	469,054	1,584,054
2017-2021	5,065,000	1,676,370	6,741,370
2022-2026	2,930,000	736,666	3,666,666
2027-2030	1,455,000	184,463	1,639,463
Total	$17,502,746	$5,972,420	$23,475,166

There is $238,388 in restricted assets of the district as of December 31, 2012 and 2011. These represent reserve requirements as contained in the various indentures.

There are a number of other limitations and restrictions contained in the various bond indentures. The District is in compliance with all significant limitations and restrictions.

Revenue Bonds

The District has pledged future gross revenue plus any LUD Assessments, net of operation and maintenance expenses to repay $6,015,000 in 2010 revenue bonds issued in November, 2010. Proceeds from the bonds will be used to finance capital improvements, to refund a portion of the District's Outstanding Bonds, to fund the Reserve Fund, and to pay the costs of issuance of the Bonds. The bonds are payable solely from future gross revenue plus any LUD Assessments and are payable through 2030. The total principal and interest remaining to be paid on the bonds is $6,628,720 and $7,345,985 as of December 31, 2012 and 2011, respectively. Principal and interest paid during 2012 and 2011 was $717,265 and $755,873, respectively.

NOTE 6 - LONG-TERM DEBT (continued)

The following bond issues were refunded with the 2010 bond issue:

Bond Issue	Amount Outstanding
1998 Water Improvement and Refunding Revenue Bonds, Series 1998	$1,075,000
1999 Water Revenue Bonds, Series 1999	70,000
2002 Water System Revenue Bonds, 2002	1,695,000
Total Refunded Bonds Outstanding	$2,840,000

This advance and current refunding was undertaken to reduce total debt service payments through 2021 by $776,354.

Debt service on these bonds is met by cash and investments held by the refunding trustee. As of December 31, 2012 and 2011, the trustee was holding cash and investments which are expected to fund debt service fully. These refunded bonds constitute a contingent liability of the district but are excluded from the financial statements.

General Obligation Bonds

The District has pledged the full faith, credit and resources to repay $4,765,000 in 2010 revenue bonds issued in November 2010. Proceeds from the bonds will be used to finance capital improvements, to refund a portion of the District's Outstanding Bonds, to fund the Reserve Fund, and to pay the costs of issuance of the Bonds. The bonds are payable solely from the full faith, credit and resources and are payable through 2030. The total principal and interest remaining to be paid on the bonds is $5,276,584 and $5,884,398 as of December 31, 2012 and 2011, respectively. Principal and interest paid during 2012 and 2011 was $607,815 and $622,392, respectively.

The following bond issues were refunded with the 2010 bond issue.

Bond Issue	Amount Outstanding
Limited Tax General Obligation Bonds, 2001 Series A (Taxable)	$2,235,000
Limited Tax General Obligation Bonds, 1998	475,000
Total Refunded Bonds Outstanding	$2,710,000

This advance and current refunding was undertaken to reduce total debt service payments through 2021 by $804,681.

NOTE 6 - LONG-TERM DEBT (continued)

Debt service on these bonds is met by cash and investments held by the refunding trustee. As of December 31, 2012 and 2011, the trustee was holding cash and investments which are expected to fund debt service fully. These refunded bonds constitute a contingent liability of the district but are excluded from the financial statements

NOTE 7 - PENSION PLAN

Substantially all of the District's 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 retirement plans. The Department of Retirement Systems (DRS), a department within the primary government of the State of Washington, issues a publicly available comprehensive annual financial report (CAFR) that includes financial statements and required supplementary information for each plan. The DRS CAFR may be obtained by writing to: Department of Retirement Systems, Communications Unit, P.O. Box 48380, Olympia, WA 98504-8380; or it may be downloaded from the DRS website at www.drs.wa.gov. The following disclosures are made pursuant to GASB Statement No. 27, *Accounting for Pensions by State and Local Government Employers* and *Statement* No. 50, *Pension Disclosures, an Amendment of GASB Statements No. 25 and No. 27.*

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

Plan Description

The Legislature established PERS in 1947. Membership in the system includes: elected officials; state employees; employees of the Supreme, Appeals, and Superior courts; employees of legislative committees; community and technical colleges, college and university employees not participating in higher education retirement programs; employees of district and municipal courts; and employees of local governments. Approximately 50% of PERS salaries are accounted for by state employment. PERS retirement benefit provisions are established in Chapters 41.34 and 41.40 RCW and may be amended only by the State Legislature.

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.

NOTE 7 - PENSION PLAN (continued)

PERS members who joined the system by September 30, 1977 are Plan 1 members. Those who joined on or after October 1, 1977 and by either, February 28, 2002 for state and higher education employees, or August 31, 2002 for local government employees, are Plan 2 members unless they exercise an option to transfer their membership to Plan 3. PERS members joining the system on or after March 1, 2002 for state and higher education employees, or September 1, 2002 for local government employees have the irrevocable option of choosing membership in either PERS Plan 2 or 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 Plan 3. Notwithstanding, PERS Plan 2 and Plan 3 members may opt out of plan membership if terminally ill, with less than five years to live.

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

PERS Plan 1 and Plan 2 retirement benefits are financed from a combination of investment earnings and employer and employee contributions. Employee contributions to the PERS Plan 1 and Plan 2 defined benefit plans accrue at a rate specified by the Director of DRS. During DRS' Fiscal Year 2012, the rate was five and one-half percent compounded quarterly. Members in PERS Plan 1 and Plan 2 can elect to withdraw total employee contributions and interest thereon upon separation from PERS-covered employment.

PERS Plan 1 members are vested after the completion of five years of eligible service.

PERS Plan 1 members are eligible for retirement after 30 years of service, or at the age of 60 with five years of service, or at the age of 55 with 25 years of service. The monthly benefit is two percent of the average final compensation (AFC) per year of service, but the benefit may not exceed 60% of the AFC. The AFC is the monthly average of the 24 consecutive highest-paid service credit months.

NOTE 7 - PENSION PLAN (continued)

The monthly benefit is subject to a minimum for retirees who have 25 years of service and have been retired 20 years, or who have 20 years of service and have been retired 25 years. Plan 1 members retiring from inactive status prior to the age of 65 may receive actuarially reduced benefits. Plan 1 members may elect to receive an optional COLA that provides an automatic annual adjustment based on the Consumer Price Index. The adjustment is capped at 3 percent annually. To offset the cost of this annual adjustment, the benefit is reduced.

PERS Plan 1 provides duty and non-duty disability benefits. Duty disability retirement benefits for disablement prior to the age of 60 consist of a temporary life annuity. The allowance amount is $350 a month, or two-thirds of the monthly AFC, whichever is less. The benefit is reduced by any workers' compensation benefit and is payable as long as the member remains disabled or until the member attains the age of 60 at which time the benefit is converted to the member's service retirement amount. A member with five years of covered employment is eligible for non-duty disability retirement. Prior to the age of 55, the benefit amount is 2 percent of the AFC for each year of service reduced by 2 percent for each year that the member's age is less than 55. The total benefit is limited to 60 percent of the AFC and is actuarially reduced to reflect the choice of a survivor option. Plan 1 members may elect to receive an optional COLA amount (based on the consumer Price Index), capped at 3 percent annually. To offset the cost of this annual adjustment, the benefit is reduced.

PERS Plan 1 members can receive credit for military service while actively serving in the military if such credit makes them eligible to retire. Members can also purchase up to 24 months of service credit lost because of an on-the-job injury.

The survivor of a PERS Plan 1 member who dies after having earned ten years of service credit has the option, upon the member's death, of either a monthly survivor benefit or the lump sum of contributions plus interest.

PERS Plan 2 members are vested after the completion of five years of eligible service. Plan 2 members are eligible for normal retirement at the age of 65 with five years of service. The monthly benefit is 2 percent of the AFC per year of service. The AFC is the monthly average of the 60 consecutive highest-paid service months. There is no cap on years of service credit; and a cost-of-living allowance is granted (based on the Consumer Price Index), capped at 3 percent annually

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

NOTE 7 - PENSION PLAN (continued)

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

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

PERS Plan 2 retirement benefits are also actuarially reduced to reflect the choice, if made, of a survivor option. The surviving spouse or eligible child(ren) of a PERS Plan 2 member who dies after having earned ten years of service credit has the option of either a monthly benefit or a lump sum payment of the member's contributions plus interest.

PERS Plan 3 has a dual benefit structure. Employer contributions finance a defined benefit component, and member contributions finance a defined contribution component. As established by Chapter 41.34 RCW, employee contribution rates to the defined contribution component range from 5 percent to 15 percent of salaries, based on member choice. There are currently no requirements for employer contributions to the defined contribution component of PERS Plan 3.

PERS Plan 3 defined contribution retirement benefits are dependent upon the results of investment activities. Members may elect to self-direct the investment of their contributions. Any expenses incurred in conjunction with self-directed investments are paid by mmebers. Absent a member's self-direction, PERS Plan 3 investments are made in the same portfolio as that of the PERS 2/3 defined benefit plan.

For DRS' fiscal year 2012, PERS Plan 3 employee contributions were $95.2 million, and plan refunds paid out were $66.2 million.

The defined benefit portion of PERS Plan 3 provides members a monthly benefit that is 1 percent of the AFC per year of service. The AFC is the monthly average of the 60 consecutive highest-paid service months. There is no cap on years of service credit, and Plan 3 provides the same cost-of-living allowance as Plan 2.

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 of service, if twelve months of that service are earned after age 44; or after five service credit years earned in PERS Plan 2 by June 1, 2003. Plan 3 members are immediately vested in the defined contribution portion of their plan.

NOTE 7 - PENSION PLAN (continued)

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

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

PERS Plan 3 benefit retirement benefits are also actuarially reduced to reflect the choice, if made, of a survivor option.

PERS Plan 2 and Plan 3 provide disability benefits. There is no minimum amount of service credit required for eligibility. The Plan 2 monthly benefit amount is 2 percent of the AFC per year of service. For Plan 3, the monthly benefit amount is 1 percent of the AFC per year of service. These disability benefit amounts are actuarially reduced for each year that the member's age is less than 65, and to reflect the choice of a survivor option. There is no cap on years of service credit, and a cost-of-living allowance is granted (based on the Consumer Price Index) capped at 3 percent annually.

PERS Plan 2 and Plan 3 members may have up to ten years of interruptive military service credit; five years at no cost and five years that may be purchased by paying the required contributions.

PERS Plan 2 and Plan 3 members who become totally incapacitated for continued employment while serving the uniformed services, or a surviving spouse or eligible child(ren), may request interruptive military service credit.

PERS Plan 2 and Plan 3 members can purchase up to 24 months of service credit lost because of an on-the-job injury.

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

NOTE 7 - PENSION PLAN (continued)

Beneficiaries of a PERS Plan 2 or Plan 3 member with ten years of service who is killed in the course of employment receive retirement benefits without actuarial reduction. This provision applies to any member killed in the course of employment, on or after June 10, 2004, if found eligible by the Department of Labor and Industries.

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

From January 1, 2007 through December 31, 2007, judicial members of PERS were given the choice to elect participation in the Judicial Benefit Multiplier (JBM) Program enacted in 2006. Justices and judges in PERS Plan 1 and Plan 2 were able to make an irrevocable election to pay increased contributions that would fund a retirement benefit with a 3.5 percent multiplier. The benefit would be capped at 75 percent of AFC. Judges in PERS Plan 3 could elect a 1.6 percent of pay per year of service benefit, capped at 37.5 percent of AFC.

Members who chose to participate would: accrue service credit at the higher multiplier beginning with the date of their election; be subject to the benefit cap of 75 percent of AFC; stop contributing to the Judicial Retirement Account (JRA); pay higher contributions; and be given the option to increase the multiplier on past judicial service. Members who did not choose to participate would: continue to accrue service credit at the regular multiplier; not be subject to a benefit cap; continue to participate in JRA, if applicable; continue to pay contributions at the regular PERS rate; and never be a participant in the JBM Program.

Newly elected or appointed justices and judges who chose to become PERS members on or after January 1, 2007, or who had not previously opted into PERS membership, were required to participate in the JBM Program. Members required into the JBM program would: return to prior PERS Plan if membership had previously been established; be mandated into Plan 2 and not have a Plan 3 transfer choice, if a new PERS member; accrue the higher multiplier for all judicial service; not contribute to JRA; and not have the option to increase the multiplier for past judicial service.

NOTE 7 - PENSION PLAN (continued)

There are 1,184 participating employers in PERS. Membership in PERS consisted of the following as of the latest actuarial valuation date for the plans of June 30, 2011:

Retirees and Beneficiaries Receiving Benefits	79,363
Terminated Plan Members Entitled to But Not Yet Receiving Benefits	29,925
Active Plan Members Vested	105,578
Active Plan Members Nonvested	46,839
Total	**261,705**

Funding Policy

Each biennium, the state Pension Funding Council adopts PERS Plan 1 employer contribution rates, PERS Plan 2 employer and employee contribution rates, and PERS Plan 3 employer contribution rates. Employee contribution rates for Plan 1 are established by statute at six percent for state agencies and local government unit employees, and at 7.5 percent for state government elected officials. 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. Under PERS Plan 3, employer contributions finance the defined benefit portion of the plan, and member contributions finance the defined contribution portion. The Plan 3 employee contribution rates range from 5% to 15%, based on member choice. Two of the options are graduated rates dependent on the employee's age.

As a result of the implementation of the Judicial Benefit Multiplier Program in January 2007, a second tier of employer and employee rates was developed to fund, along with investment earnings, the increased retirement benefits of those justices and judges that participate in the program.

The methods used to determine the contribution requirements are established under state statute in accordance with chapters 41.40 and 41.45 RCW.

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

	PERS Plan 1	PERS Plan 2	PERS Plan 3
Employer*	7.21%**	7.21%**	7.21%***
Employee	6.00%****	4.64%****	*****

* The employer rates include the employer administrative expense fee currently set at 0.16%.
** The employer rate for state elected officials is 10.74% for Plan 1 and 7.21% for Plan 2 and Plan 3.
*** Plan 3 defined benefit portion only.
**** The employee rate for state elected officials is 7.50% for Plan 1 and 4.64% for Plan 2.
***** Variable from 5.0% minimum to 15.0% maximum based on rate selected by the PERS 3 member.

NOTE 7 - PENSION PLAN (continued)

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

	PERS Plan 1	PERS Plan 2	PERS Plan 3
2012	$ 4,142	$ 149,566	$ 69,105
2011	$ 3,508	$ 127,651	$ 61,120
2010	$ 2,841	$ 111,050	$ 50,372

NOTE 8 – TELECOMMUNICATION SERVICES

The Kitsap Public Utility District telecommunications/fiber optic network will provide cost-effective, high technology communication facilities allowing: open access to wholesale bandwidth facilitating the economic development of Kitsap County and customer choice, economical and efficient service to customers, now and in the future, by maximizing productivity of the District's assets, efficient management of water resources in Kitsap County, improved transfer of Geographic Information Systems (GIS) data between the District and other agencies, and expanded and improved District telecommunications.

The Kitsap Public Utility District provides wholesale telecommunications service to internet service providers, cable companies, competitive and independent local exchange carriers, and other service providers. The District also facilitates cost-effective last mile solutions.

Depreciation is allocated based on the ratio of telecom assets to total assets in service.

Telecommunications revenue and expenses are as follows:

	2012	2011
Revenues:		
Wholesale telecommunications sales	$ 1,164,128	$ 1,023,458
Installation charges	48,600	102,048
Other telecommunications revenue	5,636	1,191
Total revenues	$ 1,218,364	$ 1,126,697
Operating Expenses:		
Operations and maintenance	(876,747)	(1,172,141)
Administrative	(8,124)	(7,200)
Total operating expenses	(884,871)	(1,179,341)
Operating Income (Loss)	$ 333,493	$ (52,644)
Depreciation	(487,170)	(471,007)
Net Income (Loss)	$ (153,677)	$ (523,651)
Capital Investment:		
Capital investment (current)	$ 510,291	$ 406,022
Capital investment (cumulative)	$ 9,159,792	$ 8,717,984

NOTE 9 – PROPERTY TAXES

The county treasurer acts as an agent to collect property taxes levied in the county for all taxing authorities. Taxes are levied annually on January 1, on property value listed as of the prior May 31. Assessed values are established by the county assessor at 100 percent of fair market value. A revaluation of all property is required every four years.

Taxes are due in two equal installments on April 30 and October 31. Collections are distributed monthly to the District by the county treasurer.

The District is permitted by law to levy up to $.45 per $1,000 of assessed valuation for general District purposes. Washington State constitution and Washington State Law, RCW 84.55.010, limit the rate. The District may also levy taxes at a lower rate.

For 2012, the District's regular tax levy was .078042 per $1,000 on a total assessed valuation of $27,132,438,757 plus timber excise distribution of $1,962 for a total regular levy of $2,119,441.

For 2011, the District's regular tax levy was .073755 per $1,000 on a total assessed valuation of $28,434,461,783 plus timber excise distribution of $1,438 for a total regular levy of $2,098,626.

Property taxes are recorded as receivables when levied. Since State law allows for sale of property for failure to pay taxes, no estimate of uncollectible taxes is made.

Special levies approved by the voters are not subject to the above limitations.

NOTE 10 - OTHER POSTEMPLOYMENT BENEFITS

Plan Description

Public Utility District No. 1 of Kitsap County Board of Commissioners provides retiree medical care through the Public Employees Benefit Board (PEBB) under a single-employer defined benefit healthcare plan (Retiree Healthcare Plan). Resolution No. 07-02-13A authorizes the PUD to provide for payment of premiums for medical and dental insurance to retired employees, spouses and dependents when said retired employee has worked for Kitsap PUD for a minimum of fifteen years. Financial reporting for the PEBB retiree healthcare plan is included in the KPUD's Comprehensive Annual Financial Report.

NOTE 10 - OTHER POSTEMPLOYMENT BENEFITS (continued)

Funding Policy

The PUD contributes between 70 and 85 percent based on years of service and the cost of current-year premiums for eligible retired plan members and their spouses. Plan members receiving benefits contribute 15 to 30 percent of their premium costs. The PUD's required contribution is based upon projected pay-as-you-go financing requirements. There is currently one participant on the Retiree Healthcare Plan.

Annual OPEB Cost and Net OPEB Obligation

The PUD's annual other postemployment benefit (OPEB) cost (expense) is calculated based upon the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement No. 45. The PUD has elected to calculate the ARC and related information using the alternative measurement method permitted under GASB Statement No. 45 for employers in plans with fewer than one hundred total plan members. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period of thirty years as of January 1, 2009.

The following table shows the components of the PUD's annual OPEB cost for the year, the amount actually contributed to the plan, and changes in the PUD's net OPEB obligation to the Retiree Health Plan. The net OPEB obligation of $520,090 is included as a noncurrent liability on the Statement of Net Position.

Annual required contribution	$ 164,542
Interest on net OPEB obligation	16,423
Adjustment to annual required contribution	(22,406)
Annual OPEB (cost) expense	158,559
Contributions made	(3,434)
Increase in net OPEB obligation	155,125
Net OPEB obligation - beginning of year	364,965
Net OPEB obligation - end of year	$ 520,090

The PUD's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for fiscal years 2012 and 2011:

Fiscal Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
12/31/2012	$158,559	0%	$520,090
12/31/2011	$112,042	0%	$364,965

NOTE 10 - OTHER POSTEMPLOYMENT BENEFITS (continued)

Funded Status and Funding Progress

As of December 31, 2012 and 2011, the most recent actuarial valuation dates, the actuarial accrued liability for benefits was $1,406,407 and $881,869, respectively, of which 0% was funded.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point.

In the December 31, 2012, actuarial valuation, the method used was the alternative measurement method permitted under GASB Statement No. 45. A single retirement age of 62.20 was assumed for all active members to determine the AAL and normal cost. Retirement, disablement, termination, and mortality rates were assumed ot follow the PERS 2 rates used in the June 30, 2010 acutarial valuation report issued by the Office of the State Actuary (OSA). Healthcare costs and trends were determined by Milliman and used by OSA in the state-wide PEBB study performed in 2011. The results were based on grouped data with 4 active groupings and 4 inactive groupings. The actuarial cost method used to determine the AAL was Projected Unit Credit. The AAL and NOO are amortized on an open basis as a level dollar over 30 years. These assumptions are individually and collectively reasonable for the purposes of this valuation.

NOTE 11- DEFERRED COMPENSATION PLANS

The District offers its employees two deferred compensation plans created in accordance with Internal Revenue Code Section 457. These plans are with independent plan administrators. The plans, available to eligible employees, permit them to defer a portion of their salary until future years. The District matches a portion of employee deferrals. Totals were $86,785 and $86,446 in 2012 and 2011, respectively. The deferred compensation is not available to employees until termination, retirement, death, or an unforeseeable emergency.

NOTE 12 – SELF INSURANCE

The District is a member of the Public Utility Risk Management Services Self-Insurance Fund (PURMS). RCW Chapter 48.62 authorizes the governing body of any one or more governmental entities to form together into or join a pool or organization for the joint purchasing of insurance, and/or joint self-insuring, an/or joint hiring or contracting for risk management services to the same extent that they may individually purchase insurance, self insure, or hire or contract for risk management services. An agreement to form a pooling arrangement was made pursuant to the provisions of RCW Chapter 54.16. The liability pool was formed on December 31, 1976 when certain PUDs in the State of Washington joined together by signing an Agreement to pool their self-insured losses and jointly purchase insurance and administrative services. Nineteen members currently belong to PURMS.

Additional pools for property and health and welfare coverage were added in March 1997 and April 2000, under the same agreements and with the same memberships. All members do not participate in all pools. The District does not participate in the PURMS health and welfare pool.

Members of each pool are assessed to maintain the designated self-insured retention. After termination, a member is still responsible for their share of contributions to the pools for any unresolved, unreported, and in-process claims for the period they were a signatory to the agreement. The pools are fully funded by its current and former members. Claims are filed by members with the Administrator, Pacific Underwriters, Seattle, WA, which as been contracted to perform claims adjustment and loss prevention services.

The pools are governed by a Board of Directors which is comprised of one designated representative from each participating member. The Administrator and an elected Administrative Committee are responsible for conducting the business affairs of the pools.

Settled claims have not exceeded insurance coverage in any of the past four fiscal years.

The liability pool has a $1 million self-insured retention with $3.0 million of reserves. In addition, the fund purchases $35 million of excess general liability insurance over the $1 million retention.

NOTE 12 – SELF INSURANCE (continued)

The majority of the property in the property pool has a $250,000 self-insured retention. Certain classes of property have higher retention requirements up to $500,000. Reserves for the Property Pool are set at $750,000. In addition, the fund purchases $200 million of excess insurance over the $250,000 (or higher) retention level.

Unemployment Claims

The District pays unemployment claims on a reimbursement basis administered by the Washington State Department of Employment Security

NOTE 13 – PARTICIPATION IN NORTHWEST OPEN ACCESS NETWORK, INC. (NoaNet)

The district, along with 10 other Washington State public entities, 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 BPA 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.

In July 2001, NoaNet issued $27 million in Telecommunications Network Revenue Bonds (taxable) to finance the repayment of the founding members and the costs of initial construction, operations and maintenance. The Bonds become due beginning in December 2003 through December 2016 with interest due semi-annually at rates ranging from 5.05% to 7.09%. The 2001 bonds were refunded in 2011 with new bonds issued in June 2011. The 2011 bonds become due beginning in December 2012 through December 2016 with interest done semi-annually at rates ranging from .75% to 3.00%. The amounts of outstanding bonds were $10,835,000 and $13,165,000 at December 31, 2012 and 2011, respectively. Each member of NoaNet has entered into a Repayment Agreement to guarantee the debt of NoaNet. The District’s guarantee is limited to 1.42% of the outstanding bonds. The District recorded as expense member assessments of $0 and $7,100 for 2012 and 2011, respectively.

The District provides communications transport and related services to NoaNet. Accounts receivable from NoaNet as of December 31, 2012 and 2011 were approximately $269,200 and $171,000, respectively. Revenue for the years ended December 31, 2012 and 2011 were $1,104,000 and $990,000, respectively.

NOTE 13 – PARTICIPATION IN NORTHWEST OPEN ACCESS NETWORK, INC. (NoaNet) (continued)

In January 2003, NoaNet opened a $5 million line of credit (Note) with Bank of America to fund capital expenditures. A second $5 million line of credit was opened with Bank of America in June 2006, a third $1.5 million line of credit was opened with Bank of America in August 2008, a fourth $1.5 million line of credit was opened with Bank of America in March 2009 and a fifth $5 million line of credit was opened with Bank of America in August 2012. Combined balances of $1,556,400 and $1,433,333 were outstanding on the Notes as of December 31, 2012 and 2011, 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 an increase in net position (excluding member assessments) of $47,709,253 for 2012 (unaudited) and an increase in net position (excluding member assessments) of $25,796,324 for 2011 (audited). In accordance with Government Accounting Standards Board No. 14, *The Financial Reporting Entity*, a proportionate share of these gains have not been recorded by the District since the District has no explicit measurable positive equity interest in NoaNet.

Financial statements for NoaNet may be obtained by writing to: Northwest Open Access Network, Accounting Department, 4312 Kitsap Way Suite 101, Bremerton, WA 98312.

Required Supplemental Information
PEBB Retiree Medical Benefits
Schedule of Funding Progress

Fiscal Year Ended	Actuarial Value of Assets	Actuarial Accrued Liability (AAL) Entry Age	Unfunded Actuarial Accrued Liabilities AAL (AUUL)	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll
Dec. 31, 2011	$ -	$ 881,869	$ 881,869	$ -	$ 3,014,427	29%
Dec. 31, 2012	-	1,406,407	1,406,407	-	3,142,891	45%

PUBLIC UTILITY DISTRICT #1 OF KITSAP COUNTY, WASHINGTON
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2012

		Expenditures		
Grantor/Program Title	Federal CFDA Number	From Pass-Through Awards	From Direct Awards	Total
US. Department of Commerce/Pass-Through from Northwest Open Access Network				
ARRA - Broadband Technology Opporunities Program NT10BIX5570111	ARRA - 11.557	$ 569,127	$ -	$ 569,127

NOTE 1 – BASIS OF PRESENTATION

The accompanying Schedule of Expenditures of Federal Awards (the Schedule) includes the federal grant activity of Public Utility District #1 of Kitsap County under programs of the federal government for the year ended December 31, 2012. The information presented in this Schedule is presented in accordance with the requirement of the Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations.* Because the schedule presents only a selected portion of the operations of Public Utility District #1 of Kitsap County, it is not intended to and does not present the financial position, changes in equity or cash flows of Public Utility District #1 of Kitsap County.

NOTE 2 – PROGRAM COSTS

The amounts shown as current year expenditures represent only the federal grant portion of the program costs. Entire program costs, including the Public Utility District #1 of Kitsap County's portion, are $572,688.

NOTE 3 – AMERICAN RECOVERY AND REINVESTMENT ACT (ARRA) OF 2009

Expenditures for this program were funded by ARRA.

NOTE 4 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

NOTE 5 – RELATIONSHIP TO BASIC FINANCIAL STATEMENTS

Federal awards are reported in the financial statements as grant revenue.

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 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 employees are located around the state to deliver services effectively and efficiently.

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

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

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

State Auditor	**Troy Kelley**
Chief of Staff	**Doug Cochran**
Director of State and Local Audit	**Chuck Pfeil, CPA**
Deputy Director of State and Local Audit	**Kelly Collins, CPA**
Deputy Director of State and Local Audit	**Jan M. Jutte, CPA, CGFM**
Deputy Director of State and Local Audit	**Sadie Armijo**
Deputy Director of Quality Assurance	**Barb Hinton**
Deputy Director of Communications	**Thomas Shapley**
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