Office of the Washington State Auditor
Pat McCarthy

November 16, 2017

Board of Commissioners
Public Utility District No. 1 of Snohomish County
Everett, Washington

Contracted CPA Firm's Audit Report on Financial Statements and Federal Single Audit

We have reviewed the audit report issued by a certified public accounting (CPA) firm on Public Utility District No. 1 of Snohomish County's financial statements and compliance with federal grant requirements for the fiscal years ended December 31, 2016 and 2015. The District contracted with the CPA firm for this audit.

Based on this review, we have accepted this report in lieu of the audit required by RCW 43.09.260. The State Auditor's Office did not audit the accompanying financial statements or the compliance with federal grant agreements and, accordingly, we do not express an opinion on those financial statements or on compliance.

This report is being published on the State Auditor's Office website as a matter of public record.

Sincerely,

Pat McCarthy
State Auditor
Olympia, WA

BAKER TILLY

INDEPENDENT AUDITORS' REPORT

To the Board of Commissioners
Snohomish County Public Utility District

Report on the Financial Statements

We have audited the accompanying combined financial statements of Public Utility District No. 1 of Snohomish County, Washington ("PUD"), which comprise the Combined Statements of Net Position as of December 31, 2016 and 2015, and the related Combined Statements of Revenues, Expenses and Changes in Net Position, and Combined Statements of Cash Flows for the years then ended and the related notes to the financial statements. We have also audited the accompanying individual Statements of Net Position of the Electric, Generation, and Water Systems as of December 31, 2016, and the related Statements of Revenues, Expenses, and Changes in Net Position and Cash Flows for the year then ended.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated 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 the consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express opinions on these combined 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 audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control over financial reporting relevant to the PUD's preparation and fair presentation of the combined 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 PUD'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 consolidated financial statements.

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

Opinion

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of the PUD at December 31, 2016 and 2015, and the changes in its financial position and its cash flows for the years then ended, and the individual financial positions of the Electric, Generation, and Water Systems as of December 31, 2016, and the individual changes in their financial positions and their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

an independent member of
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INTERNATIONAL

To the Board of Commissioners
Snohomish County Public Utility District

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management discussion and analysis (MD&A) and required supplementary information as listed in the table of contents be presented to supplement the financial statements. Such information, although not a part of the combined financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the combined financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the MD&A and 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 combined financial statements, and other knowledge we obtained during our audit of the combined 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.

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The other information as listed in the table of contents, which are the responsibility of management, are presented for purposes of additional analysis and are not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we express no opinion or provide any assurance on it.

Other Reporting Required by Government Auditing Standards

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

Baker Tilly Virchow Krause, LLP

Madison, Wisconsin
April 3, 2017

Management's Discussion and Analysis (Unaudited)

The following discussion provides an overview of Public Utility District No. 1 of Snohomish County (the PUD) financial activities for the years ended December 31, 2016 and 2015. This unaudited discussion is designed to be used in conjunction with the financial statements and notes, which follow this section.

FINANCIAL HIGHLIGHTS

Combined Operating Results

Snohomish County PUD's operating results for 2016 improved from 2015 as net income increased from $52 million in 2015 to $61 in 2016, following a decline from $56 million in 2014. This increase in 2016 operating results was primarily due to the influence of 2015 retail power rate increases that had a full year's impact in 2016. The higher rates offset the impact of unusually warm temperatures in the fourth quarter of 2016 that reduced retail energy consumption.

The PUD continued to exhibit growth in its customer base. The average number of Electric System customers increased 1.2% from 337,011 in 2015 to 341,109 in 2016, following a 1.4% increase in 2015. Similarly, the average number of Water System customers increased 2.4% from 19,436 in 2015 to 19,895 in 2016, following a 1.3% increase in 2015. However, despite the growth in customers, retail MWh sales declined from 6,474,983 MWh in 2015 to 6,285,744 MWh in 2016, after a slight 11,126 MWh decrease in 2015. The lower 2016 consumption resulted from unusually warm temperatures in October and November 2016 that led to a delay in the typical heating season and customer consumption, and as a result reduced annual retail energy revenue from expected levels.

Despite the lower consumption, combined retail sales were $586 million in 2016, higher than the $561 million in 2015 and $555 million in 2014, as a result of an Electric System 1.9% general rate increase in April 2015 and a 4.6% Electric System rate increase in October 2015 to match an increase in power resource and transmission costs from the Bonneville Power Administration (BPA).

Combined wholesale sales revenue was roughly equivalent in 2016 and 2015 at $37 million, following a substantial decline from $60 million in 2014. Driven by precipitation patterns in 2016, stronger hydroelectric production led to a 26% increase in surplus power available to sell into the wholesale market, but power market prices declined significantly to offset the production increase. In 2015, lower precipitation levels and hydroelectric production led to a 6% decrease in power available from the PUD's variable hydroelectric resources. The production decrease combined with lower wholesale market prices resulted in substantially lower wholesale energy sales revenue.

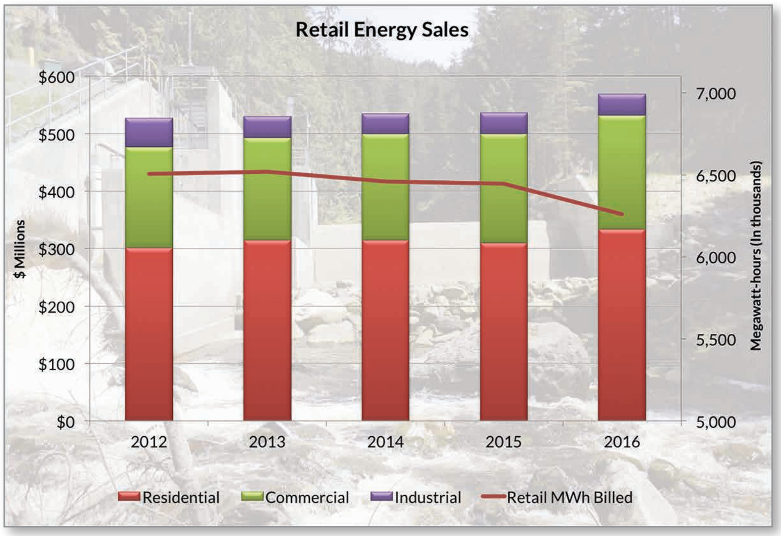

Figure 1

Combined operating expenditures were $610 million in 2016, $24 million higher than the $586 million spent in 2015 and 2014. The largest of the operating expenditures, combined purchased power expenses, increased $21 million in 2016, as a result of a full year of a significant BPA wholesale power price increase effective October 2015.

Combined operations costs increased $15 million from $179 million in 2015 to $194 million in 2016, after remaining consistent from 2014 to 2015. An increase in BPA costs for transmission and ancillary services, higher meter reading and billing costs related to a conversion from bi-monthly to monthly billing, consulting costs incurred to implement a new enterprise resource planning system, and increased energy efficiency program costs led to higher operations costs. Combined maintenance expenses were $26 million in 2016 after 2015 costs had risen to $37 million, the result of two 2015 major wind storm events that led to a combined $11 million in storm restoration costs. Maintenance costs in 2014 were a more comparable $28 million.

ELECTRIC SYSTEM

Unusually Warm Fall 2016

The PUD is a winter peaking utility in a region where a significant portion of the population relies on electricity as their primary heating source. As such, the PUD expects that as fall temperatures drop, consumption will rise through the late fall and winter period, contributing a sizable portion of annual retail energy sales.

Weather in the Puget Sound area was unusually warm during the fall of 2016, and as a result residential and commercial energy consumption was lower than expected for those months. Through September 2016, the billed retail energy sales volume was 1.8% lower than expected, but by the end of the fourth quarter that budget shortfall had grown to 5.1%. However, as a result of a full year's impact of two rate adjustments in 2015, retail energy sales revenue was $574 million for 2016, $25 million higher than the total for 2015.

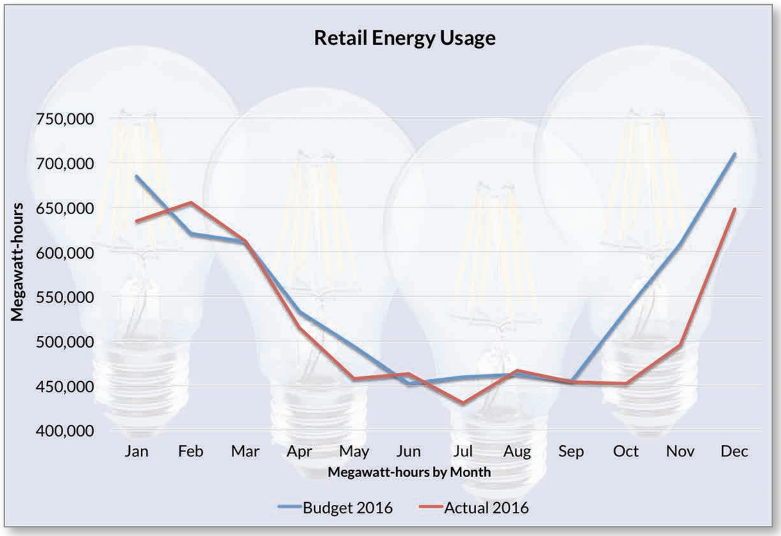

Figure 2

2015 Wind Storms

Two major windstorms impacted the Puget Sound area in 2015. The first was an unusual summer windstorm on August 29, 2015, that knocked out power to 197,000 of the PUD's 335,000 customers, the PUD's first ever major storm declaration during the summer. The PUD crews, along with contract and mutual-aid crews, spent several days repairing transmission and distribution lines throughout the county, and the utility recorded $5 million in maintenance costs as a result of the storm.

In mid-November, a second windstorm knocked out power to more than 205,000 PUD customers, one of the largest storms in the PUD's history. Significant portions of the transmission system were impaired, and damage to the electrical distribution system was extensive and widespread. System restoration efforts took almost a week for PUD and contracted crews, and the PUD recorded $6 million in maintenance costs in 2015 as a result of this second and more powerful storm.

Electric System maintenance costs increased $9 million from 2014 to 2015 due to the impacts of these storms. In 2016, maintenance costs declined $11 million as expenditures returned to previous levels.

The federal government declared both storm events major emergencies for the region, and the PUD recorded an $8 million grant receivable from the Federal Emergency Management Agency (FEMA) and state agencies as other income in 2015. The PUD has thus far received $4 million in 2016 from FEMA.

Electric System Rate Changes

During the first quarter of 2015, the PUD Board of Commissioners approved a 1.9% general electric rate increase, effective April 1, 2015. Financial impacts that led to the decision to raise electric rates included maintenance costs for a growing customer base, ongoing wood pole and underground cable replacement programs, major infrastructure projects underway including several substations, smart grid infrastructure and information system upgrades, and the impact of inflation on material and labor costs.

In August 2015, BPA announced wholesale power and transmission rate increases effective October 2015. BPA markets wholesale electricity generated from the federally owned hydroelectric projects in the Columbia River basin and one non-federal nuclear power plant. BPA provides approximately 85% of the long-term energy resources used by the PUD to serve its customers. Power purchases from BPA were $241 million and $220 million in 2016 and 2015, respectively.

BPA passes its costs of power, transmission, and ancillary services to customers through its wholesale rates. These wholesale rates are reviewed biannually and adjusted on October 1 of each year. Subject to approval by the Board of Commissioners, the PUD adjusts retail electric rates to reflect BPA rate adjustments. As a result of the increased cost of power and transmission purchases from BPA, the PUD's Board of Commissioners increased retail power rates 4.6% to match the higher costs effective October 1, 2015.

Capital Investments - Customer Growth

The PUD makes significant investments in capital programs each year to maintain, expand and enhance its electric distribution system. The number of electric connections and customers continues to grow in the PUD's service area, and the need for electric distribution infrastructure and facilities to serve customers and assure reliability is expected to continue to expand. Electric System capital expenditures were $120 million in 2016 and $121 million in 2015.

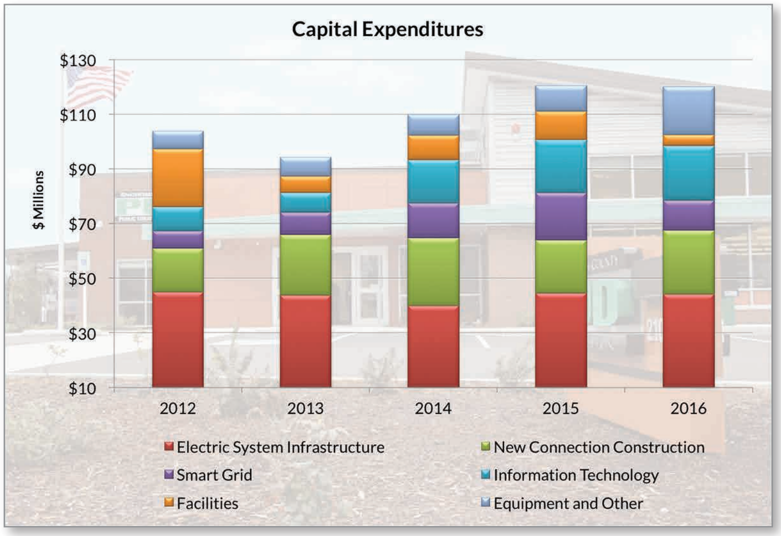

Figure 3

Key projects in 2016 included significant work on several substations: rebuilding the Norton substation, Lynnwood and Lake Chaplain transformer replacements, Halls Lake and Everett Automation projects and completion of Beverley Park North Bus and control building. Substation construction work included replacing all relays, controls, and SCADA automation in the Halls Lake and Everett 115 kV switchyards. The PUD completed its microwave system upgrades and installed communication systems on over 200 fleet vehicles. The PUD also continued its ongoing replacement of aging poles; approximately 500 distribution poles were replaced in 2016, 62 depreciated transmission poles were replaced, and 42 miles of underground distribution cables were also replaced. Reconductoring work completed in 2016 included 3.5 miles of transmission line from Lake Goodwin to Sills Corner and 1.5 miles between BPA Snohomish and PUD Snohomish substations. The PUD also worked with Snohomish County and local municipalities to relocate lines and other facilities to accommodate road projects and other construction. In addition, the PUD saw 4,510 new electrical system connections in 2016 and made further progress on its substation automation project and outage management system.

Lynnwood Office Construction

In 2016, the PUD completed construction of a new regional office in the south Snohomish County city of Lynnwood as part of a multi-year plan to replace to the PUD's five, aged regional offices. The new office consolidated two sites – the former South County administrative regional office in Edmonds and the nearby Halls Lake operations facility. The new facility houses office staff, line and service crews as well as warehouse facilities. Capital expenditures for the new facility were $1 million and $10 million in 2016 and 2015, respectively.

Energy Storage

The PUD and its business partners are building four energy storage systems based on a standard, non-proprietary and scalable approach to energy storage. Energy storage is a critical element needed to manage renewable energy growth since wind and solar power generation is irregular and not always available during peak energy demand hours. In 2015, the PUD energized two 1MW, 500 kWh battery storage systems at its Hardeson substation in Mukilteo. In 2016 substantial construction and testing was completed on a third system at the PUD's Everett substation, which is expected to be operational in 2017.

The PUD recorded $3.7 million and $6.3 million of capital expenditures related to energy storage projects in 2016 and 2015, respectively. In 2014, the PUD was awarded a $7.3 million grant in matching funds from the Washington Clean Energy Fund in support of its energy storage projects, and recorded grant funding of $2.2 million in 2016 and $1.2 million in 2015.

Enterprise Resource Planning (ERP) System Project

In 2014, the PUD began an extensive system project to replace its ERP, or business management software including the systems that manage materials and contract procurement, work order and asset management, financial management and reporting, and human resource management. As part of the project, project members worked with system implementation specialists to review current business processes and modify them to adopt industry best practices and optimize the system's capabilities.

The multi-year project involved numerous employees from around the PUD. Phase 1 of the project was implemented in September 2015, and phase 2 was completed in July 2016. The PUD recorded $13 million and $17 million of operations expense related to this project in 2016 and 2015, respectively.

Monthly Billing Change

As part of the ERP implementation, and in an effort to modernize and streamline the PUD's business practices, the utility moved from billing residential and commercial customers on a bi-monthly basis to billing every month beginning in September 2015. The move to monthly billing aligned the PUD's business processes with the new ERP system, and was initially implemented by estimating every other bill for residential and commercial customers. This change did not impact retail energy sales revenue for 2015 since the increase in billed revenue was offset by a corresponding decrease in unbilled revenue, however it did result in a one-time improvement in cash flow.

In 2016, the PUD hired a contractor to read residential and commercial accounts along with PUD meter readers so the utility could discontinue estimating meter reads and read all of the system's meters on a monthly basis. The PUD recorded $1 million in 2016 as operations expense related to the effort to read all meters on a monthly basis.

Revenue Bond Transactions

The Electric System issued $141 million of Series 2015 Revenue bonds in June 2015, the first sale of new money tax-exempt bonds since 2010. The new bonds, which have a final maturity of 2040, were sold at an average interest rate of 3.5%, as the PUD benefitted from a very low long-term interest rate environment. The proceeds of the bond sale are being used to fund construction of new facilities, substations and system improvements, including overhead and underground power lines, as well as ongoing grid modernization work. The PUD utilized bond proceeds of $38 million and $36 million in 2016 and 2015, respectively, to fund qualifying capital expenditures.

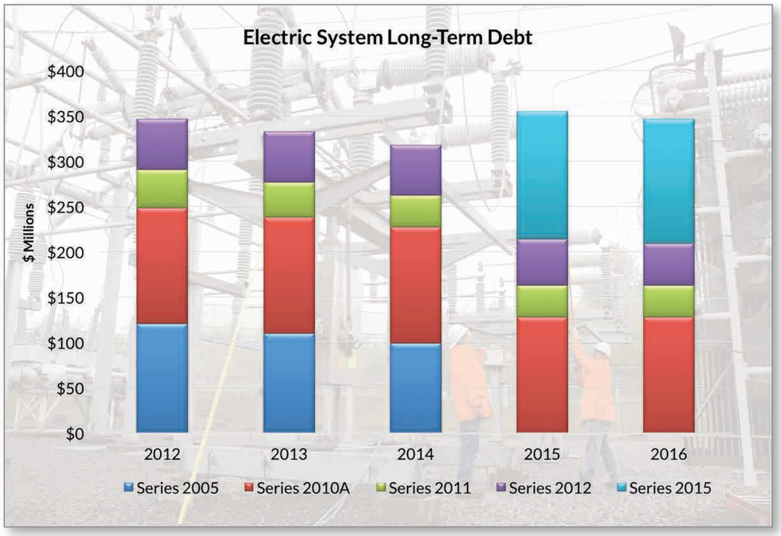

Figure 4

The PUD utilized funds from a debt management reserve in September 2015 to refund the $99 million outstanding balance of the Series 2005 Electric System Revenue bonds. These bonds had been sold at rates higher than those currently available in tax-exempt debt markets, and the bonds contained a provision that provided for early repayment at their ten-year maturity.

These two debt transactions served to increase the Electric System's overall debt level slightly; however, solid operating results over the past several years have enabled the PUD to reduce Electric System debt levels from previous levels. In recent years, the PUD has primarily utilized revenues and cash reserves to fund investments in the electric distribution system infrastructure. Long-term debt for the Electric System, including current maturities, totaled $347 million as of December 31, 2016, compared to $355 million in 2015.

Energy-Efficiency Programs

The PUD and its customers continue to demonstrate their commitment to energy-efficiency through their active participation in numerous energy-efficiency programs. These programs include residential customer incentives for installation of weatherization measures, lighting modifications, purchases of energy-efficient washing machines, heat pump programs, and solar power systems, as well as commercial incentives for new construction projects that incorporate energy-efficiency measures and rebates for retrofit projects that include installation of energy efficient lighting, HVAC equipment or equipment control devices. Some of these energy-efficiency programs are funded through an agreement with BPA.

Operations expenses in 2016 and 2015 include $21 and $19 million, respectively, related to energy-efficiency measures. In 2016, the PUD recorded $11 million of energy-efficiency reimbursements from BPA as compared to $7 million in 2015.

GENERATION SYSTEM

Calligan and Hancock Creek Hydroelectric Projects

The PUD is constructing two low-impact hydropower projects, the Calligan Creek and Hancock Creek Hydroelectric projects, based on approved licenses it received from the Federal Energy Regulatory Commission (FERC) in 2015. Both creeks are tributaries to the Snoqualmie River near North Bend in King County, Washington. Excavation began in late summer 2015 with significant progress on the construction of the powerhouses, weirs and penstocks in 2016, and generation is anticipated to begin in late 2017. The projects are located about three miles apart, south of the PUD's Jackson Hydroelectric Project. Each project will have a capacity of 6 megawatts, enough to serve about 5,000 homes each at peak output. Calligan and Hancock are both environmentally responsible, run-of-the-river projects, similar to the PUD's Youngs Creek project.

Total project costs are expected to be approximately $50 million combined when completed, and their proximity and similar design is expected to provide construction efficiencies. Both are located near existing transmission lines and close to where the power they generate will be used, minimizing line losses. In 2016 and 2015, the PUD recorded $25 million and $6 million, respectively, in capital development and construction costs related to these two projects.

Generation System Revenue Bonds

The PUD sold $40 million of Series 2015 Generation System Revenue bonds to fund the design and construction of the Calligan Creek and Hancock Creek Hydroelectric projects. The utility benefitted from favorable interest rate conditions and issued the bonds at an average interest rate of 4.1% over the 30-year term of the bonds.

This transaction increased the Generation System's overall debt level slightly in 2015, however debt levels in the Generation System have been declining in recent years since new money bonds were last sold

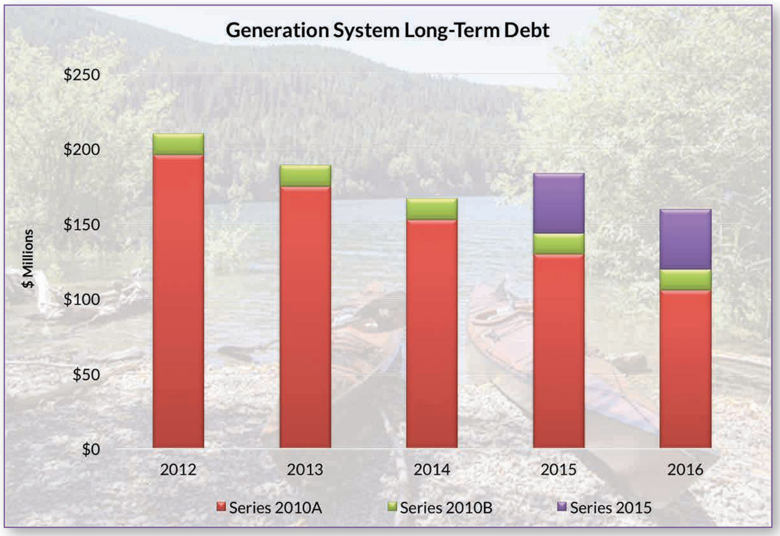

Figure 5

in 2010. Long-term debt for the Generation System, including current maturities, totaled $160 million as of December 31, 2016, compared to $184 million in 2015.

WATER SYSTEM

Water System Operating Results

Retail sales revenue for the Water System increased from $11.2 million in 2015 to $11.4 million for the year ended 2016 following a $1.0 million increase in 2015. The revenue increase in 2016 was the result of an annual rate change while the 2015 increase was also impacted by a higher level of customer consumption.

Operating expenses increased from $9.8 million in 2015 to $10.3 million in 2016, following an increase of $0.3 million in 2015 as compared to 2014. The 2016 and 2015 increases are the result of higher expenditures for maintenance of meters and water mains, as well as the impact of inflation on material and labor costs.

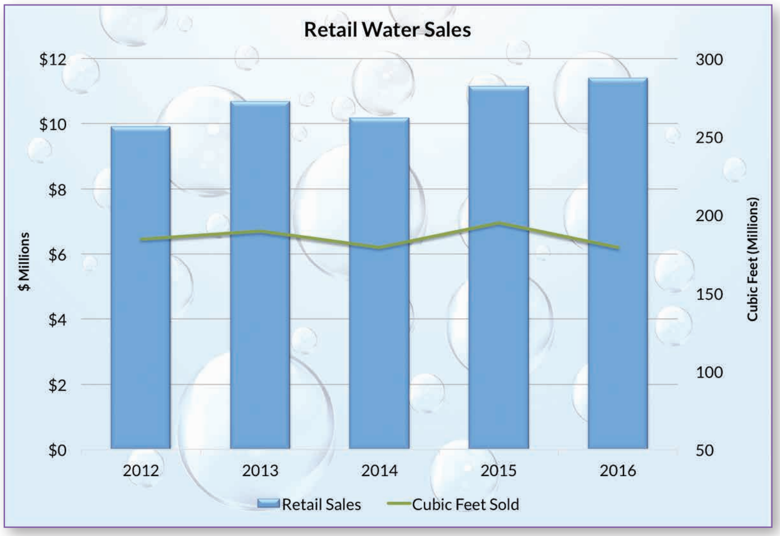

Figure 6

Water System Rate Change

In December 2012, the Board of Commissioners approved revisions to the Water System's service rate schedule including annual rate increases beginning January 2013 through 2016. Several factors led to the rate increase schedule, including higher wholesale water purchase prices, rising material and construction costs, and the need for funding capital infrastructure improvements to address growth in the Water System service area. For 2016 and 2015, retail water rates increased 4.3%.

OVERVIEW OF THE FINANCIAL STATEMENTS

Basic Financial Statements

The Combined Statements of Net Position present the PUD's net position as the difference between assets and deferred outflows of resources, and liabilities and deferred inflows of resources. The Combined Statements of Net Position provide information about the nature and amount of investments in resources (assets), the consumption of net assets in one period that are applicable to future periods (deferred outflows of resources), the obligations to creditors (liabilities), and the acquisition of net assets that are applicable to future periods (deferred inflows of resources).

The Combined Statements of Revenues, Expenses, and Changes in Net Position report the revenues and expenses during the periods indicated and identify operating activity separately from non-operating activity.

The Combined Statements of Cash Flows provide information about the PUD's cash flows from operating activities, capital and related financing activities, investing activities, and noncapital financing activities, and presents a reconciliation of net operating income to net cash provided by operating activities.

Notes to the Financial Statements

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

Financial Analysis

Analysis of the comparative financial information is provided in the following table.

Condensed Combined Financial Information

(In millions)

	2016	2015	2014
Current Assets and Special Funds	$ 655	$ 749	$ 689
Net Utility Plant	1,437	1,343	1,269
Other Assets	31	42	34
Total Assets	2,123	2,134	1,992
Deferred Outflows of Resources	37	34	29
Current Liabilities	137	168	142
Long–Term Debt	537	577	504
Other Liabilities	159	137	53
Total Liabilities	833	882	699
Deferred Inflows of Resources	12	32	28
Net Investment in Capital Assets	985	925	755
Restricted	172	162	272
Unrestricted	158	167	267
Net Position	**$ 1,315**	**$ 1,254**	**$ 1,294**
Operating Revenues	$ 658	$ 627	$ 645
Operating Expenses	610	586	585
Net Operating Income	48	41	60
Interest Charges	(25)	(25)	(27)
Other Income and Expense	14	17	1
Net Income (Loss) before Capital Contributions	37	33	34
Capital Contributions	24	19	22
Net Income	61	52	56
Net Position – beginning of year	1,254	1,294	1,238
Adjustment for pension expense (see Note 1)	–	(92)	–
Net Position	**$ 1,315**	**$ 1,254**	**$ 1,294**

Assets

Current assets and special funds declined $94 million in 2016 primarily due to spending a portion of the Series 2015 Electric System and Generation System bond proceeds on qualifying capital expenditures. In addition, the PUD used other cash reserves to fund a portion of 2016 capital expenditures. Current assets and special funds increased $60 million in 2015 as a result of the proceeds of the $141 million Series 2015 Electric System and $40 million Series 2015 Generation System bonds, net of the repayment of the remaining $99 million Series 2005 Electric System bonds and the use of bond proceeds during 2015.

The PUD had $1,437, $1,343, and $1,269 million invested in a broad range of net utility capital assets as of December 31, 2016, 2015, and 2014, respectively. Utility capital assets include three hydroelectric power generation plants, electric transmission and distribution lines and substations, water transmission and distribution pipes, storage and pump station facilities, buildings and equipment. Utility plant additions were $160 million in 2016 and $133 million in 2015, reflecting the construction of two new hydroelectric projects, investments in the distribution and transmission systems, including construction associated with growth and general facilities of the PUD. The increase in utility plant was offset by $13 million and $14 million in routine plant asset retirements in 2016 and 2015, respectively. Accumulated depreciation increased $52 million and $46 million related to routine plant asset activity in 2016 and 2015, respectively.

Other assets decreased $11 million in 2016 due primarily to the receipt of a portion of the an $8 million grant receivable from FEMA related to the restoration work from two major wind storms declared as major emergencies in 2015, and the reclassification of the remaining receivable to current assets. Other assets increased $8 million in 2015, reflecting the recording of the $8 million grant receivable from FEMA.

Deferred Outflows of Resources

Deferred outflows of resources increased $3 million in 2016 as a result of recording $8 million for pension plan net position, partially offset by a $5 million decrease in amortization of the book loss on the defeasance of debt. In 2015, deferred outflows increased $5 million as a result of recording $10 million for pension plan net position, partially offset by a $5 million decrease in amortization of the book loss on the defeasance of debt.

Liabilities

Current liabilities decreased $31 million in 2016 as a result of lower intersystem and vendor payable balances. Current liabilities increased $26 million in 2015 due to higher intersystem payable balances. These differences were largely the result of the timing of vendor payment disbursement and a one-month lag for the settling of intersystem balances in December 2015.

Long-term debt decreased $40 million in 2016 as a result of scheduled principal repayments. Long-term debt increased $73 million in 2015 as a result of the sale of the $141 million Series 2015 Electric System bonds and the $40 million Generation System bonds. Long-term debt in 2015 also reflected the repayment of the remaining $99 million of Series 2005 Electric System bonds as well as scheduled principal payments.

Other liabilities increased $22 million in 2016, and $84 million in 2015 primarily due to the recording of, and changes in the pension plan net position.

Deferred Inflows of Resources

Deferred inflows decreased $20 million in 2016 as the result of a decrease in the pension plan net position as well as the amortization of the settlement on the early termination of a power resource. Deferred inflows of resources increased $4 million in 2015 as a result of recording the pension plan net position partially offset by the amortization of the settlement on the early termination of a power resource.

Net Position

Net investment in capital assets increased $60 and $170 million in 2016 and 2015, respectively, reflecting the growth in net utility plant. The increase in 2015 also reflects the increase in revenue bond proceeds to fund capital projects. Capital expenditures are generally funded through rate-based revenues, contributions from customers and developers for requested facilities, and debt proceeds. The PUD added 4,510 and 3,702 Electric System customer connections in 2016 and 2015 respectively. The Water System added 565 and 299 customer connections in 2016 and 2015, respectively.

Restricted net position represents resources that are subject to external restrictions, such as bond covenants or third-party contractual agreements, and resources restricted by Board resolution. Restricted assets increased $10 million in 2016 due to the amortization of bond premiums and an increase in post-employment benefit reserves. Restricted assets decreased $110 million in 2015 due to the use of a $100 million debt management reserve fund and the use of a portion of a settlement designed to fund the impact of the early termination of a power resource.

Unrestricted net position is available to finance day-to-day operations without constraints established by debt covenants or other legal requirements. Unrestricted net position decreased $9 million in 2016 due to somewhat lower cash reserves, and $100 million in 2015 as a result of recording the pension plan net position.

Operating Revenues

Operating revenues increased $31 million in 2016, from $627 million in 2015 to $658 million in 2016. A full year of an April 1, 2015 Electric System general and an October 1, 2015 power contract pass-through rate increase, as well as a January 1, 2016 Water System rate increase led to a $25 million increase in retail sales revenue. In addition, other operating revenue increased $6 million in 2016 related to higher level BPA energy conservation program reimbursements and the sale of renewable energy credits.

Operating revenues decreased $18 million in 2015 as compared to 2014. Retail sales revenue increased $6 million in 2015 as a result of general and power contract pass-through rate increases during the year. Wholesale sales revenue decreased $22 million in 2015 primarily due to lower hydroelectric production in 2015 leading to a decreased level of surplus power. The PUD sells surplus power into the wholesale power markets to balance resources with customer loads.

Operating Expenses

Operating expenses increased $24 million in 2016 as a result primarily of higher BPA wholesale power costs. Operating expenses remained relatively stable from 2014 to 2015. Purchased power expenses were $11 million lower due to a lower level of purchases from the wholesale power market in 2015. Maintenance expenses were $9 million higher in 2015 as a result of restoration costs related to two major wind storms.

Other Income and Expense

A $3 million decrease in other income and expense in 2016 was due to a lower level of grant revenue recorded in 2016. The PUD recorded a $16 million increase in other income and expense in 2015 is primarily the result of a higher level of grant revenue recorded in 2015, including $8 million from FEMA related to the restoration work from two major wind storms declared as major emergencies.

Capital Contributions

Capital contributions increased $5 million in 2016 and decreased $3 million in 2015. Capital contributions are collected from property developers when they request to connect to the PUD's electric or water distribution systems or request engineering or construction services. The capital contributions increase in 2016 reflects development of the PUD's service area.

Requests for Information

The basic financial statements, notes, and management's discussion and analysis are designed to provide a general overview of the PUD's finances. Questions concerning any of the information provided in this report should be directed to the PUD at 2320 California Street, Everett, WA 98201.

Combined Statements of Net Position

December 31, 2016 and 2015

(In thousands)

	2016				2015
Assets	Electric System	Generation System	Water System	Combined	Combined
Current Assets:					
Cash and temporary investments:					
Cash and cash equivalents	$ 34,805	$ 14,064	$ 3,563	$ 52,432	$ 75,822
Temporary investments	168,542	501	6,003	175,046	178,395
	203,347	14,565	9,566	227,478	254,217
Accounts and other receivables, net	96,685	804	1,469	98,992	110,541
Intersystem loans receivable	3,313	1,092	–	–	–
Materials and supplies	19,373	–	290	19,663	19,069
Prepayments and other	6,725	169	62	5,264	5,768
Total Current Assets	**329,443**	**16,630**	**11,387**	**351,397**	**389,595**
Special Funds – Bond Funds and Other	**253,843**	**42,819**	**6,288**	**302,950**	**359,588**
Utility Plant:					
Plant in service	1,639,156	265,764	143,312	2,048,232	1,935,033
Construction work in progress	143,762	46,340	3,942	194,044	160,163
Total utility plant	1,782,918	312,104	147,254	2,242,276	2,095,196
Accumulated depreciation	(640,791)	(132,062)	(32,015)	(804,868)	(752,556)
Net Utility Plant	**1,142,127**	**180,042**	**115,239**	**1,437,408**	**1,342,640**
Other Assets:					
Conservation loans and other receivables, net	3,390	46	512	3,948	10,939
Intersystem loans and receivables	40,720	3,145	–	–	–
FERC licenses	–	17,197	–	17,197	17,770
Other assets	1,873	8,118	5	9,996	13,505
Total Other Assets	**45,983**	**28,506**	**517**	**31,141**	**42,214**
Total Assets	**1,771,396**	**267,997**	**133,431**	**2,122,896**	**2,134,037**
Deferred Outflows of Resources					
Unamortized loss on refunding debt	1,930	16,077	333	18,340	23,458
Net pension deferral	18,169	473	464	19,106	10,797
Total Deferred Outflows of Resources	**20,099**	**16,550**	**797**	**37,446**	**34,255**
Total Assets and Deferred Outflows	**$ 1,791,495**	**$ 284,547**	**$ 134,228**	**$ 2,160,342**	**$ 2,168,292**

The accompanying notes are an integral part of these combined financial statements.

Combined Statements of Net Position

December 31, 2016 and 2015

(In thousands)

	2016				2015
Liabilities	Electric System	Generation System	Water System	Combined	Combined
Current Liabilities:					
Accounts payable	$ 53,063	$ 1,598	$ 780	$ 55,468	$ 87,828
Accrued taxes	16,380	108	55	16,543	17,205
Accrued interest	1,543	2,342	67	2,260	2,488
Other accrued liabilities	21,760	182	5	21,947	21,388
Customer deposits	4,439	–	27	4,466	4,590
Current maturities of long–term debt	9,045	25,205	2,024	36,274	34,714
Intersystem loans payable	1,092	3,313	–	–	–
Total Current Liabilities	**107,322**	**32,748**	**2,958**	**136,958**	**168,213**
Long–Term Debt:					
Revenue bonds	364,979	150,817	17,389	533,185	572,601
Other notes payable	–	–	3,989	3,989	4,308
Total Long–Term Debt	**364,979**	**150,817**	**21,378**	**537,174**	**576,909**
Other Liabilities:					
Intersystem loans and payables	3,145	40,713	–	–	–
FERC license obligations	–	17,197	–	17,197	17,770
Net pension liability	100,843	2,596	2,646	106,085	86,388
Other liabilities	33,343	1,246	1,026	35,615	32,905
Total Other Liabilities	**137,331**	**61,752**	**3,672**	**158,897**	**137,063**
Total Liabilities	**609,632**	**245,317**	**28,008**	**833,029**	**882,185**
Deferred Inflows of Resources					
Unearned FERC license contributions	–	7,000	–	7,000	7,500
Unearned settlement proceeds	–	–	–	–	6,037
Net pension deferral	1,860	24	83	1,967	13,174
Other deferred inflows	2,591	–	927	3,518	4,936
Total Deferred Inflows of Resources	**4,451**	**7,024**	**1,010**	**12,485**	**31,647**
Net Position					
Net investment in capital assets	855,107	37,762	92,170	985,039	924,884
Restricted:					
Reserve funds	247	9,073	–	9,320	9,721
Rate stabilization	114,660	–	1,498	116,158	116,300
Debt service and other	28,165	14,184	3,954	46,303	36,060
Unrestricted	179,233	(28,813)	7,588	158,008	167,495
Total Net Position	**1,177,412**	**32,206**	**105,210**	**1,314,828**	**1,254,460**
Total Liabilities, Deferred Inflows and Net Position	**$ 1,791,495**	**$ 284,547**	**$ 134,228**	**$ 2,160,342**	**$ 2,168,292**

The accompanying notes are an integral part of these combined financial statements.

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

Years ended December 31, 2016 and 2015

(In thousands)

	2016				2015
	Electric System	Generation System	Water System	Combined	Combined
Operating Revenues:					
Retail sales	$ 574,455	$ –	$ 11,406	$ 585,861	$ 560,506
Wholesale sales	37,076	53,874	343	37,419	37,128
Other	28,100	6,281	325	34,706	29,250
Total Operating Revenues	**639,631**	**60,155**	**12,074**	**657,986**	**626,884**
Operating Expenses:					
Purchased power	347,494	–	–	293,620	272,418
Purchased water	–	–	2,096	2,096	2,009
Operations	185,700	4,952	3,434	194,086	179,492
Maintenance	22,995	1,616	1,382	25,993	37,430
Depreciation	51,460	3,693	2,794	57,947	58,048
Taxes	35,448	108	628	36,184	36,112
Total Operating Expenses	**643,097**	**10,369**	**10,334**	**609,926**	**585,509**
Net Operating Income (Loss)	**(3,466)**	**49,786**	**1,740**	**48,060**	**41,375**
Interest Charges:					
Interest	18,506	10,195	874	27,833	27,507
Amortization of debt related costs	(1,233)	3,262	(41)	1,988	2,219
Allowance for funds used during construction	(3,119)	(1,156)	(98)	(4,373)	(4,117)
Total Interest Charges	**14,154**	**12,301**	**735**	**25,448**	**25,609**
Other Income and Expense:					
Interest income	5,171	1,479	209	5,117	3,208
Other income and expense, net	7,654	337	939	8,930	13,950
Total Other Income and Expense	**12,825**	**1,816**	**1,148**	**14,047**	**17,158**
Net Income (Loss) Before Capital Contributions	**(4,795)**	**39,301**	**2,153**	**36,659**	**32,924**
Capital Contributions	**20,094**	**95**	**3,520**	**23,709**	**19,220**
Net Income	**15,299**	**39,396**	**5,673**	**60,368**	**52,144**
Net Position, beginning of year	1,162,113	(7,190)	99,537	1,254,460	1,293,998
Adjustment for pension expense (see Note 1)	–	–	–	–	(91,682)
Net Position, end of year	**$ 1,177,412**	**$ 32,206**	**$ 105,210**	**$ 1,314,828**	**$ 1,254,460**

The accompanying notes are an integral part of these combined financial statements.

Combined Statements of Cash Flows

Years ended December 31, 2016 and 2015

(In thousands)

	2016				2015
	Electric System	Generation System	Water System	Combined	Combined
Cash Flows From Operating Activities:					
Cash received from customers	$ 615,989	$ 57,930	$ 17,488	$ 639,508	$ 582,618
Cash payments to suppliers	(489,236)	(7,524)	(13,701)	(458,562)	(382,307)
Cash payments to employees	(79,973)	(1,947)	(2,099)	(84,019)	(83,356)
Cash payments for taxes	(36,162)	(79)	(626)	(36,867)	(34,634)
Other cash received (paid)	28,334	(422)	130	28,042	18,291
Net Cash Provided by Operating Activities	**38,952**	**47,958**	**1,192**	**88,102**	**100,612**
Cash Flows From Capital & Related Financing Activities:					
Capital construction, including interest paid on debt charged to capital projects	(107,153)	(37,145)	(2,711)	(147,009)	(126,814)
Proceeds from debt	-	-	-	-	203,422
Repayment of debt	(8,635)	(24,060)	(2,019)	(34,714)	(128,709)
Debt Issuance Costs	-	-	-	-	(1,454)
Interest paid on debt	(15,533)	(8,614)	(792)	(23,688)	(24,320)
Capital contributions	16,272	95	2,862	19,229	15,925
Capital grants received	2,880	-	30	2,910	1,809
Intercompany loans	14,574	(14,574)	-	-	-
Net Cash (Used for) Capital & Related Financing Activities	**(97,595)**	**(84,298)**	**(2,630)**	**(183,272)**	**(60,141)**
Cash Flows From Investing Activities:					
Sale of special funds and investment securities	256,201	30,382	3,506	290,089	263,009
Purchase of special funds and investment securities	(222,579)	(3,530)	(3,710)	(229,819)	(308,921)
Interest on investment securities	6,482	1,761	203	7,195	6,225
Net Cash Provided by (Used for) Investing Activities	**40,104**	**28,613**	**(1)**	**67,465**	**(39,687)**
Cash Flows From Non-Capital Financing Activities:					
Non-capital grants received	4,315	-	-	4,315	144
Net Cash Provided by Non-Capital Financing Activities	**4,315**	**-**	**-**	**4,315**	**144**
Net Increase (Decrease) in Cash & Cash Equivalents	(14,224)	(7,727)	(1,439)	(23,390)	928
Beginning of year	49,029	21,791	5,002	75,822	74,894
Cash & Cash Equivalents – end of year	**$ 34,805**	**$ 14,064**	**$ 3,563**	**$ 52,432**	**$ 75,822**
Reconciliation of Net Operating Income to Net Cash Provided by Operating Activities:					
Net Operating Income (Loss)	$ (3,466)	$ 49,786	$ 1,740	$ 48,060	$ 41,375
Adjustments to net operating income:					
Depreciation	51,460	3,693	2,794	57,947	58,048
Other cash received (paid)	(969)	(222)	(15)	(1,206)	(3,161)
(Increase) decrease in receivables	5,699	3,812	5,755	17,241	(13,571)
(Increase) decrease in other assets	(2,266)	6,323	(20)	4,037	(2,080)
Increase (decrease) in payables	(12,557)	(9,197)	(8,891)	(32,620)	28,131
Increase (decrease) in other liabilities	1,051	(6,237)	(171)	(5,357)	(8,130)
Total adjustments	**42,418**	**(1,828)**	**(548)**	**40,042**	**59,237**
Net Cash Provided by Operating Activities	**$ 38,952**	**$ 47,958**	**$ 1,192**	**$ 88,102**	**$ 100,612**
Non-cash Investing, Capital and Related Financing Activities:					
Non-cash contributions	$ 4,601	$ –	$ 658	$ 5,259	$ 3,948
Allowance for funds used during construction	3,119	1,156	98	4,373	4,117
Changes in valuation of financial instruments	156	119	9	284	544
Amortization of debt related costs	1,233	(3,262)	41	(1,988)	(2,219)

The accompanying notes are an integral part of these combined financial statements.

Notes to Combined Financial Statements

December 31, 2016 and 2015

Note 1
Summary of Significant Accounting Policies

GENERAL

Public Utility District No. 1 of Snohomish County, Washington, (the PUD) is a public electric and water utility serving Snohomish County and Camano Island in Island County, Washington. The PUD's operations consist of three systems: the Electric System, the Generation System and the Water System. The PUD is governed by a three-member Commission, which is elected for staggered six-year terms. The legal responsibilities and powers of the PUD, including the establishment of rates and charges for services rendered, are exercised through the Commission.

The Electric System is made up of the PUD's electric transmission and distribution system. The Generation System is composed of the PUD's Jackson Hydroelectric Project and two smaller hydroelectric projects. The Water System is made up of the PUD's water distribution system.

The accompanying financial statements for 2016 include the individual and combined statements of net position for the Electric System, Generation System and Water System, and the statements of revenues, expenses, and changes in net position and cash flows for each system. System columns presented in the financial statements and notes may not add to the combined totals due to the elimination of intercompany transactions, which consist of intersystem loans and routine intercompany transactions.

The PUD's financial statements are reported using the accrual basis of accounting. Revenues are recorded when earned, and expenses are recorded when incurred. Revenues and costs that are directly related to the generation, purchase, transmission and distribution of electricity or water are reported as operating revenues and expenses. All other revenues and expenses are reported as non–operating revenues and expenses.

The accompanying financial statements have been prepared in conformity with Generally Accepted Accounting Principles (GAAP) as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard–setting body for establishing governmental accounting and financial reporting principles. In addition, the PUD has elected to implement, where not in conflict with GASB pronouncements, GAAP prescribed by the Financial Accounting Standards Board (FASB).

The PUD's other significant accounting and financial policies are described in the following sections.

Retail Sales

Prior to September 2015, Electric and Water System customers were billed on a monthly or bimonthly cyclical basis. The PUD began billing all customers monthly beginning September 1, 2015. The accompanying financial statements include estimated unbilled revenues for energy and water delivered to customers between the last billing date and the end of the year. Unbilled energy revenue was $40.5 million in 2016 and $31.8 million in 2015. Unbilled water revenue was $531,000 in 2016 and $497,000 in 2015.

Power Sales and Purchases

Power sales and purchase transactions are recognized over the duration of the contracts as a component of retail and wholesale revenue and purchased power operating expenses.

Capital Contributions

The PUD records capital contributions from customers and developers, primarily relating to expansions to the PUD's distribution facilities, as a separate category of non-operating revenue.

Cash Equivalents

The PUD considers highly liquid, short–term investments with original maturities of three months or less to be cash equivalents.

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable are recorded when invoices are issued and are written off when they are determined to be uncollectible. A reserve is established for uncollectible accounts receivable based upon historical write–off trends and knowledge of specific circumstances that indicate collection of an account may be unlikely. The allowance for doubtful accounts was $3.1 million and $3.4 million as of December 31, 2016 and 2015, respectively.

Material and Supplies

Material and supplies are recorded at average cost and consist primarily of materials for construction and maintenance of utility plant.

Special Funds

Special funds are restricted or limited–use funds that have been established in accordance with Board of Commissioner resolutions, bond resolutions, state law or other agreements. These funds, which consist of cash, cash equivalents and investments, are restricted for specific purposes, including debt service, bond reserves, rate stabilization, qualifying capital expenditures, post-employment benefits, FERC license commitments, and other reserve requirements. It is the PUD's policy to use unrestricted funds prior to using restricted funds except for bond proceeds used for qualifying capital expenditures and funds set aside for debt service payments.

Utility Plant

Utility plant is stated at cost, including an allowance for funds used during construction (AFUDC). The PUD's capitalization threshold for utility plant is $5,000. Depreciation is calculated using the straight–line method over the estimated useful lives of the assets, ranging from 5 to 77 years. When utility plant assets are retired, the original cost together with removal costs, less salvage, is charged to accumulated depreciation. The cost of maintenance and repairs is charged to expense as incurred, while the cost of replacements and betterments is capitalized. See Table 1 for additional utility plant details.

The PUD periodically reviews the carrying value of its utility plant and other equipment whenever events or changes in circumstances indicate that the carrying value may not be recoverable.

Reacquisition Costs on Bond Refundings

The difference between the cost to defease outstanding debt and the carrying value of bonds defeased by refunding bonds is deferred and amortized over the shorter of the remaining term of the refunded bonds or the term of the refunding bonds, using the straight–line or effective–interest method. This difference for bonds defeased by operating funds is charged to operations currently.

Net Position

Net position consists of the following components:

Net investment in capital assets – This component consists of capital assets, net of accumulated depreciation reduced by the net outstanding debt balances related to capital assets, net of unamortized debt related costs.

Restricted – This component consists of assets and liabilities with constraints placed on use. Constraints include those imposed by bond covenants or third–party contractual agreements, and resources restricted by Board resolution.

Unrestricted – This component consists of assets and liabilities that do not meet the definition of "net investment in capital assets" or "restricted."

Table 1
Utility Plant
(In thousands)

Electric System

	2014	2015			2016		
	Ending Balance	Additions	Retirements & Transfers	Ending Balance	Additions	Retirements & Transfers	Ending Balance
Transmission	$ 125,718	$ 1,287	$ (1,013)	$ 125,992	$ 6,016	$ (714)	$ 131,294
Distribution	1,074,267	33,344	(12,615)	1,094,996	58,281	(9,759)	1,143,518
General Plant & Other	266,265	42,987	(185)	309,067	57,493	(2,216)	364,344
Plant in Service [1]	1,466,250	77,618	(13,813)	1,530,055	121,790	(12,689)	1,639,156
Construction Work in Progress	102,705	42,902	–	145,607	(1,845)	–	143,762
Utility Plant	1,568,955	120,520	(13,813)	1,675,662	119,945	(12,689)	1,782,918
Less Accumulated Depreciation	(557,661)	(51,730)	15,116	(594,275)	(62,093)	15,577	(640,791)
Net Utility Plant	**$1,011,294**	**$ 68,790**	**$ 1,303**	**$1,081,387**	**$ 57,852**	**$ 2,888**	**$1,142,127**

[1] Plant in service includes land and non–depreciable assets of $64.6 million and $64.4 million as of December 31, 2016 and 2015 respectively.

Generation System

	2014	2015			2016		
	Ending Balance	Additions	Retirements & Transfers	Ending Balance	Additions	Retirements & Transfers	Ending Balance
Generation/Production	$ 238,912	$ 1,430	$ (262)	$ 240,080	$ 1,202	$ –	$ 241,282
Transmission	2,964	–	–	2,964	–	–	2,964
Distribution	10,073	–	–	10,073	–	–	10,073
General Plant & Other	11,290	–	155	11,445	–	–	11,445
Plant in Service [2]	263,239	1,430	(107)	264,562	1,202	–	265,764
Construction Work in Progress	3,977	6,368	–	10,345	35,995	–	46,340
Utility Plant	267,216	7,798	(107)	274,907	37,197	–	312,104
Less Accumulated Depreciation	(122,065)	(6,143)	(110)	(128,318)	(3,749)	5	(132,062)
Net Utility Plant	**$ 145,151**	**$ 1,655**	**$ (217)**	**$ 146,589**	**$ 33,448**	**$ 5**	**$ 180,042**

[2] Plant in service includes land and non–depreciable assets of $14.0 million and $12.8 million, as of December 31, 2016 and 2015 respectively.

Water System

	2014	2015			2016		
	Ending Balance	Additions	Retirements & Transfers	Ending Balance	Additions	Retirements & Transfers	Ending Balance
Generation/Production	$ 10,051	$ –	$ –	$ 10,051	$ –	$ –	$ 10,051
Transmission & Distribution	113,624	2,278	(250)	115,652	3,113	(250)	118,515
General Plant & Other	14,788	–	(75)	14,713	33	–	14,746
Plant in Service [3]	138,463	2,278	(325)	140,416	3,146	(250)	143,312
Construction Work in Progress	1,764	2,447	–	4,211	(269)	–	3,942
Utility Plant	140,227	4,725	(325)	144,627	2,877	(250)	147,254
Less Accumulated Depreciation	(27,151)	(3,060)	248	(29,963)	(2,953)	901	(32,015)
Net Utility Plant	**$ 113,076**	**$ 1,665**	**$ (77)**	**$ 114,664**	**$ (76)**	**$ 651**	**$ 115,239**

[3] Plant in service includes land and non–depreciable assets of $4.0 million as of December 31, 2016 and 2015.

Compensated Absences

Employees accrue paid time off (PTO) or vacation in varying amounts according to their years of service. Accrued liability for PTO and vacation was $11.2 million and $10.9 million at December 31, 2016 and 2015, respectively.

Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The PUD has used estimates in determining reported amounts including unbilled revenue, allowance for doubtful accounts receivable, accrued liability for injuries and damages, depreciable lives of utility plant and other contingencies. Actual results could differ from these estimates.

Accounting Changes and Reclassifications

GASB Statement No. 68, Accounting and Financial Reporting for Pensions requires governments providing defined benefit pensions to their employees to recognize the net pension liability for pension benefits on their statements of net position. Net position liability is measured as total pension liability, less the amount of a plan's fiduciary net position. The PUD participates in a multiple-employer plan, known as Washington State Public Employees Retirement System (PERS) and has implemented this statement.

GASB Statement No. 71, Pension Transition for Contributions Made Subsequent to the Measurement Date relates to amounts associated with contributions, if any, made by a state or local government employer, or non-employer contributing entity, to a defined benefit pension plan after the measurement date of the government's beginning net pension liability. Currently, the PUD makes contributions to PERS after the measurement date and has implemented this statement.

The collective financial impact resulting from the implementation of *GASB Statements No. 68* and *71* is the restatement of 2015 beginning balances by $91.7 million for the PUD's portion of the net pension expense incurred in prior years, which is then allocated across business units. This collective financial impact includes a pension liability of $67.0 million, and a deferred inflow and outflow of resources equal to $29.2 million and $4.5 million, respectively.

GASB Statement No. 72, Fair Value Measurement and Application requires governments to address accounting and financial reporting issues related to fair value measurements. The definition of fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This statement provides guidance for determining a fair value measurement for financial reporting purposes, provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements. The implementation of Statement No. 72 had no impact to the financial results of the PUD, but required additional disclosures.

GASB Statement No. 76, The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments reduces the GAAP hierarchy to two categories of authoritative GAAP and addresses the use of authoritative and non-authoritative literature in the event that the accounting treatment for a transaction or other event is not specified within a source of authoritative GAAP. The implementation of Statement No. 76 had no impact to the financials results of the PUD.

GASB Statement No. 79, Certain External Investment Pools and Pool Participants allows governments to elect amortized cost for certain external investment pools and pool participants. An external investment pool qualifies for that reporting by meeting all of the applicable criteria established in this statement. In addition, the statement requires disclosures if the election to use amortized cost is made. The PUD invests with the Washington State Local Government Investment Pool (LGIP), and the PUD has elected to account for LGIP investments at amortized cost. The implementation of Statement No. 79 had no impact on the financial results of the PUD, but required additional disclosures.

Certain reclassifications have been made to the 2015 financial statements to conform to the 2016 presentation.

Note 2
Special Funds and Cash and Temporary Investments

The PUD's investment policy authorizes the investment of funds in U.S. Treasury, federal and state agency obligations, interest–bearing demand or time deposits, repurchase agreements, bankers' acceptances and certain other investments. Interest–bearing demand or time deposits with a qualified public depository of the State of Washington are protected and collateralized under the Washington State Public Deposit Protection Act. In all instances, the PUD evaluates the credit-worthiness of the financial institutions with which it invests.

All PUD investments are in compliance with the State of Washington statutes and PUD bond resolutions. Substantially all PUD investments are recorded at fair value based on quoted market prices. Premiums and discounts are amortized over the life of the investment using the straight–line method. The relative type of PUD's investments at December 31, 2016 and 2015 are summarized in Table 2.

Table 2
Special Funds and Cash and Temporary Investments

	Electric System		Generation System		Water System	
	2016	2015	2016	2015	2016	2015
U.S. Treasury Notes	18%	16%	3%	–	–	–
U.S. Agency Obligations						
Federal Home Loan Bank	12%	23%	13%	8%	38%	35%
Federal Farm Credit Bank	19%	7%	17%	22%	9%	–
Federal National Mortgage Association	8%	10%	–	–	–	–
Federal Home Loan Mortgage Corporation	21%	14%	–	5%	–	21%
Federal Agricultural Mortgage Association	–	2%	–	–	–	–
Cash and Interest–bearing Demand or Time Deposits	7%	8%	27%	16%	10%	6%
Washington State Local Government Investment Pool	15%	20%	40%	49%	43%	38%

The PUD invests funds consistent with the following objectives: conform with state and local statutes, preserve principal, maintain adequate liquidity and maximize yield. The PUD's investments are purchased with the objective of holding the security until maturity.

Investment securities owned by the PUD are registered in the PUD's name and held in trust by banks or trust companies. Repurchase agreements are fully collateralized by eligible securities registered in the PUD's name. Other PUD investments are insured by federal depository insurance or protected against loss since they are on deposit with financial institutions recognized as qualified public depositories of the State of Washington.

The Washington State Local Government Investment Pool (LGIP) is an investment vehicle operated by the Washington State Treasurer, offering governmental agency investors the economies of scale available from a multi-billion-dollar pooled fund investment portfolio. As of December 31, 2016, LGIP investments include primarily U.S. Agency Securities, U.S. Treasury Securities and Repurchase Agreements. Assets held in LGIP are invested in a manner consistent with the U.S. Securities and Exchange Commission's rule 2a-7 of the Investment Company Act of 1940. The PUD records these investments at amortized cost.

The PUD must give notice to the LGIP if the PUD plans to withdraw over $1.0 million on the same day. The LGIP may suspend withdrawals or liquidate if the difference between the amortized cost per share and the market net asset value per share results in material dilution or other unfair results. The LGIP may suspend redemptions if the New York Stock Exchange suspends trading or closes, if the US bond markets are closed, and if the Securities and Exchange Commission declares an emergency.

The PUD's investment policy specifies that the investment portfolio be structured so maturing investments match projected cash flow needs in order to mitigate interest rate risk. In order to address custodial credit risk, all investments except cash, interest–bearing demand or time deposits, and funds held in the LGIP, which are not evidenced by securities, are held in the PUD's name by a third–party custodian. The PUD addresses concentration of credit risk by investing in a diversified portfolio.

The PUD manages its exposure to decreases in the fair value of its investments arising from increasing interest rates by setting maturity limits for its investments. While bond reserves are invested in U.S. agency obligations that approximate the term of the related bonds, all other funds are invested in instruments with maturities of less than five years, and most are invested for terms of two years or less. Investment maturities for combined special funds and cash and temporary investments as of December 31, were as follows:

	2016		2015	
Term	Amount Invested (in thousands)	Percent of Invested Fund	Amount Invested (in thousands)	Percent of Invested Fund
Less than 30 days	$ 130,267	25%	$ 171,435	28%
30 to 90 days	44,023	8	40,082	6
90 days to 1 year	189,576	36	126,192	21
1 year to 5 years	125,110	23	234,237	38
Bond reserves invested to bond maturity	41,452	8	41,859	7
	$ 530,428	100%	$ 613,805	100%

Fair value is the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date. The PUD's investments, at fair value, can be categorized by valuation techniques into two levels. Level 1 investments are traded on a national securities exchange and are valued at the last reported sales price on the last business day of the year. Level 2 investments are valued using pricing models maximizing the use of observable inputs for similar securities.

The table below shows the investments using the fair value hierarchy as of December 31 (in thousands):

	2016						2015	
	Electric		Generation		Water		Combined	
	Level 1	Level 2	Level 1	Level 2	Level 1	Level 2	Level 1	Level 2
U.S. Treasury Notes	$ 81,969	$ –	$ 1,700	$ –	$ –	$ –	$ 78,903	$ –
Federal Home Loan Mortgage Corporation		98,625	–	–	–	–	–	77,778
Federal Farm Credit Bank	–	84,894	–	9,979	–	1,498	–	53,159
Federal Home Loan Bank	–	53,061	–	7,519	–	6,002	–	130,564
Federal National Mortgage Association	–	37,137		–	–	–	–	50,076
Federal Agricultural Mortgage Association	–	–	–	–	–	–	–	8,020
Assets Valued at Fair Value	$ 81,969	$ 273,717	$ 1,700	$ 17,498	$ –	$ 7,500	$ 78,903	$ 319,597

Note 3
Long-Term Debt

Debt service (principal and interest) payments on the PUD's revenue bonds and other notes payable to maturity, excluding intersystem borrowing, are set forth in Table 3.

TABLE 3
Debt Service (Principal & Interest)
(In thousands)

	Electric System		Generation System		Water System	
	Principal	Interest	Principal	Interest	Principal	Interest
2017	$ 9,045	$ 17,808	$ 25,205	$ 7,807	$ 2,024	$ 816
2018	9,460	17,393	26,315	6,702	2,029	752
2019	9,880	16,975	27,605	5,407	1,979	679
2020	10,335	16,520	5,310	4,059	1,959	607
2021	10,820	16,033	5,505	3,841	2,009	536
2022-2026	59,645	71,798	21,010	15,049	7,344	1,707
2027-2031	61,480	56,519	8,665	11,661	5,085	601
2032-2036	80,705	31,801	11,180	9,141	374	7
2037-2041	95,220	1,279	14,420	5,900	–	–
2042-2046	–	–	14,410	1,845	–	–
Total	**$ 346,590**	**$ 246,126**	**$ 159,625**	**$ 71,412**	**$ 22,803**	**$ 5,705**

Each system's revenues net of specified operating expenses are pledged as security for the system's revenue bonds until the bonds are defeased or repaid. Principal and interest paid for 2016 and 2015 were $62.4 million and $63.5 million, respectively. Total revenues available for debt service as defined for the same periods were $139.0 million and $133.6 million. At December 31, 2016, annual principal and interest payments are expected to require between 45% and 56% of revenues. During 2015, the PUD paid the outstanding balance of the Electric System 2005 Revenue Refunding bonds.

The majority of the PUD's long-term debt is tax–exempt bonds that are subject to Internal Revenue Service Code (the Code) requirements for arbitrage rebate. The rebate is calculated based on earnings on gross proceeds of the bonds that are in excess of the amount prescribed by the Code. The arbitrage liability as of December 31, 2016 and 2015 was $0.5 million and $0.2 million, respectively.

Electric System

A summary of principal outstanding on Electric System long-term debt follows:

	December 31, 2016	December 31, 2015
	(In thousands)	
Series 2015 Revenue bonds, 5.0%, due 2017-2040, earliest call 2025	$ 136,985	$ 140,920
Series 2012 Revenue Refunding bonds, 3.0-5.0%, due 2017-2028, earliest call 2022	46,415	51,115
Series 2011 Revenue Refunding bonds, 3.0-5.0%, due 2018-2024, earliest call 2021	35,115	35,115
Series 2010A Revenue bonds, 3.7-5.6%, due 2017-2035, currently callable	128,075	128,075
Total Principal Outstanding on Long-Term Debt	**$346,590**	**$355,225**

Changes in the Electric System long-term debt during the years ended December 31, 2016 and 2015, follow (in thousands):

	2014	2015			2016		
	Balance	Additions	Reductions	Balance	Additions	Reductions	Balance
Revenue bonds, face amount	$ 317,900	$ 140,920	$ (103,595)	$ 355,225	$ –	$ (8,635)	$ 346,590
Unamortized bond premium	17,297	17,122	(5,123)	29,296	–	(1,771)	27,525
Unamortized bond discount	(100)	–	4	(96)	–	5	(91)
Total Debt	335,097	158,042	(108,714)	384,425	–	(10,401)	374,024
Less: Current maturities	(14,220)			(8,635)			(9,045)
Total Long–Term Debt	**$ 320,877**			**$375,790**			**$364,979**

In June 2015, the PUD issued $140.9 million of Series 2015 Electric System Revenue bonds. The net proceeds of the Series 2015 bonds are being used to finance additions, betterments and improvements to and renewals, replacements and extensions of the Electric System.

The PUD is required to maintain a cash reserve for certain Electric System bonds. At December 31, 2016 and 2015, the PUD maintained the reserve requirement of $25.1 million and $25.5 million, respectively, in the Electric System.

The fair value of the Electric System's long-term debt was $395.8 million and $415.5 million, respectively, at December 31, 2016 and 2015. The fair value of the Electric System's long-term debt is estimated based on quoted market prices for the same or similar issues.

The PUD provided an irrevocable $2.3 million letter of credit to Bonneville Power Administration to secure transmission projects under an agreement. The letter of credit will expire on July 1, 2017, and the PUD has not had any draws on this letter of credit since its inception.

Generation System

A summary of principal outstanding on Generation System long-term debt follows:

	December 31, 2016	December 31, 2015
	(In thousands)	
Series 2015 Revenue bonds, 5.0%, due 2025-2045, earliest call 2025	$39,985	$39,985
Series 2010A Revenue Refunding bonds, 3.5-5.0%, due 2017-2024, earliest call 2020	105,590	$129,650
Series 2010B Revenue bonds, 5.3-5.7%, due 2020-2040, currently callable	14,050	14,050
Total Principal Outstanding on Long-Term Debt	**$ 159,625**	**$ 183,685**

Changes in the Generation System long-term debt during the years ended December 31, 2016 and 2015, follow (in thousands):

	2014	2015			2016		
	Balance	Additions	Reductions	Balance	Additions	Reductions	Balance
Revenue bonds, face amount	$ 166,770	$ 39,985	$ (23,070)	$ 183,685	$ –	$ (24,060)	$ 159,625
Unamortized bond premiums	14,065	5,395	(1,455)	18,005	–	(1,598)	16,407
Unamortized bond discounts	(11)	–	1	(10)	–	–	(10)
Total Debt	180,824	45,380	(24,524)	201,680	–	(25,658)	176,022
Less: Current maturities	(23,070)			(24,060)			(25,205)
Total Long–Term Debt	**$ 157,754**			**$177,620**			**$150,817**

In September 2015, the PUD issued $40.0 million of Series 2015 Generation System Revenue bonds. The net proceeds of the Series 2015 bonds are being used to finance additions, betterments and improvements to and renewals, replacements and extensions of the Generation System, including costs of design and construction of the Calligan Creek and the Hancock Creek hydroelectric projects.

The PUD is obligated as part of its bond resolution to purchase for use in its Electric System all power available to the Electric System from the Generation System. The PUD is also unconditionally obligated by the bond resolution to set aside revenues in amounts sufficient to pay, to the extent not otherwise paid, all the debt service on the Generation System bonds on a parity of lien with the Electric System Senior bonds.

The PUD is required to maintain a cash reserve for certain Generation System bonds. At December 31, 2016 and 2015, the PUD maintained the reserve requirement of $15.1 million in the Generation System.

At December 31, 2016, $12.7 million of the Series 1989 Generation System Revenue bonds and $24.3 million of the Series 1986A Generation System Revenue Refunding bonds were considered defeased.

The fair value of the Generation System's long-term debt was $174.3 million and $206.1 million, respectively, at December 31, 2016 and 2015. The fair value of the Generation System's long-term debt is estimated based on quoted market prices for the same or similar issues.

Water System

A summary of principal outstanding on Water System long-term debt follows:

	December 31, 2016	December 31, 2015
	(In thousands)	
Series 2011 Revenue Refunding bonds, 3.0-5.0%, due 2017-2022, earliest call 2021	$ 5,080	$ 6,040
Series 2009 Revenue bonds, 4.0-4.4%, due 2017-2031, earliest call 2019	10,320	10,815
Series 2006 Revenue and Refunding bonds, 4.3%, due 2020-2026, currently callable	3,095	3,340
State of Washington Drinking Water Revolving Fund loans:		
equal principal payments plus 1.0% interest due annually through 2034	2,242	2,367
equal principal payments plus 1.5% interest due annually through 2029	1,074	1,157
equal principal payments plus 1.5% interest due annually through 2027	705	768
equal principal payments plus 2.5% interest due annually through 2022	287	335
Total Principal Outstanding on Long-Term Debt	**$ 22,803**	**$ 24,822**

Changes in the Water System long-term debt during the years ended December 31, 2016 and 2015, follow (in thousands):

	2014	2015			2016		
	Balance	Additions	Reductions	Balance	Additions	Reductions	Balance
Revenue bonds, face amount	$ 21,900	$ –	$ (1,705)	$ 20,195	$ –	$ (1,700)	$ 18,495
Unamortized bond premiums	794	–	(98)	696	–	(97)	599
Unamortized bond discounts	–	–	–	–	–	–	–
Other notes payable	4,966	–	(339)	4,627	–	(319)	4,308
Total Debt	27,660	–	(2,142)	25,518	–	(2,116)	23,402
Less: Current maturities	(2,044)			(2,019)			(2,024)
Total Long–Term Debt	**$ 25,616**			**$ 23,499**			**$ 21,378**

The Water System periodically enters into low-interest loan agreements with the Washington State Public Works Trust Fund and the State of Washington Drinking Water Revolving Fund. These funds have provided various loans to the PUD for the repair, replacement, rehabilitation and reconstruction of water facilities.

The PUD is required to maintain a cash reserve for certain Water System bonds. At December 31, 2016 and 2015, the PUD maintained the reserve requirement of $1.2 million in the Water System.

The fair value of the Water System's long-term debt was $23.7 million and $26.4 million, respectively, at December 31, 2016 and 2015. The fair value of the Water System's long-term debt is estimated based on quoted market prices for the same or similar issues. The carrying amounts for the Washington State Public Works Trust Fund loan and the State of Washington Drinking Water Revolving Fund loans approximate fair value since such loans are exclusive and have no market.

Note 4
Power Purchase Agreements

The PUD is a preference customer of BPA, from which it acquired approximately 85% and 86% of its energy purchases in 2016 and 2015, respectively. The PUD entered into participation agreements in Energy Northwest's Nuclear Projects Nos. 1, 2 and 3. Additionally, the PUD has committed the Electric System to purchase the output of its Generation System at the cost of the power produced. The PUD also receives energy from various power supply agreements. Finally, the PUD enters into various short–term agreements for the sale and purchase of power.

BPA Contracts

The PUD purchases power from BPA under power supply contracts offered pursuant to the Pacific Northwest Electric Planning and Conservation Act. These contracts provide the PUD with the ability to purchase power in excess of its declared resources on an as–needed basis. The PUD entered into contracts with BPA to purchase approximately 75–85% of its power requirements from the federal agency through 2028.

Energy Northwest Nuclear Projects Nos. 1, 2 and 3

The PUD, Energy Northwest and BPA have entered into separate Net Billing Agreements with respect to Energy Northwest's Project No. 1, Project No. 2 and 70% ownership share of Project No. 3. The PUD is obligated to purchase from Energy Northwest, and BPA is obligated to purchase from the PUD, a maximum of approximately 20%, 15% and 19%, respectively, of the capacity of Project Nos. 1 and 2 and Energy Northwest's 70% ownership share of Project No. 3. BPA is unconditionally obligated to pay Energy Northwest the PUD's pro rata share of the total annual costs of the projects, including debt service on revenue bonds issued to finance the projects. The effect of these net billing agreements is that the cost of power sold by BPA to all of its customers, including the PUD, includes the cost of these projects.

Notwithstanding the assignment of the PUD's share of the capability of a net billed project to BPA, the PUD remains unconditionally obligated to pay to Energy Northwest its share of the total annual costs of the projects to the extent payment is not received by Energy Northwest from BPA.

Short–Term Power Supply Transactions and Open Market Purchases

During 2016 and 2015, the PUD entered into various short-term power supply transactions to meet normal load requirements. As of December 31, 2016, the PUD has not committed to any short-term power supply transactions during 2017.

In 2016 and 2015, respectively, the PUD purchased 3% and 4% of its total energy kWh purchases through short–term power supply and open market purchases for a total cost of $7.8 million and $10.6 million.

Note 5
Generation System Projects

The Generation System consists of the PUD's Henry M. Jackson Hydroelectric Project (Jackson Project) and two smaller hydroelectric projects.

Jackson Project

The Jackson Project is a multipurpose hydroelectric project with a capacity of 111.8 megawatts. In 2016 and 2015, the Jackson Project supplied 5% of the PUD's energy needs.

The project is currently operating under a 45-year license issued by the Federal Energy Regulatory Commission (FERC). The license is scheduled to expire in 2056. The license agreement includes requirements for fish, wildlife and recreation enhancement in the Jackson Project area. The PUD has also negotiated settlement agreements with the cities of Everett and Sultan, Washington Department of Fish and Wildlife, United States Forest Service and the Tulalip Tribes that call for funding commitments over the course of the 45-year license.

Small Hydroelectric Projects

The Generation System currently owns two small hydroelectric projects located near Sultan, Washington, in Snohomish County: the Youngs Creek Hydroelectric Project (Youngs Creek) and the Woods Creek Hydroelectric Project (Woods Creek). Completed in 2011, Youngs Creek has a capacity of 7.5 MW, and its FERC license expires in 2042. Woods Creek was built in the 1980s and purchased by the PUD in 2008. The project has a capacity of 650 kW and has been upgraded by the PUD to meet current operating standards.

In 2010, the PUD purchased land on Calligan Creek and Hancock Creek in North King County in order to construct two 6.0 MW hydroelectric projects. The PUD received FERC licenses for the projects in 2015, and began construction that same year, with project completion and commissioning expected in 2017. The PUD recorded development, engineering and construction costs of $25.1 million and $6.2 million in 2016 and 2015, respectively, related to the projects.

Note 6
Related Party Transactions

The Generation System sells power to the Electric System at the cost of power produced including debt service and any other cash transactions. The Generation System sold $53.9 million of power in 2016 and $48.1 million of power in 2015 to the Electric System.

The Electric, Generation and Water Systems enter into various transactions to prudently and efficiently allocate resources and costs while treating each system as a stand–alone entity. Amounts due the Electric System from the Generation System for routine intercompany transactions totaled $6.6 million at December 31, 2015. Amounts due the Electric System from the Water System for routine intercompany transactions totaled $8.4 million at December 31, 2015.

The Electric and Generation Systems periodically enter into loan transactions between the systems for various purposes including to defease bonds, to fund energy generation project construction, and to fund energy generation project studies, including the purchase and development of small hydroelectric projects. These loans are assigned terms consistent with the associated asset acquired, and interest rates are set at tax–exempt bond market rates at the time of the loan.

Electric System loans to the Generation System were $33.4 million and $49.0 million at December 31, 2016 and 2015, respectively. The Generation System recorded interest expense on these loans of $1.4 million in 2016 and $1.9 million in 2015.

A Generation System loan to the Electric System was $4.2 million and $5.3 million at December 31, 2016 and 2015, respectively. The Electric System recorded interest expense on this loan of $0.3 million in 2016 and $0.4 million in 2015.

Note 7
Retirement and Deferred Compensation Plans

DEFINED BENEFIT PENSION PLANS

The Public Employee Retirement System (PERS) is a cost-sharing multiple-employer retirement system comprised of three separate pension plans for membership purposes. PERS Plan 1 and PERS Plan 2 are defined benefit plans, and PERS Plan 3 is a defined benefit plan with a defined contribution component. PERS members include elected officials, state employees, and employees of governmental agencies in the State of Washington.

PERS members who joined the system by September 30, 1977 are Plan 1 members. Those who joined after that date are Plan 2 members unless they exercised 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. Employees who fail to choose within 90 days default to Plan 3.

PERS is comprised of and reported as three separate plans for accounting purposes. Plan 1 accounts for 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; and 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 portion of Plan 2 and Plan 3 are accounted for in the same pension trust fund. All assets of Plan 2/3 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.

General Benefits Provided

PERS provides retirement, disability and death benefits. Benefit provisions are established by state statute and can only be modified by the state legislature.

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 interest at a rate specified by the Director of DRS. Benefit increases are provided to benefit recipients each January. Increases are related to the funding ratio of the plan.

The benefit provisions stated in the following paragraphs of this section are current provisions and apply to active plan participants. Vested, terminated employees who are entitled to benefits but are not receiving them yet are bound by the provisions in effect at the time they terminated their public service.

Substantially all full-time and qualifying part-time PUD employees participate in PERS which is administered by the Washington State Department of Retirement Systems, (DRS). The state Legislature establishes, and amends, laws pertaining to the creation and administration of all public retirement systems.

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

	PERS Plan 1	PERS Plan 2	PERS Plan 3
		(In thousands)	
2016	$ 98	$ 10,117	$ 1,808
2015	$ 124	$ 8,992	$ 1,589
2014	$ 155	$ 7,627	$ 1,362

PERS Plan 1

PERS Plan 1 provides retirement, disability and death benefits. Retirement benefits are determined as two percent of the member's average final compensation (AFC) times the member's years of service. The AFC is the average of the member's 24 highest consecutive service months. Members are eligible for retirement from active status at any age with at least 30 years of service, at age 55 with at least 25 years of service, or at age 60 with at least five years of service. Members retiring from active status prior to the age of 65 may receive actuarially reduced benefits. Retirement benefits are actuarially reduced to reflect the choice of a survivor benefit. Other benefits include duty and non-duty disability payments, an optional cost-of-living adjustment (COLA), and a one-time duty-related death benefit, if found eligible by the Department of Labor and Industries. PERS 1 members were vested after the completion of five years of eligible service. The plan was closed to new entrants on September 30, 1977.

The PERS Plan 1 member contribution rate is established by State statute at 6 percent. The employer contribution rate is developed by the Office of the State Actuary and includes an administrative expense component that is currently set at 0.18 percent. Each biennium, the state Pension Funding Council adopts Plan 1 employer contribution rates. The PERS Plan 1 required contribution rates (expressed as a percentage of covered payroll) were as follows:

Actual Contribution Rates	*Employer*	*Employee*
January 2014 through June 2015	9.21%	6.00%
July 2015 through December 2016	11.18%	6.00%

The PUD's contributions as reported by PERS to the plan were $5.3 million, and $4.7 million for the years ended December 31, 2016, and 2015, respectively.

PERS Plan 2/3

PERS Plan 2/3 provides retirement, disability and death benefits. Retirement benefits are determined as two percent of the member's AFC times the member's years of service for Plan 2 and 1 percent of AFC for Plan 3. The AFC is the average of the member's 60 highest-paid consecutive service months, and there is no cap on years of service credit. Members are eligible for retirement with a full benefit at 65 with at least five years of service credit. Retirement before age 65 is considered an early retirement. PERS Plan 2/3 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 benefit that is reduced by a factor that varies according to age for each year before age 65. PERS Plan 2/3 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 three 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 2/3 members hired on or after May 1, 2013, have the option to retire early by accepting a reduction of five percent for each year of retirement before age 65. This option is available only to those who are age 55 or older and have at least 30 years of service credit. PERS Plan 2/3 retirement benefits are also actuarially reduced to reflect the choice of a survivor benefit. Other PERS Plan 2/3 benefits include duty and non-duty disability payments, a cost-of-living allowance (based on the CPI) capped at three percent annually and a one-time duty-related death benefit, if found eligible by the Department of Labor and Industries. PERS 2 members are vested after completing five years of eligible service. 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 12 months of that service are earned after age 44.

PERS Plan 3 defined contribution benefits are totally dependent on employee contributions and investment earnings on those contributions. PERS Plan 3 members choose their contribution rate upon joining membership and have a chance to change rates upon changing employers. As established by statute, Plan 3 required defined contribution rates are set at a minimum of 5 percent and escalate to 15 percent with a choice of six options. Employers do not contribute to the defined contribution benefits. PERS Plan 3 members are immediately vested in the defined contribution portion of their plan.

The PERS Plan 2/3 employer and employee contribution rates are developed by the Office of the State Actuary to fully fund Plan 2 and the defined benefit portion of Plan 3. The Plan 2/3 employer rates include a component to address the PERS Plan 1 Unfunded Actuarial Accrued Liability (UAAL) and an administrative expense that is currently set at 0.18 percent. Each biennium, the state Pension Funding Council adopts Plan 2 employer and employee contribution rates and Plan 3 contribution rates. The PERS Plan 2/3 required contribution rates (expressed as a percentage of covered payroll) were as follows:

Actual Contribution Rates	*Employer Plan 2/3*	*Employee Plan 2*	*Employee Plan 3*
January 2014 through June 2015	9.21%	4.92%	varies
July 2015 through December 2016	11.18%	6.12%	varies

The PUD's contributions as reported by PERS to the plan were $6.8 million, and $5.9 million for the years ended December 31, 2016, and 2015, respectively.

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

At June 30, 2016 and 2015, the PUD reported a total pension liability of $106.1 million and $86.4 million for its proportionate share of the net pension liabilities. The pension liability was $48.8 million and $46.6 million for PERS Plan 1 and $57.3 million and $39.8 million for PERS Plan 2/3 at June 2016 and 2015, respectively.

The PUD's proportionate share of the net pension liabilities for PERS Plan 1 was 0.91% and 0.89% for June 30, 2016 and 2015 respectively. The PUD's proportionate share of the PERS Plan 2/3 was 1.14% and 1.11% for June 30, 2016 and 2015, respectively.

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

The collective net pension liability was measured as of June 30, 2016, and the actuarial valuation date on which the total pension liability (asset) is based was as of June 30, 2015, with update procedures used to roll forward the total pension liability to the measurement date.

For the year ended December 31, 2016, the PUD recognized a pension credit of $1.5 million for PERS Plan 1 and pension expense of $1.7 million for PERS Plan 2/3. For the year ended December 31, 2015, the PUD recognized a pension credit of $1.9 million for PERS Plan 1 and a pension credit of $1.1 million for PERS Plan 2/3.

At December 31, the PUD reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources (in thousands):

	PERS PLAN 1				PERS PLAN 2/3			
	Deferred Outflows of Resources		*Deferred Inflows of Resources*		*Deferred Outflows of Resources*		*Deferred Inflows of Resources*	
	2016	*2015*	*2016*	*2015*	*2016*	*2015*	*2016*	*2015*
Differences between expected and actual experience	$ –	$ –	$ –	$ –	$ 3,050	$ 4,228	$ 1,891	$ –
Net difference between projected and actual investment earnings on pension plan investments	1,229	–	–	2,550	7,009	–	–	10,618
Changes of assumptions	–	–	–	–	592	65	–	–
Changes in proportion and differences between contributions and proportionate share of contributions	–	–	–	–	1,285	459	76	6
Contributions subsequent to the measurement date	2,604	2,651	–	–	3,337	3,394	–	–
TOTAL	$ 3,833	$ 2,651	$ –	$ 2,550	$ 15,273	$ 8,146	$ 1,967	$ 10,624

Deferred outflows of resources related to pensions resulting from the PUD's contributions subsequent to the measurement date is recognized as a reduction of the net pension liability in the year ended December 31, 2016 and 2015. Other amounts reported as deferred outflows and deferred inflows of resources related to pensions will be recognized in pension expense as follows (in thousands):

Year ended December 31:	PERS 1	PERS 2/3
2017	$ 303	$ (451)
2018	303	(451)
2019	(1,129)	(5,690)
2020	(706)	(3,377)
Total	$ (1,229)	$ (9,969)

Actuarial Assumptions

The total pension liability (TPL) for each of the DRS plans was determined using the most recent actuarial valuation completed as of June 30, 2015 with results rolled forward to June 30, 2016. The actuarial assumptions used in the June 30, 2015, valuation were based on the results of the Washington Office of the State Actuary's (OSA) 2007-2012 Experience Study.

Additional assumptions for subsequent events and law changes are current as of the 2016 actuarial valuation report. Plan liabilities were rolled forward from June 30, 2015, to June 20, 2016, reflecting each plan's normal cost (using the entry-age cost method), assumed interest and actual benefit payments. Assumptions included:

- Inflation: 3% total economic inflation; 3.75% salary inflation
- Salary increases: In addition to the base 3.75% salary inflation assumption, salaries are also expected to grow by promotions and longevity.
- Investment rate of return: 7.5%

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

The discount rate used to measure the total pension liability for all DRS plans was 7.5%. To determine that rate, an asset sufficiency test included an assumed 7.7% long-term discount rate to determine funding liabilities for calculating future contribution rate requirements. Consistent with the long-term expected rate of return, a 7.5% future investment rate of return on invested assets was assumed for the test. Contributions from plan members and employers are assumed to continue being made at contractually required rates (including PERS 2/3 employers, whose rates include a component for the PERS 1 liabilities). Based on these assumptions, the pension plans' fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return of 7.5% was used to determine the total liability.

The long-term expected rate of return on DRS pension plan investments of 7.5% was determined using a building-block-method. The Washington State Investment Board (WSIB) used a best estimate of expected future rates of return (expected returns, net of pension plan investment expense, including inflation) to develop each major asset class. Those expected returns make up one component of WSIB's capital market assumptions. WSIB uses the capital market assumptions and their target asset allocation to simulate future investment returns at various future times. The long-term expected rate of return of 7.5% approximately equals the median of the simulated investment returns over a 50-year time horizon.

Estimated Rates of Return by Asset Class

Best estimates of arithmetic real rates of return for each major asset class included in the pension plan's target asset allocation as of June 30, 2016, are summarized in the table below.

Asset Class	Target Allocation	% Long-term Expected Real Rate of Return Arithmetic
Fixed Income	20%	1.70%
Tangible Assets	5%	4.40%
Real Estate	15%	5.80%
Global Equity	37%	6.60%
Private Equity	23%	9.60%

The inflation component used to create the table is 2.2% and represents WSIB's most recent long-term estimate of broad economic inflation.

Sensitivity of Net Pension Liability

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

($ Millions)

	2016			2015		
	1% Decrease (6.5%)	Current Discount Rate (7.5%)	1% Increase (8.5%)	1% Decrease (6.5%)	Current Discount Rate (7.5%)	1% Increase (8.5%)
PERS Plan 1	$ 58.9	$ 48.8	$ 40.2	$ 56.8	$ 46.6	$ 37.9
PERS Plan 2/3	$ 105.5	$ 57.3	$ (29.8)	$ 116.3	$ 39.8	$ (18.8)

Pension Liability Allocation

The pension liability has been allocated to the Electric, Generation and Water Systems, based on percentages of staffing levels between the systems. The PUD's proportionate share of net pension liability for each plan, as of December 31, is as follows (in thousands):

	2016		2015	
	PERS Plan 1	PERS Plan 2/3	PERS Plan 1	PERS Plan 2/3
Electric System	$ 46,390	$ 54,454	$ 44,298	$ 37,787
Generation System	1,182	1,413	1,128	978
Water System	1,237	1,409	1,187	1,010

Pension Plan Fiduciary Net Position

The pension plans' fiduciary net position has been determined on the same basis used by the pension plan accounted for in pension trust funds using the flow-of-economic-resources measurement focus and the accrual basis of accounting. Investments are reported at fair value. Unrealized gains and losses are included as investment income in the Statement of Changes in Fiduciary Net Position. The net assets of the retirement funds are valued using the publicly traded securities, limited partnerships, private equity limited partnerships and real estate limited partnerships.

Detailed information about each defined benefit pension plans' fiduciary net position is available in the separately issued DRS 2016 CAFR financial report. The DRS CAFR may be obtained by writing to: Department of Retirement Systems, Communications Unit, P.O. Box 48380, Olympia WA 98504-8380.

POST–EMPLOYMENT HEALTHCARE DEFINED BENEFIT HEALTHCARE PLAN

The PUD administers retiree self–insured medical and vision insurance and Health Reimbursement arrangement (HRA) benefits for eligible retirees hired before July 1, 2009, and their dependents. Retiree benefit provisions are established by Commission resolution.

In general, the PUD pays a contribution toward the retiree's PUD group health plan premiums or to a Health Reimbursement Arrangement (HRA). For retirees and their dependents under age 65 who elect a PUD group medical plan, the PUD contribution is based on 75% of the premium for the most commonly elected retiree health plan during the prior year. Retirees and their dependents under age 65 who waive PUD group medical plan coverage receive a $180 monthly contribution into their HRA. When a retiree or dependent becomes eligible for Medicare at age 65, the retiree is no longer eligible for the group medical plan; however, the PUD contributes $180 a month to the retiree's HRA. In 2016 and 2015, the PUD contributed $2.4 and $2.2 million, respectively, to the plans. Plan members receiving benefits contributed $0.6 million in both 2016 and 2015.

The PUD's annual Post–Employment Healthcare Benefit (PEHB) cost is calculated based on the annual required contribution (ARC) of the employer, an amount actuarially determined in accordance with *GASB Statement 45*. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal costs each year and amortize any unfunded liabilities (or funding excess) over a 30–year period. ARC amounts are calculated assuming a level percent of payroll and an open amortization period equal to the average future lifetime of the population to reflect the short duration of the liability. The following table shows the components of the PUD's annual PEHB cost for the years ended December 31, the amount actually contributed to the plan and the changes in the PUD's net PEHB obligation (in thousands):

	2016			2015
	Electric	Generation	Water	Combined
Annual required contribution (ARC)	$ 4,303	$ 112	$ 103	$ 4,458
Interest on net OPEB obligation	585	15	14	577
Adjustment to ARC	(908)	(24)	(22)	(896)
Annual OPEB costs	3,980	103	95	4,139
Contributions made	(2,932)	(83)	(115)	(3,073)
Change in net PEHB obligation	1,048	20	(20)	1,066
Net PEHB obligation – beginning of year	16,652	441	444	16,471
Net PEHB obligation – end of year	**$ 17,700**	**$ 461**	**$ 424**	**$ 17,537**

The PUD made contributions of $2.1 million to the net PEHB obligation, both in 2016 and 2015.

As of December 31, 2016, the unfunded actuarial accrued liability (UAAL) was $57.4 million, based on the entry age normal cost method. The annual payroll of active employees covered by the plan was $74.7 million. 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 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 is included in the Required Supplementary Information.

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. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short–term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations. Actuarial assumptions include a rate of return on investments of 3.5%. The medical trend rate is estimated to gradually decrease from 7.2% in 2015 to 4.1% in 2021 and remain level thereafter.

POST-EMPLOYMENT DEFINED CONTRIBUTION HEALTHCARE PLAN

Employees hired after July 1, 2009, are not eligible for the post-employment defined benefit healthcare plan but are instead eligible for a defined contribution health care plan. Under this plan, the PUD currently contributes $53.86 per month into an employee's individual HRA account, also known as the Retirement Health Savings (RHS) Plan. These funds are available to the employee for qualified health care costs upon termination of employment or retirement from the PUD.

POST-EMPLOYMENT DEFINED BENEFIT RETIREE LIFE INSURANCE BENEFIT

The PUD administers life insurance benefits related to a term life insurance plan terminated in 1986 for eligible retirees. The retiree life insurance benefit provisions were established by Commission resolution.

Employees who were covered by the PUD's group term life insurance prior to November 1986 may reinstate this insurance at the time of retirement subject to a $60,000 maximum benefit. Retiree insurance premium contribution amounts are established by the Commission.

The PUD contributed $500,000 and $665,000 in 2016 and 2015, respectively to a PUD fund used to provide for future payment of the PUD's portion of the insurance premiums and fund the costs of administering the plan.

The following table shows the components of the PUD's retiree life insurance benefit cost for the years ended December 31, the amount actually contributed to the plan and the changes in the PUD's net obligation (in thousands):

	2016			2015
	Electric	Generation	Water	Combined
Annual required contribution (ARC)	$ 5,260	$ 137	$ 126	$ 5,684
Interest on net OPEB obligation	178	5	4	295
Adjustment to ARC	(5,266)	(137)	(126)	(8,709)
Annual OPEB costs	172	5	4	(2,730)
Contributions made	(315)	(9)	(8)	(342)
Change in net retiree life insurance obligation	(143)	(4)	4	(3,072)
Net retiree life insurance obligation – beginning of year	5,088	133	122	8,415
Net retiree life insurance obligation – end of year	**$ 4,945**	**$ 129**	**$ 118**	**$ 5,343**

As of December 31, 2016, the unfunded actuarial accrued liability (UAAL) was $5.3 million. 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 mortality and insurance premium recoveries. Amounts determined regarding the funded status of the benefit and the annual 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 is included in the Required Supplementary Information.

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. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short–term volatility in actuarial accrued liabilities and the actuarial value of assets. Actuarial assumptions include a rate of return on investments of 3.5%.

DEFERRED COMPENSATION PLANS

The PUD administers an Internal Revenue Code Section 457 deferred compensation program, covering eligible employees as defined in the plan document. Participants may contribute and defer, up to defined limits, a portion of their current year's salary. The deferred compensation is not available to employees until termination, retirement, death or an unforeseeable emergency. All plan assets are held in trust for the exclusive benefit of participants and their beneficiaries and as such are not included on the PUD's financial statements.

The PUD administers a 401(k) Savings Plan (the Plan) effective May 1, 1985. Participation in the Plan is offered to eligible employees of the PUD as defined in the plan document. The Plan is a defined contribution plan, which provides that participants may make voluntary salary deferral contributions, on a pretax basis, up to a maximum amount as indexed for cost–of–living adjustments. The PUD makes matching contributions in an amount equal to 50% of the first 4% of a participant's compensation contributed as a salary deferral. The PUD made matching contributions of $1.6 million both in 2016 and 2015, respectively.

Note 8
Self–Insurance Fund

The PUD maintains a comprehensive insurance program that includes liability insurance coverage of $35 million in excess of a $2 million self–insured retention per occurrence. This coverage insures against certain losses arising from property damage or bodily injury damage claims filed by third parties against the PUD. At December 31, 2016, the PUD's $2 million self–insured retention was fully funded. Self-insurance funds of $12.7 million and $12.6 million as of December 31, 2016 and 2015, respectively, are included in special funds at market value. The PUD did not utilize any of the self-insurance funds in 2016 or 2015.

Note 9
Contingencies

The PUD is involved in various claims arising in the normal course of business. The PUD does not believe that the ultimate outcome of these matters will have a material adverse impact on its financial position or results of operations.

The PUD has received federal and state grants for specific purposes that are subject to review and audit by the grantor agencies. Such audits could lead to requests for reimbursements to the grantor agency for expenditures disallowed under terms of the grants. Management believes such disallowances, if any, would be immaterial.

REQUIRED SUPPLEMENTARY INFORMATION (Unaudited)

SCHEDULE OF PROPORTIONATE SHARE OF THE NET PENSION LIABILITY – PERS

As of June 30, 2016, and 2015

	PERS 1		PERS 2/3	
	2016	2015	2016	2015
Employer's proportion of the net pension liability (asset)	0.91%	0.89%	1.14%	1.11%
Employer's proportionate share of the net pension liability	$48,809	$46,613	$57,276	$39,776
Employer's covered employee payroll	$1,059	$1,481	$106,886	$98,786
Employer's proportionate share of the net pension liability as a percentage of covered employee payroll	4,610.37%	3,147.32%	53.59%	40.26%
Plan fiduciary net position as a percentage of the total pension liability	57.03%	59.10%	85.82%	89.20%

Notes to Schedule:

Factors that significantly affect trends in the amounts reported in the schedule include changes in benefit terms, changes in the size or composition of the population covered by the benefit terms, or the use of different assumptions such as the discount rate. DRS allocates a portion of contributions from the PERS 2/3 to PERS 1 in order to fund its unfunded actuarially accrued liability.

SCHEDULE OF EMPLOYER CONTRIBUTIONS – PERS

As of December 31 *(in thousands)*

PERS 1	2016	2015	2014	2013	2012	2011	2010	2009	2008	2007
Contractually required contributions	$ 98	$ 124	$ 155	$ 152	$ 158	$ 160	$ 148	$ 197	$ 223	$ 220
Contributions in relation to the contractually required contributions	(98)	(124)	(155)	(152)	(158)	(160)	(148)	(197)	(223)	(220)
Contribution deficiency (excess)	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –
Covered Employer Payroll	879	1,221	1,611	1,854	2,196	2,574	2,780	2,876	3,133	3,825
Contributions as a percentage of covered employee payroll	11.15%	10.14%	9.62%	8.20%	7.19%	6.22%	5.32%	6.85%	7.12%	5.75%
PERS 2/3										
Contractually required contributions	$ 11,925	$ 10,581	$ 8,989	$ 7,668	$ 6,619	$ 5,337	$ 4,393	$ 5,270	$ 5,372	$ 3,805
Contributions in relation to the contractually required contributions	(11,925)	(10,581)	(8,989)	(7,668)	(6,619)	(5,337)	(4,393)	(5,270)	(5,372)	(3,805)
Contribution deficiency (excess)	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –
Covered Employer Payroll	106,716	103,383	97,703	93,277	92,171	85,198	83,012	78,025	73,941	65,652
Contributions as a percentage of covered employee payroll	11.17%	10.23%	9.20%	8.22%	7.18%	6.26%	5.29%	6.75%	7.27%	5.80%

SCHEDULE OF FUNDING PROGRESS – OTHER POST-EMPLOYMENT BENEFITS

The schedule of funding progress for the other post-employment benefit healthcare plan is presented below for two prior years (in millions):

Actuarial Valuation Date December 31,	Actuarial Value of Assets (a)	Actuarial Accrued Liabilities (AAL) Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funding Ratio (a/b)	Covered Payroll (c)	Percentage of Covered Payroll ((b-a)/c)
2014	$ –	$ 49.7	$ 49.7	0%	$ 78.6	63.20%
2015	$ –	$ 57.1	$ 57.1	0%	$ 78.0	73.21%
2016	$ –	$ 57.4	$ 57.4	0%	$ 74.7	76.87%

The PUD has established a fund to address the unfunded portion of future post-employment benefit healthcare. The balance of this account was $14.6 million and $12.5 million as of December 31, 2016 and 2015, respectively, and is included in special funds on the statements of net position. Since these funds have not been placed in an irrevocable trust as required by GASB 45, the PUD has not reduced the unfunded actuarial liability by these funds.

The schedule of funding progress for other post-employment benefit retiree life insurance is presented below for two prior years (in millions):

Actuarial Valuation Date December 31,	Actuarial Value of Assets (a)	Actuarial Accrued Liabilities (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funding Ratio (a/b)	Covered Payroll (c)	Percentage of Covered Payroll ((b-a)/c)
2014	$ –	$ 8.5	$ 8.5	0%	N/A	N/A
2015	$ –	$ 5.5	$ 5.5	0%	N/A	N/A
2016	$ –	$ 5.3	$ 5.3	0%	N/A	N/A

The PUD has established a fund to address the unfunded portion of future post-employment life insurance benefits. The balance of this account was $5.8 million and $5.3 million as of December 31, 2016 and 2015, respectively, and is included in special funds on the statements of net position. Since these funds have not been placed in an irrevocable trust, the PUD has not reduced the unfunded actuarial liability by these funds. Effective January 1, 2015, the PUD has entered into an insurance product that is expected to fund the remaining life insurance liability.

Electric System
Statements of Revenues, Expenses, and Debt Service Coverage (Unaudited)

(In thousands)

Years Ended December 31,	2012	2013	2014	2015	2016
Operating Revenues:					
Sale of electric energy	$ 566,210	$ 584,331	$ 609,019	$ 602,913	$ 602,811
Other operating revenues	20,800	21,672	24,563	21,186	28,100
Unbilled revenues	4,000	3,000	(5,000)	(16,800)	8,720
Total Operating Revenues	**591,010**	**609,003**	**628,582**	**607,299**	**639,631**
Operating Expenses:					
Purchased power	317,301	323,572	332,375	320,515	347,494
Operations and maintenance	176,840	182,955	198,716	207,676	208,695
Depreciation	43,854	45,968	48,336	49,042	51,460
Taxes	31,517	32,582	33,149	35,417	35,448
Total Operating Expenses	**569,512**	**585,077**	**612,576**	**612,650**	**643,097**
Net Operating Income (Loss)	21,498	23,926	16,006	(5,351)	(3,466)
Interest Charges	**17,111**	**15,507**	**14,191**	**13,553**	**14,154**
Other Income and Expense:					
Interest income	5,890	5,121	4,486	4,648	5,015
Net increase (decrease) in the fair value of investments	402	(379)	(591)	(434)	156
Other income and expense, net	10,959	5,527	(1,582)	13,619	7,654
Total Other Income and Expense	**17,251**	**10,269**	**2,313**	**17,833**	**12,825**
Capital Contributions:					
Cash contributions	10,125	11,904	13,756	13,350	15,493
Non–cash contributions	1,309	2,520	4,531	3,162	4,601
Total Capital Contributions	**11,434**	**14,424**	**18,287**	**16,512**	**20,094**
Net Income	33,072	33,112	22,415	15,441	15,299
Non–cash contributions	(1,309)	(2,520)	(4,531)	(3,162)	(4,601)
Interest charges	17,111	15,507	14,191	13,553	14,154
Depreciation	43,854	45,968	48,336	49,042	51,460
Net increase (decrease) in the fair value of investments	(402)	379	591	434	(156)
Tidal project termination charge	–	–	6,939	–	–
Balance Available for Debt Coverage	**92,326**	**92,446**	**87,941**	**75,308**	**76,156**
Parity Debt Service Costs:					
Interest	18,205	17,408	16,863	18,227	18,186
Principal	14,645	13,259	13,780	11,323	8,669
Total Parity Debt Service Costs	**$ 32,850**	**$ 30,667**	**$ 30,643**	**$ 29,550**	**$ 26,855**
Parity Debt Service Coverage	**2.8x**	**3.0x**	**2.9x**	**2.5x**	**2.8x**

Electric System
Revenue and Statistical Data (Unaudited)

Years Ended December 31,	2012	2013	2014	2015	2016	% Change From 2015
Retail Customers (average)						
Residential	294,178	297,175	301,639	305,916	309,761	1.3%
Commercial	30,011	30,280	30,524	30,793	31,046	0.8%
Industrial	79	77	76	74	77	4.1%
Other	313	339	277	228	225	–1.3%
Retail Customers	**324,581**	**327,871**	**332,516**	**337,011**	**341,109**	**1.2%**
Megawatt–Hours Billed						
Residential	3,531,333	3,557,593	3,502,748	3,491,910	3,368,728	–3.5%
Commercial	2,364,872	2,390,699	2,390,801	2,387,839	2,335,126	–2.2%
Industrial	610,717	569,021	565,246	567,017	555,919	–2.0%
Wholesale	2,658,970	1,976,233	2,326,185	1,765,021	2,220,976	25.8%
Other	28,662	27,395	27,314	28,217	25,971	–8.0%
Megawatt–Hours Billed	**9,194,554**	**8,520,941**	**8,812,294**	**8,240,004**	**8,506,720**	**3.2%**
Revenues Billed (in thousands)						
Residential	$ 297,937	$ 311,773	$ 319,720	$ 326,772	$ 324,675	–0.6%
Commercial	178,463	184,939	190,242	198,569	199,982	0.7%
Industrial	37,038	35,440	36,289	37,125	37,521	1.1%
Wholesale	49,178	48,758	59,257	36,770	37,076	0.8%
Other	3,594	3,421	3,511	3,677	3,557	–3.3%
Revenues Billed	**$ 566,210**	**$ 584,331**	**$ 609,019**	**$ 602,913**	**$ 602,811**	**0.0%**
Average Retail Rate per kWh:						
Residential	$ 0.084	$ 0.088	$ 0.091	$ 0.094	$ 0.096	2.1%
Commercial	$ 0.075	$ 0.077	$ 0.080	$ 0.083	$ 0.086	3.6%
Industrial	$ 0.061	$ 0.062	$ 0.064	$ 0.065	$ 0.067	3.1%
Number of Employees	976	978	980	972	1,002	3.1%
Electric Line Miles	6,195	6,321	6,339	6,359	6,388	0.5%
New Electric Service Connections	3,165	3,774	4,760	3,702	4,510	21.8%

Water System
Statements of Revenues, Expenses, Debt Service Coverage, and Statistical Data (Unaudited)

(In thousands)

Years Ended December 31,	2012	2013	2014	2015	2016
Operating Revenues:					
Sale of water	$ 10,207	$ 11,033	$ 10,546	$ 11,521	$ 11,749
Other operating revenues	240	143	256	268	325
Total Operating Revenues	10,447	11,176	10,802	11,789	12,074
Operating Expenses:					
Purchased water	1,883	1,877	1,899	2,009	2,096
Operations and maintenance	3,837	4,395	4,278	4,210	4,816
Depreciation	2,657	2,997	2,780	2,931	2,794
Taxes	534	570	535	612	628
Total Operating Expenses	8,911	9,839	9,492	9,762	10,334
Net Operating Income	1,536	1,337	1,310	2,027	1,740
Interest Charges	939	947	860	799	735
Other Income and Expense:					
Interest income	130	122	120	162	200
Net increase (decrease) in the fair value of investments	–	(3)	(15)	8	9
Other income and expense, net	932	927	927	1,071	939
Total Other Income and Expense	1,062	1,046	1,032	1,241	1,148
Capital Contributions:					
Cash contributions	2,024	1,987	733	1,606	2,862
Non–cash contributions	600	1,009	2,104	786	658
Total Capital Contributions	2,624	2,996	2,837	2,392	3,520
Net Income	4,283	4,432	4,319	4,861	5,673
Non–cash contributions	(600)	(1,009)	(2,104)	(786)	(658)
Interest charges	939	947	860	799	735
Depreciation	2,657	2,997	2,780	2,931	2,794
Settlement amortization[1]	–	(927)	(927)	(927)	(927)
Net increase (decrease) in the fair value of investments	–	3	15	(8)	(9)
Rate stabilization fund transfer	(500)	–	–	–	–
Balance Available for Debt Coverage	6,779	6,443	4,943	6,870	7,608
Parity Debt Service Costs:					
Interest	1,039	992	935	869	814
Principal	1,693	1,828	1,696	1,705	1,701
Total Parity Debt Service Costs	2,732	2,820	2,631	2,574	2,515
Less: Assessment payments received	(143)	(112)	(78)	(100)	(75)
Debt Service Paid from Revenues	$ 2,589	$ 2,708	$ 2,553	$ 2,474	$ 2,440
Parity Debt Service Coverage	2.6x	2.4x	1.9x	2.8x	3.1x
Number of Water Customers (average)[1]	20,572	20,799	19,185	19,436	19,895
Water Sales & Purchases (thousand cubic feet)					
Retail Cubic Feet Sold	184,227	189,489	179,158	195,158	178,826
Wholesale Cubic Feet Sold	19,133	19,396	20,370	18,962	16,802
Total Cubic Feet Sold	203,360	208,885	199,528	214,120	195,628
Average Retail Water Rates (thousand cubic feet)					
Residential	$2.92	$3.05	$3.18	$3.31	$3.46
Commercial	$2.64	$2.75	$2.87	$3.00	$3.12

[1]On December 31, 2013, 2,095 water system customers were transferred to the City of Marysville as part of an annexation settlement agreement.

SNOHOMISH COUNTY PUBLIC UTILITY DISTRICT

Everett, Washington

REPORT ON FEDERAL AWARDS

For the Year Ended December 31, 2016

SNOHOMISH COUNTY PUBLIC UTLITY DISTRICT

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INDEPENDENT AUDITORS' REPORT

To the Board of Commissioners
of Snohomish County Public Utility District
Everett, Washington

We have audited, in accordance with the 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 combined financial statements of Snohomish County Public Utility District as of and for the year ended December 31, 2016, and the related notes to the combined financial statements, and have issued our report thereon dated April 3, 2017.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Snohomish County Public Utility 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 Snohomish County Public Utility District's internal control. Accordingly, we do not express an opinion on the effectiveness of Snohomish County Public Utility 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 entity'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.

To the Board of Commissioners
of Snohomish County Public Utility District

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Snohomish County Public Utility District's financial statements are free from material misstatement, we performed tests of its 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 entity'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 entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Baker Tilly Virchow Krause, LLP

Madison, Wisconsin
April 3, 2017

REPORT ON COMPLIANCE FOR THE MAJOR FEDERAL PROGRAM; REPORT ON INTERNAL CONTROL OVER COMPLIANCE; AND REPORT ON THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS REQUIRED BY THE UNIFORM GUIDANCE

INDEPENDENT AUDITORS' REPORT

To the Board of Commissioners
of Snohomish County Public Utility District
Everett, Washington

Report on Compliance for the Major Federal Program

We have audited the Snohomish County Public Utility District's compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on the Snohomish County Public Utility District's major federal program for the year ended December 31, 2016. The Snohomish County Public Utility District's major federal program is identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

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

Auditors' Responsibility

Our responsibility is to express an opinion on compliance for Snohomish County Public Utility District's major federal program based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance 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 Snohomish County Public Utility 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 the major federal program. However, our audit does not provide a legal determination of the Snohomish County Public Utility District's compliance.

To the Board of Commissioners
of Snohomish County Public Utility District

Opinion on the Major Federal Program

In our opinion, Snohomish County Public Utility District complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on its major federal program for the year ended December 31, 2016.

Report on Internal Control Over Compliance

Management of Snohomish County Public Utility 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 Snohomish County Public Utility District's internal control over compliance with the types of requirements that could have a direct and material effect on the major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for the major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, 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 Snohomish County Public Utility District's internal control over compliance.

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

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. 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 the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

To the Board of Commissioners
of Snohomish County Public Utility District

Report on Schedule of Expenditures of Federal Awards Required by the Uniform Guidance

We have audited the combined financial statements of Snohomish County Public Utility District as of and for the year ended December 31, 2016, and have issued our report thereon dated April 3, 2017, which contained an unmodified opinion on those combined financial statements. Our audit was conducted for the purpose of forming an opinion on the combined financial statements as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by the Uniform Guidance and is not a required part of the combined 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 combined financial statements. The information has been subjected to the auditing procedures applied in the audit of the combined financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the combined financial statements or to the combined financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards is fairly stated in all material respects in relation to the basic financial statements as a whole.

Baker Tilly Virchow Krause, LLP

Madison, Wisconsin
August 23, 2017, except for the schedule of expenditures
of federal awards, as to which the date is April 3, 2017

SNOHOMISH COUNTY PUBLIC UTILITY DISTRICT

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
For The Year Ended December 31, 2016

				Expenditures			
Federal Agency/ Pass-Through Agency	Cluster/Federal Program	CFDA Number	Other Award Number	From Pass-Through Awards	From Direct Awards	Total	Passed through to Subrecipients
Department of Energy/Bonneville Power Administration (BPA)	BPA Technology Innovation Project (TIP) #331	**81.67756**	BPA Cooperative Agreement # 67756	**-**	**500,000**	**500,000**	-
Environmental Protection Agency - pass through from WA State Department of Health Office of Drinking Water	Drinking Water State Revolving Fund Cluster/Capitalization Grants for Drinking Water State Revolving Funds	**66.468**	DWSRF N21920; Federal Grant Award 99083915	**30,000**	**-**	**30,000**	-
U.S. Department of Homeland Security - pass through from WA State Military Department	Disaster Grants - Public Assistance (Presidentially Declared Disasters)	**97.036**	FEMA 4242-DR-WA	**4,107,695**	**-**	**4,107,695**	-
U.S. Department of Homeland Security - pass through from WA State Military Department	Disaster Grants - Public Assistance (Presidentially Declared Disasters)	**97.036**	FEMA 4249-DR-WA	**4,877,042**	**-**	**4,877,042**	-
Subtotal by CFDA		**97.036**		**8,984,737**	**-**	**8,984,737**	
			Grand Total	**9,014,737**	**500,000**	**9,514,737**	

The accompanying notes to the Schedule of Expenditures of Federal Awards are an integral part of this schedule.

SNOHOMISH COUNTY PUBLIC UTILITY DISTRICT

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
For the Year Ended December 31, 2016

NOTE 1 – BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards (the "schedule") includes the federal award activity of the Snohomish County Public Utility District (the "District") under programs of the federal government for the year ended December 31, 2016. The information in this schedule is presented in accordance with the requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Because the schedule presents only a selected portion of the operations of the District, it is not intended to and does not present the financial position, changes in net position or cash flows of the District.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Expenditures reported on the schedule are reported on the accrual basis of accounting. Such expenditures are recognized following the cost principles contained in the Uniform Guidance, wherein certain types of expenditures are not allowable or are limited as to reimbursement. Negative amounts shown on the schedule represent adjustments or credits made in the normal course of business to amounts reported as expenditures in prior years. Pass-through entity identifying numbers are presented where available.

NOTE 3 – INDIRECT COST RATE

The District has not elected to use the 10% de minimis indirect cost rate.

SNOHOMISH COUNTY PUBLIC UTILITY DISTRICT

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
For the Year Ended December 31, 2016

SECTION I – SUMMARY OF AUDITORS' RESULTS

FINANCIAL STATEMENTS

Type of auditors' report issued: unmodified

Internal control over financial reporting:

> Material weakness (es) identified?	____	yes	X	no
> Significant deficiency (ies) identified?	____	yes	X	none reported
Noncompliance material to financial statements noted?	____	yes	X	no

FEDERAL AWARDS

Internal control over major program:

> Material weakness (es) identified?	____	yes	X	no
> Significant deficiency (ies) identified?	____	yes	X	none reported

Type of auditor's report issued on compliance for major program: unmodified

Any audit findings disclosed that are required to be reported in accordance with section 2 CFR 200.516(a) of the Uniform Guidance?	____	yes	X	no
Auditee qualified as low-risk auditee?	____	yes	X	no

Identification of major federal program:

CFDA Number	Name of Federal Program or Cluster
97.036	Disaster Grants – Public Assistance (Presidentially Declared Disasters)

Dollar threshold used to distinguish between type A and type B programs: $750,000

SNOHOMISH COUNTY PUBLIC UTILITY DISTRICT

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
For the Year Ended December 31, 2016

SECTION II – FINANCIAL STATEMENT FINDINGS REQUIRED TO BE REPORTED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

None reported.

SECTION III – FEDERAL AWARDS FINDINGS AND QUESTIONED COSTS

None reported.