



Report of Independent Auditors
and Financial Statements
(with supplemental information) for

**Pacific Northwest
Generating Cooperative, Inc.**
(d.b.a. PNGC Power)

September 30, 2012 and 2011

MOSS ADAMS LLP

Certified Public Accountants | Business Consultants

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REPORT OF INDEPENDENT AUDITORS

To the Board of Directors
Pacific Northwest Generating Cooperative, Inc. (d.b.a. PNGC Power)

We have audited the accompanying balance sheets of Pacific Northwest Generating Cooperative, Inc. (the Cooperative) as of September 30, 2012 and 2011 and the related statements of revenue and expense, equities, margins and term certificates and cash flows for the years then ended. These financial statements are the responsibility of the Cooperative's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Cooperative's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Pacific Northwest Generating Cooperative, Inc. as of September 30, 2012 and 2011 and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Cooperative's financial statements. The supplemental schedule of administrative and general expense is presented for purposes of additional analysis and is not a required part of the 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 financial statements. The supplemental schedule of administrative and general expense has been subjected to the auditing procedures applied in the audit of the financial statements and certain other procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplemental schedule of administrative and general expense is fairly stated in all material respects in relation to the financial statements as a whole.

Moss Adams LLP

Portland, Oregon
December 4, 2012

PACIFIC NORTHWEST GENERATING COOPERATIVE, INC.
BALANCE SHEETS

ASSETS

	September 30,	
	2012	2011
NET PLANT	\$ 660,115	\$ 588,972
INVESTMENT IN ASSOCIATED ORGANIZATIONS	85,723	83,627
CURRENT ASSETS		
Cash and cash equivalents	29,825,224	15,951,710
Accounts and grant receivable	9,939,417	9,260,732
Prepaid expenses	224,124	289,680
Total current assets	39,988,765	25,502,122
DEFERRED DEBITS	901,539	3,318,940
Total assets	\$ 41,636,142	\$ 29,493,661

LIABILITIES, EQUITIES, MARGINS, AND TERM CERTIFICATES

	September 30,	
	2012	2011
EQUITIES, MARGINS, AND TERM CERTIFICATES	\$ 17,229,455	\$ 15,517,135
CURRENT LIABILITIES		
Accounts payable	23,331,238	12,283,610
Accrued liabilities and payables	1,075,449	1,692,916
Total current liabilities	24,406,687	13,976,526
Total liabilities, equities, margins, and term certificates	\$ 41,636,142	\$ 29,493,661

PACIFIC NORTHWEST GENERATING COOPERATIVE, INC.
STATEMENTS OF REVENUE AND EXPENSE

	Years Ended September 30,	
	<u>2012</u>	<u>2011</u>
OPERATING REVENUE		
Members	\$ 146,246,434	\$ 144,425,396
Nonmembers	3,507,152	29,520,707
	<u>149,753,586</u>	<u>173,946,103</u>
OPERATING EXPENSES		
Purchased power	124,636,794	143,891,765
Transmission expense	17,895,513	16,240,954
Administrative and general	5,431,182	7,952,737
Interest expense	19,558	1,177,902
Depreciation	72,181	1,132,850
Credit facility expense	<u>(45,775)</u>	<u>195,891</u>
	<u>148,009,453</u>	<u>170,592,099</u>
OPERATING INCOME	1,744,133	3,354,004
NONOPERATING MARGINS		
Interest and investment income	7,192	4,441
Smart grid grant proceeds	3,805,889	11,837,806
Smart grid grant expenditures	<u>(3,805,889)</u>	<u>(11,837,806)</u>
	<u>7,192</u>	<u>4,441</u>
NET MARGINS BEFORE INCOME TAXES	1,751,325	3,358,445
INCOME TAXES	<u>39,005</u>	<u>127,454</u>
NET MARGINS	<u>\$ 1,712,320</u>	<u>\$ 3,230,991</u>

PACIFIC NORTHWEST GENERATING COOPERATIVE, INC.
STATEMENTS OF EQUITIES, MARGINS, AND TERM CERTIFICATES

	Years Ended September 30,	
	2012	2011
Memberships		
Balance at October 1,	\$ 158,518	\$ 158,518
Addition	-	-
Balance at September 30,	158,518	158,518
Patronage capital		
Balance at October 1,	5,640,352	5,640,352
Margins allocated to patronage capital	94,093	-
Balance at September 30,	5,734,445	5,640,352
Subordinated capital term certificates		
Balance at October 1,	10,041,480	9,845,399
Addition	-	196,081
Balance at September 30,	10,041,480	10,041,480
Margins		
Balance at October 1,	(323,215)	(3,554,206)
Net margins for the year	1,712,320	3,230,991
Margins allocated to patronage capital	(94,093)	-
Balance at September 30,	1,295,012	(323,215)
Total equities, margins, and term certificates	\$ 17,229,455	\$ 15,517,135

PACIFIC NORTHWEST GENERATING COOPERATIVE, INC.
STATEMENTS OF CASH FLOWS

	Years Ended September 30,	
	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Net margins	\$ 1,712,320	\$ 3,230,991
Adjustments to reconcile net margins to net cash from operating activities		
Depreciation	72,181	1,132,850
Change in assets and liabilities		
Accounts and grant receivable	(678,685)	5,111,381
Prepaid expenses	65,556	(188,702)
Deferred debits	2,417,401	7,974
Accounts payable	11,047,628	4,636,503
Accrued liabilities and payables	(617,467)	(364,355)
Subordinated capital term certificates	-	(3,154,601)
Net cash from operating activities	<u>14,018,934</u>	<u>10,412,041</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of equipment	(143,324)	(236,421)
Net investment activity	<u>(2,096)</u>	<u>(2,199)</u>
Net cash from investing activities	<u>(145,420)</u>	<u>(238,620)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Additions in membership equity	-	196,081
Net cash from financing activities	<u>-</u>	<u>196,081</u>
CHANGE IN CASH AND CASH EQUIVALENTS	13,873,514	10,369,502
CASH AND CASH EQUIVALENTS, beginning of year	<u>15,951,710</u>	<u>5,582,208</u>
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 29,825,224</u>	<u>\$ 15,951,710</u>
CASH PAID DURING THE YEAR FOR		
Income taxes	<u>\$ 43,800</u>	<u>\$ 120,000</u>
Interest	<u>\$ 19,558</u>	<u>\$ 1,177,902</u>

PACIFIC NORTHWEST GENERATING COOPERATIVE, INC.
NOTES TO FINANCIAL STATEMENTS

Note 1 – Organization and Summary of Significant Accounting Policies

Pacific Northwest Generating Cooperative, Inc. (PNGC or the Cooperative) is engaged in the purchase, sale and transmission of electric power. It also provides management services to Power Resources Cooperative (PRC) and Pacific Northwest Service Cooperative (PNSC), related by common ownership, and represents its members in various legislative, governmental and judicial proceedings. The Cooperative's members operate primarily in Oregon, Washington, Idaho, and Montana.

A summary of the significant accounting policies applied in the preparation of the accompanying financial statements follows:

Basis of accounting and presentation – The Uniform System of Accounts, as prescribed by the Federal Energy Regulatory Commission (FERC), is the basis for the Cooperative's accounting and reporting policies.

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

Concentration of credit risk – The Cooperative's financial instruments that are exposed to concentrations of credit risk consist primarily of cash and receivables.

Credit risk results from potential counterparty non-performance. The Cooperative uses credit policies to control its credit risks, including utilizing an established credit approval process, monitoring counterparty limits and exposures, employing credit mitigation measures such as margin, collateral or prepayment arrangements and using netting agreements. The Cooperative measures credit risk and replacement costs for energy commodity positions plus amounts owed from counterparties for settled transactions.

The Bonneville Power Administration (BPA), electric utilities and merchant energy companies comprise the majority of counterparties with which the Cooperative transacts in wholesale power markets. As of September 30, 2012, the Cooperative had corporate guarantees from its counterparties totaling \$25,005,000.

Net plant – Equipment and leasehold improvements are stated at cost (see Note 2). Cost includes contracted services, direct labor and materials, interest and indirect charges for engineering, supervision and other similar overhead items. Depreciation has been determined by use of the straight-line method over the estimated useful lives of the related assets ranging from five to forty years.

Repairs and maintenance are charged to operations as incurred. The actual or average cost of property replaced or renewed is removed from plant and such cost plus removal cost less salvage is charged to accumulated depreciation. Management evaluates impairment annually or as circumstances warrant.

PACIFIC NORTHWEST GENERATING COOPERATIVE, INC.

NOTES TO FINANCIAL STATEMENTS

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Cash equivalents – The Cooperative considers short-term investments with maturities of three months or less to be cash equivalents.

Accounts receivable – Accounts receivable are recorded when invoices are issued and are written off when they are determined to be uncollectible (see Note 3). The allowance for doubtful accounts is estimated based on the Cooperative's historical losses, review of specific problem accounts, existing economic conditions, and the financial stability of its customers. Generally, the Cooperative considers accounts receivable past due after 30 days. No allowance was deemed necessary as of September 30, 2012 and 2011. Grants receivable are recorded as allowable expenditures under such agreements are incurred.

Investment in associated organizations – The investment in associated organizations is carried at cost plus capital credits allocated and not retired.

Deferred debits – Deferred debits consist primarily of unamortized option contract premiums to be either expensed upon termination or amortized over the exercise period of the contract (see Note 9).

Patronage capital – Either accumulated tax basis net patronage margins or book margins, depending on the taxable status of the Cooperative, are credited to patronage capital. These margins are assigned to patrons' capital credit accounts. Such amounts are assignable at year end although the assignment takes place in the subsequent year. Capital credits are returned to member and non-member patrons in accordance with the Cooperative's policies.

Income taxes – For the current year, the Cooperative is exempt from income taxes under the provisions of Section 501(c)(12) of the Internal Revenue Code, except to the extent of unrelated business income, if any. In the prior year, the Cooperative was taxable for federal and state income tax purposes as a result of revenues from members being less than 85% of total revenues. The Cooperative adopted Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 740-10, relating to accounting for uncertain tax positions. As of September 30, 2012 and 2011, the Cooperative does not have any uncertain tax positions nor did it have uncertain tax positions under previous guidance. The Cooperative files an exempt organization tax return in the U.S. federal jurisdiction and is no longer subject to examination by taxing authorities before 2008.

Revenue recognition – The Cooperative recognizes revenue as earned, in accordance with contractual terms, if applicable (see Note 9).

Smart grid grant – The Cooperative submitted an application on behalf of itself and ten of its member cooperatives to the US Department of Energy (DOE) for a grant to fund 50% of the costs to implement smart grid systems. This grant is part of the grant awards made available by the American Reinvestment and Recovery Act. The DOE approved this grant for \$19,576,743 effective May 27, 2010 through May 26, 2015. The grant activity is reported as non-operating on the accrual basis. Substantially all grant proceeds will be distributed to the members as sub-recipients and are subject to audit by DOE.

PACIFIC NORTHWEST GENERATING COOPERATIVE, INC.
NOTES TO FINANCIAL STATEMENTS

Note 2 – Net Plant

Net plant consists of the following:

	<u>2012</u>	<u>2011</u>
Plant in service		
Intangible plant	\$ 10,000	\$ 10,000
Office furniture and equipment	692,033	1,260,083
Leasehold improvements	393,443	393,443
Communication and operating equipment	<u>169,418</u>	<u>5,104,812</u>
Total plant in service	1,264,894	6,768,338
Less accumulated depreciation	<u>604,779</u>	<u>6,405,558</u>
Net plant in service	660,115	362,780
Construction work in progress	<u>-</u>	<u>226,192</u>
Net plant	<u><u>\$ 660,115</u></u>	<u><u>\$ 588,972</u></u>

Due to the changes in the power supply contracts (See Note 9, *Power Supply*) the Cooperative disposed of a significant amount of infrastructure which was included in Office Furniture and Equipment and Communication and Operating Equipment.

Note 3 – Accounts Receivable

Accounts receivable consists of the following:

	<u>2012</u>	<u>2011</u>
Due from members	\$ 9,393,639	\$ 7,167,651
Due from non-members and smart grid grant	<u>545,778</u>	<u>2,093,081</u>
Total accounts receivable	<u><u>\$ 9,939,417</u></u>	<u><u>\$ 9,260,732</u></u>

PACIFIC NORTHWEST GENERATING COOPERATIVE, INC.

NOTES TO FINANCIAL STATEMENTS

Note 4 – Credit Facility

The Cooperative maintains a \$20,000,000 Revolving Credit Facility with the National Rural Utilities Cooperative Finance Corporation (CFC) through September 30, 2014. The full amount of the facility may be dedicated to providing irrevocable standby letters of credit with the balance available as a line of credit. Interest on outstanding balances is payable quarterly at the standard CFC line of credit rate which is not to exceed the prime rate plus one percent per annum. Commitment and issuance fees associated with letters of credit are due in advance or at the time of issuance. The line of credit portion of the facility includes a zero out provision which requires the line of credit to be paid down to a zero balance for at least 10 consecutive days between annual anniversary dates (September 30th). In addition, the credit facility is subject to certain financial covenants and contains a mandatory prepayment provision if the Cooperative does not maintain certain equity and margin targets. The credit facility is collateralized by substantially all Cooperative assets. In addition, the members of the Cooperative have entered into Member Reimbursement Agreements as guarantee for the debt. Member guarantees are limited to their member share based on load percentage.

As of September 30, 2012 and 2011, the letters of credit issued under the BPA portion of the facility were approximately \$19,378,000.

The prime interest rate at September 30, 2012 was 3.25%.

Note 5 – Subordinated Capital Term Certificates

Subordinated Capital Term Certificates (CTC's) are subordinated obligations purchased by members as a condition of membership with maturity coinciding to the termination dates of long-term power supply agreements with members. The CTC's fall into two tranches with the first tranche associated with the 2001 (2001-2011 deliveries) power supply agreements and the second tranche associated with the 2008 (2011-2028 deliveries) power supply agreements. The first tranche consisted of two categories, with the first proportional to membership and the second proportional to contracted power supply agreements. Those CTC's bore interest at 9% and were payable quarterly and matured on September 30, 2011. Two members who terminated membership commensurate with the end of 2001 agreements received \$1,005,240 of the \$13,000,000 that matured on September 30, 2011.

On September 30, 2011, members purchased \$10,041,480 of CTC's in relation to the new power supply agreements (see Note 9). The amounts determined were proportional to the first year load forecast under the new power supply agreements. Of this amount, \$538,725 came from a member new to the cooperative under the 2008 agreements. These CTC's are non-interest bearing and mature concurrent with the 2008 power supply contracts (see Note 9). As such, this amount was classified as long-term equity under the caption equities, margins and term certificates. As of September 30, 2012, all CTC's are classified as equity.

PACIFIC NORTHWEST GENERATING COOPERATIVE, INC.
NOTES TO FINANCIAL STATEMENTS

Note 6 – Related Party Transactions

Facility lease – The Cooperative leases an office building from PNSC. This agreement commenced on January 1, 2003 and was extended through December 31, 2012. Total lease expense was \$194,392 and \$212,079 for the years ended September 30, 2012 and 2011, respectively.

In November 2012, the Cooperative purchased the building and the lease with PNSC was terminated.

Management services – The Cooperative provides management and administrative services to PRC and PNSC. Revenue for these services was \$1,409,126 and \$1,302,712 for the years ended September 30, 2012 and 2011, respectively.

Note 7 – Sales to Major Customers and Purchases from Major Supplier

Revenue from four members accounted for approximately 54% of all revenue for the years ended September 30, 2012 and 2011. Power and transmission purchases from one supplier accounted for approximately 95% and 92% of all such purchases for the years ended September 30, 2012 and 2011, respectively (see Note 9).

Note 8 – Retirement Plans

The Cooperative participates in a multi-employer pension plan administered by the National Rural Electric Cooperative Association (NRECA). The plan is a noncontributory defined benefit plan qualified under Section 401 and tax exempt under Section 501(a) of the Internal Revenue Code. The plan covers substantially all of the Cooperative's employees. The Cooperative makes contributions to the plan equal to the amounts accrued for pension expense as determined by NRECA. The multi-employer pension plan is available to all member cooperatives of NRECA. Information concerning the Cooperative's proportionate share of the excess, if any, of the actuarially computed value of vested benefits over the total of the pension plan's net assets is not available from NRECA, the plan administrator. Withdrawal from the plan may result in the Cooperative having an obligation to the plan; however, the Cooperative has no plans to withdraw at this point. Contributions by the Cooperative to the plan were \$549,540 and \$837,124 for the years ended September 30, 2012 and 2011, respectively.

In addition, the Cooperative participates in a 401(k) defined contribution plan for which all employees are eligible to contribute a portion of their compensation after three months of service and receive matching contributions after one year of service. The Cooperative matches 100% of the employee contribution up to the first 3% and 50% of the next 2% of eligible compensation. Contributions by the Cooperative to the 401(k) plan were \$87,393 and \$123,394 for the years ended September 30, 2012 and 2011, respectively.

PACIFIC NORTHWEST GENERATING COOPERATIVE, INC.

NOTES TO FINANCIAL STATEMENTS

Note 9 – Power Supply

In November of 2008 the Cooperative entered into a 20-year power supply contract with BPA. Power deliveries under the contract commenced on October 1, 2011 and continue through September 30, 2028. The contract is for Load Following service coupled with a new Tiered Rate Methodology (TRM). The TRM establishes an initial High Water Mark (HWM) load that qualifies for service at BPA's lowest cost power (Tier 1) from the Federal Base System (FBS). Any requirement above the HWM load is known as Above High Water Mark (AHWM) load. The AHWM load obligation for each year is established in advance of each rate period, which spans two years, based upon load forecasts and projected FBS capability. The AHWM load can be served with non-federal resources or purchased from BPA as Tier 2 power. Tier 2 power purchased from BPA is expected to be priced at or around market.

Concurrently with its BPA wholesale power supply contract, the Cooperative executed new Membership and Requirements Power Purchase Agreements (MRPPA) for a 20-year term also ending September 30, 2028. The Cooperative's MRPPA contains automatic extensions to coincide with the longer of the term (including any performance right or obligation that survives termination) of any power supply or generating resource contract to which the Cooperative is a party, including without limitation contracts for the purchase or sale of electric power, the acquisition or provision of transmission service, or the financing of any Cooperative capital asset or expense. The Cooperative is obligated under this agreement to meet members load requirements in excess of member owned resources.

Prior to 2012, the Cooperative was party to, through assignments with its members, a 10-year Block and Slice Power Sales Agreement (Slice) with the BPA. In addition, the Cooperative had concurrently entered into 10-year Membership and Requirements Power Purchase Agreements with its members. The Power Sales Agreement specified that BPA rates were variable and included provisions for various adjustments depending on actual load and BPA costs. In addition, the Slice portion of the agreement included a true-up provision that allowed BPA to recover Slice costs not previously recovered during the fiscal year. BPA assessed this true-up on an annual basis subsequent to year-end. The true-up was paid, or refunded if a credit, in installments during the next fiscal year.

The Cooperative periodically enters into forward and option contracts to meet member load requirements. As of September 30, 2012, the Cooperative entered into option and forward contracts with exercise dates extending through December 31, 2013. The options contain premiums to be amortized over the exercise period of the contract. As of September 30, 2012 and 2011, the Cooperative had \$890,300 and \$3,306,500, respectively, in unamortized premiums, which are presented as deferred debits. As of September 30, 2012, the Cooperative had \$49.99 million in forward purchase contracts and \$9.86 million in forward sales contracts. The Cooperative has not marked the option or forward contracts to market. This is in accordance with guidance issued under the "Normal Purchase and Normal Sales Exception for Option-Type Contracts and Forward Contracts in Electricity." The contracts are recognized in income upon settlement consistent with rate-making decisions.

PACIFIC NORTHWEST GENERATING COOPERATIVE, INC.
NOTES TO FINANCIAL STATEMENTS

Note 9 – Power Supply (continued)

Residential exchange settlement – During fiscal year 2008, BPA settled a long running dispute regarding the treatment of Residential Exchange payments to Investor Owned Utilities. This resulted in refund payments to the Cooperative from BPA in the amount of \$18,005,961. For remaining refunds under the Residential Exchange settlement, BPA proposes to amortize the refunds over approximately seven years. The total refunded in fiscal years 2012 and 2011 was \$5,115,276 and \$5,436,372, respectively. The final determination of amounts to be refunded in future periods will be subject to individual rate case determinations. Settlement amounts are recorded as a reduction to purchased power expense.

Note 10 – Subsequent Events

Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are available to be issued. The Cooperative recognizes in the financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing the financial statements. The Cooperative's financial statements do not recognize subsequent events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after the balance sheet date and before financial statements are available to be issued. See Note 6, *Related Party Transactions*, for subsequent event.

The Cooperative has evaluated subsequent events through December 4, 2012, which is the date the financial statements were available to be issued.

SUPPLEMENTARY INFORMATION

PACIFIC NORTHWEST GENERATING COOPERATIVE, INC.
SCHEDULE OF ADMINISTRATIVE AND GENERAL EXPENSE

	Years Ended September 30,	
	2012	2011
Salaries and wages	\$ 2,590,492	\$ 3,947,945
Employee benefits	979,982	1,416,355
Outside services	703,116	1,010,635
Office supplies and expenses	261,026	425,231
Taxes	214,509	360,368
Other	376,163	339,431
Office rent and maintenance	254,684	270,946
Scheduling and accounting charges	-	124,075
Insurance	51,210	57,751
	<u>\$ 5,431,182</u>	<u>\$ 7,952,737</u>