

**SACRAMENTO MUNICIPAL UTILITY DISTRICT
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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Sacramento Municipal Utility District
Sacramento, California

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Sacramento Municipal Utility District and its blended component units, which comprise the Consolidated Statements of Net Position as of December 31, 2015 and 2014, and the related Consolidated Statements of Revenues, Expenses and Changes in Net Position, and Consolidated Statements of Cash Flows for the years then ended and the related notes to the financial statements.

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 an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the 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 Sacramento Municipal Utility District's preparation and fair presentation of the consolidated 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 Sacramento Municipal Utility District's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

To the Board of Directors of
Sacramento Municipal Utility District

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Sacramento Municipal Utility District and its blended component units at December 31, 2015 and 2014, and the changes in their financial position and their cash flows for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 3, Sacramento Municipal Utility District has adopted the provisions of GASB Statement No. 68, *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27* and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date – an amendment of GASB Statement No. 68*, effective January 1, 2015. Our opinion is not modified with respect to this matter.

Other Matter

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis and Schedule of Funding Progress information as listed in the table of contents be presented to supplement the financial statements. Such information, although not a part of the consolidated financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the consolidated financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the consolidated financial statements, and other knowledge we obtained during our audit of the consolidated 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 Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we will also issue a report on our consideration of Sacramento Municipal Utility District'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 Sacramento Municipal Utility District's internal control over financial reporting and compliance.

Baker Tilly Virchow Krause, LLP

Madison, Wisconsin
February 19, 2016

Sacramento Municipal Utility District Management's Discussion and Analysis (Unaudited)

Using this Financial Report

This annual financial report for Sacramento Municipal Utility District (SMUD) consists of management's discussion and analysis and the consolidated financial statements, including notes to the financial statements. The Consolidated Financial Statements consist of the Statements of Net Position, the Statements of Revenue, Expenses and Changes in Net Position and the Statements of Cash Flows.

SMUD maintains its accounting records in accordance with Generally Accepted Accounting Principles for proprietary funds as prescribed by the Governmental Accounting Standards Board (GASB). SMUD's accounting records generally follow the Uniform System of Accounts for Public Utilities and Licensees prescribed by the Federal Energy Regulatory Commission (FERC), except as it relates to accounting for contributions of utility property in aid of construction.

Overview of the Financial Statements

The following discussion and analysis of the financial performance of SMUD provides an overview of the financial activities for the years ended December 31, 2015 and 2014. This discussion and analysis should be read in conjunction with the consolidated financial statements and accompanying notes, which follow this section.

The Consolidated Statements of Net Position provide information about the nature and amount of resources and obligations at a specific point in time.

The Consolidated Statements of Revenues, Expenses and Changes in Net Position report all of SMUD's revenues and expenses for the periods shown.

The Consolidated Statements of Cash Flows report the cash provided and used by operating activities, as well as other cash sources, such as investment income and debt financing, and other cash uses such as payments for debt service and capital additions.

The Notes to the consolidated financial statements provide additional detailed information to support the financial statements.

Nature of Operations

Under provisions of California's Municipal Utility District Act, the citizens of Sacramento voted in 1923 to form their own electric utility – SMUD. The independently run community-owned utility began operations on December 31, 1946 and is not subject to regulation or oversight by the California Public Utilities Commission. It is now the sixth largest community-owned electric utility in the nation.

Governed by an elected board of directors (Board), SMUD has the rights and powers to fix rates and charges for commodities and services it furnishes, incur indebtedness, and issue bonds or other obligations. SMUD is responsible for the acquisition, generation, transmission and distribution of electric power to its service area with a population of approximately 1.4 million – most of Sacramento County and small, adjoining portions of Placer and Yolo counties. Its purpose is to provide solutions for meeting customers' electrical energy needs with a vision of empowering customers with solutions and options that increase energy efficiency, protect the environment, reduce global warming, and lower the cost to serve the region.

The Board has independent authority to set SMUD's rates and charges. Changes in rates require a public hearing and formal action by the Board. In August 2013, the Board approved a 2.5 percent rate increase effective January 1, 2014, and an additional 2.5 percent rate increase effective January 1, 2015. The rate increases were designed to achieve a fixed charge ratio of at least 1.5. In July 2015, the Board approved another 2.5 percent rate increase for both 2016 and 2017 to allow for additional investments in technology and infrastructure. The Board also approved an optional residential Time of Use (TOU) rate that would be made available in 2016 and 2017 and declared its intent to make TOU rates the standard for residential customers in 2018. The TOU rate structure puts SMUD at the industry forefront by setting the stage to better align rates with the actual cost of electricity. Even with these increases, SMUD's rates continue to remain amongst the lowest in the state. In 2015, the average system rate was 25.7 percent below the nearest investor owned utility's average rate.

SMUD's vision is to be the trusted partner with its customers and the community, providing innovative solutions to ensure energy affordability and reliability, improve the environment, reduce our region's carbon footprint, and enhance the vitality of our community. SMUD's business strategy focuses on serving its customers in a progressive, forward looking manner, addressing current regulatory and legislative issues and potential competitive forces. This includes ensuring financial stability by establishing rates that provide acceptable cash coverage of all fixed charges on a consolidated basis, taking into consideration the impact of capital expenditures and other factors on cash flow.

Financial & Operational Highlights

In 2015, SMUD continued working toward realizing the vision of meeting increased customer expectations and improving operational efficiencies. In April 2015, SMUD's bonds were upgraded by Moody's from A1 to Aa3 and as a result, SMUD is now experiencing the strongest bond ratings in almost 30 years by all three major rating agencies. SMUD was recognized by its residential customers as the top California utility for the fourteenth consecutive year by J.D. Power and was ranked first among midsize utilities in the West and No. 1 in California for the tenth consecutive year for business customer satisfaction. Negotiations were completed for the development and power purchase of 10.88 MW solar project at the decommissioned Rancho Seco nuclear plant site which will supply renewable energy for the commercial SolarShares program. The first commercial SolarShares offering was launched as a result of completing a 20-year agreement with the Sacramento Kings and the California Department of General Services. This agreement will help create one of the lightest environmental footprints of any arena in the U.S. by meeting LEED Gold standards. SMUD was awarded the Diamond Member Reliable Public Power Provider designation (Diamond RP3®), the highest possible designation from the American Public Power Association (APPA) for delivering reliable and safe electric services and also hosted the 2015 APPA Lineworkers Rodeo. Other accomplishments include celebrating 25 years of a partnership that has resulted in providing more than a half million free shade trees to residences and businesses since 1990, the development of the SMUD Power Academy with state certification for seven apprentice training programs, and relocating all employees from the headquarters building in preparation for its renovation. Through its economic development program, SMUD played a key role in the attraction, retention and expansion of several companies in its service territory which led to the creation of over 1,800 jobs.

In July 2014, FERC issued a new fifty year license for the Upper American River Project (UARP), which included authority to build the Iowa Hill pumped-storage project. The UARP consists of three relatively large storage reservoirs and eight powerhouses containing eleven turbines. The UARP is one of SMUD's lowest cost power sources. In addition to providing clean hydroelectric power and operational flexibility, it provides habitat for fish and wildlife and a variety of recreational opportunities, including camping, fishing, boating, hiking, horseback riding, mountain biking, and cross-country skiing. The combined capacity of the UARP is approximately 673 megawatts (MW) and represents about 15 percent of SMUD's average annual retail energy requirements. The Iowa Hill pumped-storage project was a proposed 3 unit, 400 MW variable speed powerhouse. The first phase of the geotechnical exploration plan and most of the required permitting was completed in 2014. In December 2015, after much analysis, SMUD made the decision to terminate the Iowa Hill pumped-storage project as it was determined to no longer be financially feasible (Board approved February 2016). SMUD's other power generation facilities include 3 MW of solar photovoltaic installations, the 102 MW Solano Wind Project, and five local gas-

fired power plants with total capacity of approximately 1,012 MW. In addition, SMUD has several power purchase agreements to help meet its remaining power requirements.

As part of the hydro relicensing process, SMUD entered into long-term contracts to provide certain services to four different government agencies – U.S. Department of Interior Bureau of Land Management, U.S. Department of Agriculture Forest Service, El Dorado County, and the California Department of Parks and Recreation. The aggregate present value of all contract payments of \$56.1 million was recorded as a Noncurrent Liability at December 31, 2014. The balance of the Liability at December 31, 2015 was \$55.0 million.

The impact of the drought continued to plague California in 2015. SMUD experienced a fourth year of below average precipitation, which reduced its hydroelectric generation from the UARP by more than 50 percent. A Hydro Rate Stabilization Fund (HRSF) was established to help absorb higher energy costs when hydroelectric production is down and to serve as a buffer against unexpected financial developments. In April 2015, the \$3.1 million remaining balance was transferred from the HRSF as a result of the lower precipitation. In 2014, \$24.3 million was also transferred from the HRSF due to lower precipitation. The zero balance in the HRSF at December 31, 2015 is an indicator of the significant cumulative effect of the drought over the last few years. Although SMUD's mitigation efforts have protected its rate payers from rate volatility due to higher operating costs, it was determined that the reserves were not adequate to cover all costs. Accordingly, in April 2015, SMUD applied an automatic 12-month Hydro Generation Adjustment (HGA) surcharge of 1.3 percent to its customers' electric bills.

SMUD also has a long-term agreement with the Western Area Power Administration (WAPA) to purchase power generated by the Central Valley Project, a series of federal hydroelectric facilities operated by the U.S. Bureau of Reclamation. SMUD uses a Rate Stabilization Fund (RSF) to offset any excess or deficits in WAPA energy deliveries. As a result of the drought, WAPA's deliveries fell short by about 54 percent and in December 2015, \$12.0 million was transferred from the RSF due to the lower energy deliveries. In December 2014, \$11.8 million was transferred from the RSF due to energy deliveries falling short in that year as well. At December 31, 2015 and 2014, the balance of the RSF was \$30.3 million and \$42.3 million, respectively.

Decommissioning

During 2014, SMUD made significant progress toward completing the Decommissioning Plan for its Rancho Seco nuclear facility, which was shut down in 1989. The plan consists of two phases that allow SMUD to terminate its possession-only license. Phase I of the decommissioning was completed at the end of 2008. Phase II consists of a storage period for the Class B and Class C radioactive waste overseen by the existing facility staff, followed by shipment of the waste for disposal, and then complete termination of the possession-only license. SMUD also established and funded an external decommissioning trust fund as part of its assurance to the Nuclear Regulatory Commission (NRC) to pay for the cost of decommissioning. In September 2013, SMUD entered into a contract with the operator of a low-level radioactive waste facility located in Andrews, Texas. Shipment of the previously stored Class B and Class C radioactive waste was completed in November 2014. The disposal and shipment costs totaling over \$22.0 million were funded from the decommissioning trust fund. The remaining Phase II decommissioning activities that will lead to termination of the possession-only license began during 2015 and license termination activities are expected to be completed by the end of 2016. No funds were withdrawn from the decommissioning trust fund during 2015; therefore the balance remained at \$8.3 million as of December 31, 2015 and 2014. The Accrued Decommissioning balance in the Consolidated Statements of Net Position includes \$150.4 and \$152.1 million for costs related to Rancho Seco as of December 31, 2015 and 2014, respectively.

As part of the Decommissioning Plan, the nuclear fuel and Greater Than Class C (GTCC) radioactive waste is being stored in a dry storage facility constructed by SMUD and licensed separately by the NRC. The U.S. Department of Energy (DOE), under the Nuclear Waste Policy Act of 1982, was responsible for permanent disposal of used nuclear fuel and GTCC radioactive waste and SMUD contracted with the DOE for removal and disposal of that waste. In 1998, SMUD filed suit against the DOE for breach-of-contract because the DOE never provided a permanent waste disposal site. In September

2014 and February 2015, SMUD received awards for \$53.1 million and \$22.5 million, respectively, from the U. S. Court of Claims which was recorded as Other Income – Net in the Consolidated Statements of Revenues, Expenses and Changes in Net Position. In June 2015, SMUD filed a suit against DOE which covered the costs incurred from 2010 through at least June 2015.

Employee Relations and Benefits

Effective January 1, 2013, SMUD began operating under a new five year memorandum of understanding (MOU) with both of its collective bargaining units, the International Brotherhood of Electrical Workers Local Union 1245 and the Organization of SMUD Employees.

SMUD participates in the California Public Employees' Retirement System (PERS), an agent multiple-employer public employee defined benefit pension plan. In 2015, SMUD implemented Governmental Accounting Standards Board (GASB) Statement of Governmental Accounting Standards (SGAS) No. 68 *“Accounting and Financial Reporting for Pensions – An Amendment of GASB Statement No. 27”* (GASB No. 68). The primary objective of GASB No. 68 is to improve accounting and financial reporting by state and local governments for pensions. Under GASB No. 68, SMUD is required to report the net pension liability (i.e., the difference between the total pension liability and the pension plan's net position or market value of assets) in its Statement of Net Position. This standard requires shorter amortization periods for recognition of non-investment gains and losses and actuarial assumption changes, as well as for recognition of investment gains and losses. GASB No. 68 also separates financial reporting from funding requirements for pension plans. Prior to this new guidance, a liability was recognized only to the extent that contributions made to the plan were less than the actuarially calculated contributions. At December 31, 2015 and 2014, the Net Pension Liability was \$381.3 million and \$326.7 million, respectively. SMUD elected to follow accounting for regulated operations under GASB SGAS No. 62 *“Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements”* (GASB No. 62) and recorded a regulatory asset as of December 31, 2014, in the amount of \$425.7 million to account for the net effect of required prior period adjustments to recognize the net pension liability. Amortization of the regulatory asset will begin in 2018.

SMUD provides postemployment healthcare benefits (OPEB) to all employees who retire from SMUD and their dependents in accordance with SMUD policy and MOUs. These benefits are funded through the PERS California Employer's Retiree Benefit Trust, an agent multiple-employer plan. SMUD opted to make additional \$22.0 million and \$40.0 million contributions to the trust in 2015 and 2014, respectively. At June 30, 2015, the plan was 55.2 percent funded and the balance of the OPEB asset at December 31, 2015 and 2014 was \$96.1 million and \$77.7 million, respectively.

Developments in the Energy Market

New developments in the energy market at both the federal and state level kept SMUD on high alert as it continued to monitor and address the potential impacts on the organization. Legislation at the federal level include the Executive Order “Improving Critical Infrastructure Security” on cyber security, the Energy Policy Act of 1992 related to federal regulation of transmission access that includes FERC Order 1000, the North American Electric Reliability Corporation reliability standards, anti-market manipulation rules, and greenhouse gas emissions. Legislation at the state level include Assembly Bill 32 Global Warming Solutions Act of 2006 (AB 32) establishing the cap-and-trade program for carbon allowances, Senate Bill (SB)-1 solar program, SB-2 1X the California Renewable Energy Resources Act that codifies the Renewable Portfolio Standards target, and SB-350 Clean Energy and Pollution Reduction Act of 2015, further defined the renewable portfolio standards.

Significant Accounting Policies

In accordance with GASB No. 62, the Board has taken regulatory actions for ratemaking that result in the deferral of expense and revenue recognition. These actions result in regulatory assets and liabilities. SMUD has regulatory assets that cover costs related to decommissioning, derivative financial instruments, SB-1 solar investments, debt issuance costs, and the newly added pension costs as a result of GASB No. 68. As of December 31, 2015 and 2014, total regulatory assets were \$624.2 million and \$629.3 million, respectively. SMUD also has regulatory credits that cover costs related to contributions in aid of construction, the RSF and HRSF, AB 32 carbon allowances, grant revenues, and TANC operations costs. As of December 31, 2015 and 2014, total regulatory credits were \$353.8 million and \$368.9 million, respectively.

FINANCIAL POSITION

CONDENSED CONSOLIDATED STATEMENTS OF NET POSITION

	<u>2015</u>	<u>December 31, 2014 (Restated)</u>	<u>2013</u>
		(millions of dollars)	
Assets			
Electric Utility Plant – net	\$ 3,324	\$ 3,332	\$ 3,323
Restricted and Designated Assets	44	137	174
Current Assets	1,021	1,062	1,062
Noncurrent Assets	<u>1,241</u>	<u>1,245</u>	<u>784</u>
Total Assets	\$ 5,630	\$ 5,776	\$ 5,343
Deferred Outflows of Resources	<u>267</u>	<u>219</u>	<u>149</u>
Total Assets and Deferred Outflows of Resources	<u>\$ 5,897</u>	<u>\$ 5,995</u>	<u>\$ 5,492</u>
Liabilities			
Long-Term Debt - net	\$ 2,674	\$ 2,882	\$ 3,076
Current Liabilities	650	661	589
Noncurrent Liabilities	<u>767</u>	<u>682</u>	<u>289</u>
Total Liabilities	\$ 4,091	\$ 4,225	\$ 3,954
Deferred Inflows of Resources	664	757	691
Net Position:			
Net Investment in Capital Assets	658	485	345
Restricted	72	127	116
Unrestricted	<u>412</u>	<u>401</u>	<u>386</u>
Total Liabilities, Deferred Inflows of Resources, and Net Position	<u>\$ 5,897</u>	<u>\$ 5,995</u>	<u>\$ 5,492</u>

ASSETS AND DEFERRED OUTFLOWS OF RESOURCES

Electric Utility Plant – net

2015 compared to 2014

As of December 31, 2015 SMUD has invested approximately \$3,324.0 million in electric utility plant assets and construction work in progress (CWIP) after accumulated depreciation. Electric Utility Plant - net makes up about 56 percent of SMUD's Total Assets and Deferred Outflow of Resources, which is about four percent less than 2014. In 2015, SMUD capitalized approximately \$123.0 million of additions to electric utility plant in the Consolidated Statements of Net Position. The additions were primarily due to distribution line work and purchases related to the replacement of bulk substations.

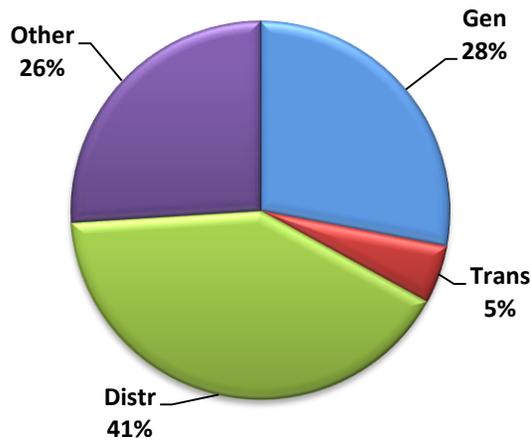
These additions were offset by the retirement of a portion of SMUD’s headquarters building in preparation for a major renovation, some fleet assets, and some hardware equipment.

2014 compared to 2013

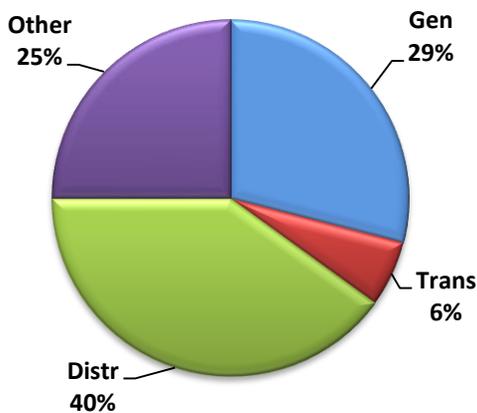
As of December 31, 2014 SMUD has invested approximately \$3,332.0 million in electric utility plant assets and CWIP after accumulated depreciation. Net Electric Utility Plant makes up about 60 percent of SMUD’s Total Assets and Deferred Outflow of Resources, which is about one percent less than 2013. In 2014, SMUD capitalized approximately \$199.0 million of additions to electric utility plant in the Consolidated Statements of Net Position. The additions were primarily due to distribution line work, hardware and software upgrades, and purchase of land for additional wind capacity and replacement of bulk substations. These additions were offset by the retirement of the UARP recreational facilities and some photovoltaic assets.

The following charts show the breakdown of Electric Utility Plant – net by major plant category – Generation (Gen), Transmission (Trans), Distribution (Distr), and Other:

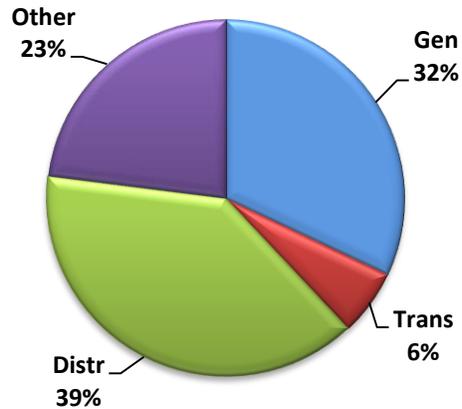
December 31, 2015



December 31, 2014



December 31, 2013



Restricted and Designated Assets

2015 compared to 2014

SMUD's restricted and designated assets are comprised of debt service reserves, nuclear decommissioning trust funds, rate stabilization reserves, and other third party agreements or Board actions. These assets decreased by \$92.7 million during 2015. The decrease was due to a transfer of \$15.1 million from the RSF (including the HRSF) as a result of lower precipitation and lower energy deliveries from WAPA, and a \$16.1 million reduction in revenue bond and debt service reserves. In addition, there was a decrease of \$60.7 million in the other funds due to the release of various restricted funds of the component units, Sacramento Municipal Utility District Financing Authority (SFA) and Sacramento Power Authority (SPA), as a result of SFA's bond refunding and SPA's bond redemptions.

2014 compared to 2013

SMUD's restricted and designated assets decreased by \$37.4 million during 2014. The decrease was partially due to a transfer of \$36.2 million from the RSF (including the HRSF) as a result of lower precipitation and lower energy deliveries from WAPA. In addition, there was a decrease of \$22.9 million in the nuclear decommissioning fund mainly due to payments made for the shipment of the low level radioactive waste to a permanent waste disposal facility. These decreases were offset by \$11.0 million increase in the component units' overhaul and maintenance reserve and \$13.7 million in the current portion of these assets.

Current Assets

2015 compared to 2014

Current assets decreased \$41.1 million in 2015. The unrestricted cash and cash equivalents and investments decreased by \$78.9 million. This decrease was offset by increases in credit support collateral deposits of \$19.7 million, along with a total increase of \$18.3 million in receivables-net, inventories, prepaid gas to be delivered within one year, and prepayments.

2014 compared to 2013

Current assets remained relatively flat in 2014 compared to 2013. The unrestricted investments increased by \$91.3 million along with a total increase of \$8.9 million in the current portion of regulatory costs and prepaid gas, inventories, and credit support collateral deposits. These increases were offset by decreases of \$59.0 million in unrestricted cash and cash equivalents, \$13.7 million in restricted and designated cash and cash equivalents and investments, \$12.8 million in prepayments, \$12.7 million in receivables-net, and \$2.6 million in the current portion of investment and hedging derivative instruments.

Noncurrent Assets

2015 compared to 2014

Total noncurrent assets decreased by \$3.9 million mainly due to a decrease in prepaid gas of \$27.8 million, offset by a \$25.0 million increase in credit support collateral deposits.

2014 compared to 2013

Total noncurrent assets increased by \$460.1 million mainly due to the recording of the regulatory asset related to implementation of GASB No. 68 in the amount of \$425.7 million, and a \$40.0 million additional contribution to the OPEB trust fund.

Deferred Outflows of Resources

2015 compared to 2014

Total deferred outflows of resources increased \$47.9 million due to a \$51.6 million increase in the value of hedging derivative instruments and deferred pension outflows, offset by \$3.7 million amortization of bond losses.

2014 compared to 2013

Total deferred outflows of resources increased \$70.0 million due to a \$49.7 million increase in the fair value of hedging derivative instruments and the recording of \$27.2 million of deferred pension outflows related to the implementation of GASB No. 68, offset by \$7.0 million amortization of bond losses.

LIABILITIES AND DEFERRED INFLOWS OF RESOURCES

Long-term debt - net

2015 compared to 2014

SMUD's long-term debt includes the component units' debt and consists of a variety of financial instruments, including interest rate swap agreements, subordinated electric revenue bonds and variable rate bonds. Proceeds from the bonds provide financing for various capital improvement projects, component unit capital projects, and the prepayment of a 20 year supply of natural gas.

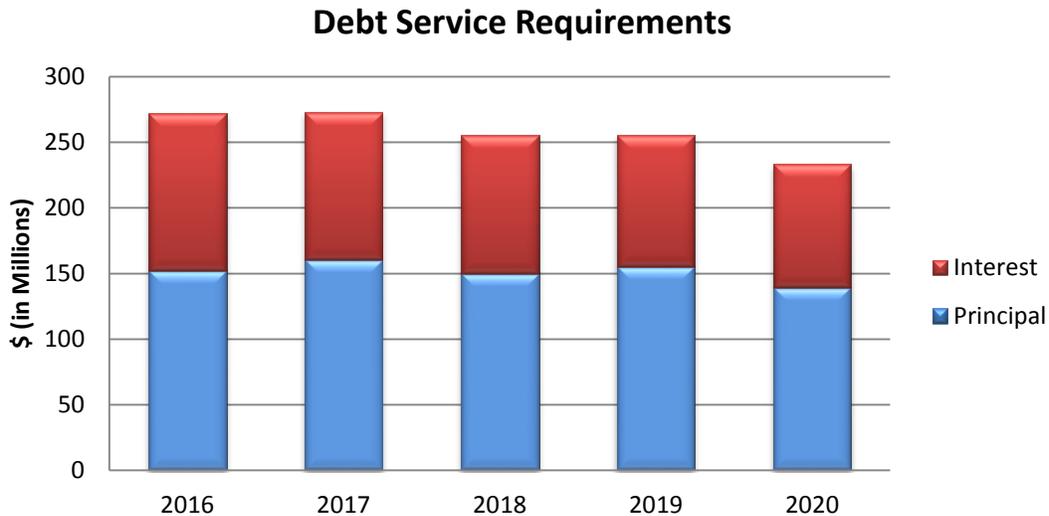
In June 2015, SFA issued \$193.3 million of 2015 Series Cosumnes Project Revenue Refunding Bonds. Proceeds from the 2015 Series Bonds and \$24.8 million of available funds were used to refund \$233.2 million of the outstanding 2006 Series Bonds through a legal defeasance, and accordingly, the liability for the defeased bonds was removed from Long-Term Debt in the Statements of Net Position. The refunding resulted in the recognition of a deferred accounting loss of \$4.4 million, which is being amortized over the life of the refunding issue, and a current period loss of \$0.03 million which is included in Interest on Debt in the Statement of Revenues, Expenses, and Changes in Net Assets. As a result of the refunding, future aggregate debt service payments are reduced by \$46.7 million and there is a total economic gain of \$35.5 million.

In January and July 2015, SPA redeemed \$29.9 million and the remaining \$41.4 million, respectively, of the 2005 Series Bonds maturing July 2015 through July 2022, along with the accrued interest. The redemptions resulted in a current accounting loss of \$0.2 million, which is included in Interest on Debt in the Statements of Revenues, Expenses, and Changes in Net Position.

2014 compared to 2013

In December 2014, SMUD redeemed \$8.7 million of 2004 Series T Bonds. The redemption resulted in a current accounting gain of \$23 thousand, which is included in Interest on Debt. Redeeming the bonds will reduce the aggregate future debt service payments by \$11.0 million.

The following table shows SMUD’s future debt service requirements through 2020 as of December 31, 2015:



As of December 31, 2015, SMUD’s bonds had an underlying rating of “AA-” from Standard & Poor’s, “AA-” from Fitch, and “Aa3” from Moody’s. SMUD’s bonds were upgraded by Moody’s from A1 to Aa3 in April of 2015. Some of SMUD’s bonds are insured and are rated by the rating agencies at the higher of the insurer’s rating or SMUD’s underlying rating.

Current Liabilities

2015 compared to 2014

Current liabilities decreased by \$11.8 million during 2015. Current portion of long-term debt decreased \$18.4 million and accounts payable decreased \$6.7 million, offset by an increase of \$13.8 million in hedging derivative instruments maturing within one year.

2014 compared to 2013

Current liabilities increased by \$72.0 million during 2014. Current portion of long-term debt increased \$32.8 million mainly due to a \$29.9 million early call of a component unit’s bonds. In addition, there was a \$38.7 million increase in investment and hedging derivative instruments.

Noncurrent Liabilities

2015 compared to 2014

Noncurrent liabilities increased by \$85.6 million during 2015. The increase was mainly due to a \$54.6 million increase in the net pension liability and a \$34.4 million increase in investment and hedging derivative instruments.

2014 compared to 2013

Noncurrent liabilities increased by \$392.4 million during 2014. The increase was mainly due to the recording of the net pension liability of \$326.7 million as a result of implementing GASB No. 68, a \$56.1 million liability associated with the new hydro license, and \$18.4 million in investment and hedging derivative instruments.

Deferred Inflows of Resources

2015 compared to 2014

Total deferred inflows of resources decreased \$93.0 million mainly due to a \$63.8 million reduction in deferred pension inflows. Other reductions include \$15.1 million in regulatory credits for transfers from the rate stabilization funds as a result of lower precipitation and lower energy deliveries from WAPA, and \$10.2 million for the Solano Phase 3 wind facilities.

2014 compared to 2013

Total deferred inflows of resources increased \$66.2 million due to the recording of deferred pension inflows of \$111.4 million as a result of implementing GASB No. 68, a transfer of \$36.2 million from the RSF (including the HRSF) as a result of lower precipitation and lower energy deliveries from WAPA, and the amortization of \$10.0 million for the Solano Phase 3 wind facilities.

RESULTS OF OPERATIONS

CONDENSED CONSOLIDATED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

	<u>2015</u>	<u>December 31,</u> <u>2014 (restated)</u>	<u>2013</u>
		(millions of dollars)	
Operating revenues	\$ 1,474	\$ 1,529	\$ 1,428
Operating expenses	<u>(1,270)</u>	<u>(1,320)</u>	<u>(1,255)</u>
Operating income	204	209	173
Other revenues	35	79	22
Interest charges	<u>(110)</u>	<u>(122)</u>	<u>(125)</u>
Change in net position	129	166	70
Net position – beginning of year	<u>1,013</u>	<u>847</u>	<u>777</u>
Net position – end of year	<u>\$ 1,142</u>	<u>\$ 1,013</u>	<u>\$ 847</u>

Operating Revenues

2015 compared to 2014

Operating revenues decreased \$55.2 million in 2015. Approximately \$47.2 million from retail sales includes the 2.5 percent rate increase that went into effect January 1, 2015. As of December 31, 2015, the number of customers increased to 617,307 at a slightly higher average revenue per kilowatt hour as compared to the end of 2014.

In 2015 and 2014, SMUD transferred \$12.0 million and \$11.8 million from the RSF and \$3.1 million and \$24.3 million from the HRSF, respectively. The transfer from the HRSF caused the fund to be depleted and subsequently the 1.3 percent HGA surcharge was implemented.

Wholesale revenues are comprised of both surplus gas and energy sales which are part of the operational strategy in managing fuel and energy costs. In 2015, surplus gas sales were lower than 2014 by \$55.2 million due to lower gas prices and less gas sold. Energy sales were also lower in 2015 by \$29.0 million as compared to 2014 due to lower prices and lower energy sales.

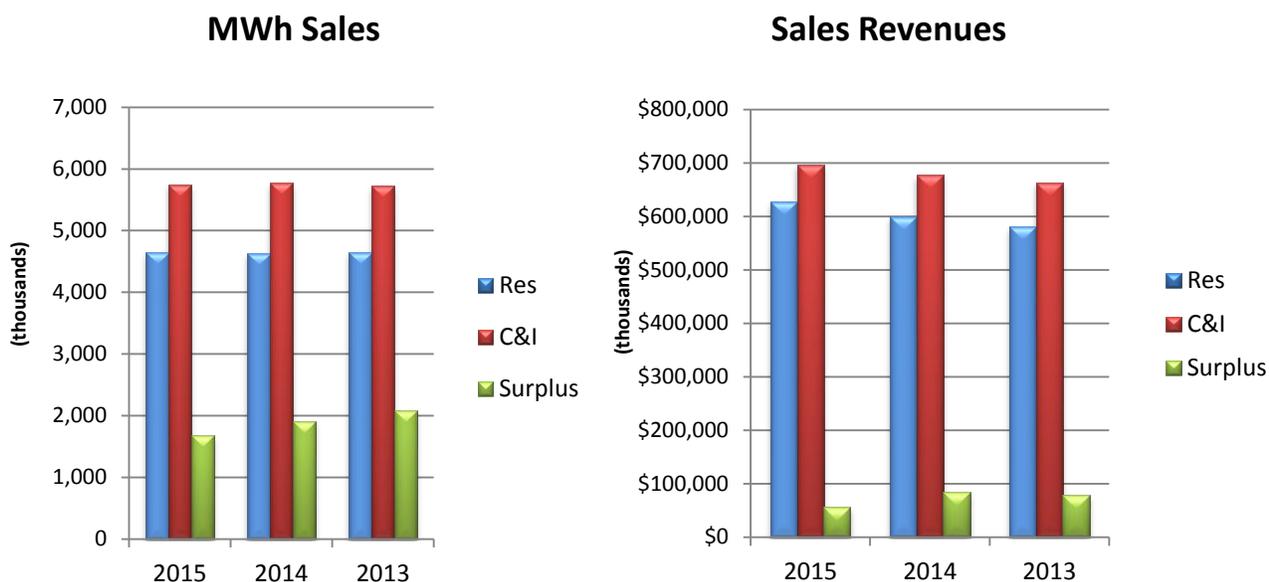
2014 compared to 2013

Operating revenues increased \$100.9 million in 2014, of which \$36.7 million includes the 2.5 percent rate increase that went into effect January 1, 2014. As of December 31, 2014, the number of customers had increased approximately one percent to 614,143 at slightly higher average revenue per kilowatt hour as compared to the end of 2013.

SMUD transferred \$11.8 million from the RSF in 2014 compared to a transfer of \$1.8 million to the RSF in 2013. SMUD also transferred \$24.3 million and \$6.6 million from the HRSF in 2014 and 2013, respectively.

Wholesale revenues are comprised of both surplus gas and energy sales which are part of the operational strategy in managing fuel and energy costs. In 2014, surplus gas sales were higher than 2013 by \$29.3 million due to higher gas prices and more gas sold. Energy sales were also higher in 2014 by \$5.8 million as compared to 2013 due to higher prices offset by lower volume.

The following charts show the megawatt hour (MWh) sales, and sales revenue for the past three years by surplus energy sales (Surplus), commercial and industrial (C&I) and residential (Res) customers.



Operating Expenses

2015 compared to 2014

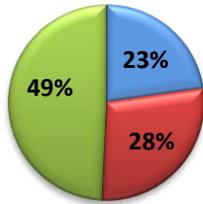
Operating expenses decreased \$49.5 million compared to 2014. Operations which includes purchased power, production, transmission and distribution, and depletion, decreased by \$74.0 million mainly due to lower gas and power prices as well as lower volumes. This decrease was offset by a \$23.5 million increase in administrative, general and customer costs.

2014 compared to 2013

Operating expenses increased \$64.7 million compared to 2013 mainly due to the impact of the drought on hydro generation. The reduction in hydro generation contributed significantly to the \$42.5 million increase in purchased power expense, which is about 16 percent higher than in 2013. Production costs, which include depletion, were higher by \$13.9 million. Net fuel costs for generation is included in production costs and was \$37.0 million lower than 2013 mainly due to a 14 percent reduction in the average net fuel price.

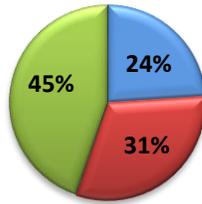
The following charts show the breakdown of operating expenses:

2015 Operating Expenses



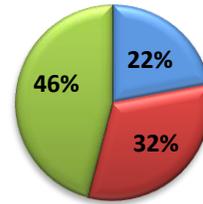
- Purchased Power
- Production
- Other

2014 Operating Expenses



- Purchased Power
- Production
- Other

2013 Operating Expenses



- Purchased Power
- Production
- Other

Other Revenues and (Expenses)

2015 compared to 2014

Other revenues were \$44.1 million lower in 2015, which was partially attributable to the difference in the amount of settlement proceeds received related to the Rancho Seco nuclear waste disposal litigation. In 2015 and 2014, SMUD received settlement proceeds of \$22.5 million and \$53.1 million, respectively. In addition, \$16.9 million was written off for the terminated Iowa Hill Project.

2014 compared to 2013

Other revenues were \$56.7 million higher in 2014 most of which was attributable to the \$53.1 million settlement related to the Rancho Seco nuclear waste disposal litigation. Other changes include lower investment expense of \$13.2 million due to ineffective hedges, offset by \$5.0 million lower revenues associated with grants.

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**SACRAMENTO MUNICIPAL UTILITY DISTRICT
CONSOLIDATED STATEMENTS OF NET POSITION**

	DECEMBER 31,	
	2015	2014 (Restated)
	(thousands of dollars)	
ASSETS		
ELECTRIC UTILITY PLANT		
Plant in service	\$ 5,637,649	\$ 5,575,013
Less accumulated depreciation and depletion	(2,489,820)	(2,354,642)
Plant in service - net	3,147,829	3,220,371
Construction work in progress	176,071	111,594
Total electric utility plant - net	3,323,900	3,331,965
RESTRICTED AND DESIGNATED ASSETS		
Revenue bond and debt service reserves	114,231	130,430
Nuclear decommissioning trust fund	8,292	8,250
Rate stabilization fund	30,251	45,306
Other funds	6,082	66,752
Less current portion	(114,574)	(113,805)
Total restricted and designated assets	44,282	136,933
CURRENT ASSETS		
Unrestricted cash and cash equivalents	214,390	237,709
Unrestricted investments	341,036	396,575
Restricted and designated cash and cash equivalents	43,518	37,765
Restricted and designated investments	71,056	76,040
Receivables - net:		
Retail customers	166,205	153,658
Wholesale	1,695	7,837
Other	23,019	26,479
Regulatory costs to be recovered within one year	21,242	20,838
Investment derivative instruments maturing within one year	-0-	39
Hedging derivative instruments maturing within one year	7,740	9,025
Inventories	61,486	52,626
Prepaid gas to be delivered within one year	27,768	24,893
Credit support collateral deposits	20,523	829
Prepayments	21,278	17,708
Total current assets	1,020,956	1,062,021
NONCURRENT ASSETS		
Regulatory costs for future recovery	602,934	608,473
Prepaid gas	287,844	315,612
Prepaid power and capacity	135,332	140,507
Hedging derivative instruments	23,275	25,703
Energy efficiency loans - net	29,039	33,173
Credit support collateral deposits	28,177	3,171
Due from affiliated entity	16,208	7,687
Prepayments and other	118,169	110,575
Total noncurrent assets	1,240,978	1,244,901
TOTAL ASSETS	5,630,116	5,775,820
DEFERRED OUTFLOWS OF RESOURCES		
Accumulated decrease in fair value of hedging derivatives	199,621	152,033
Deferred pension outflows	31,303	27,269
Unamortized bond losses	36,085	39,830
Total deferred outflows of resources	267,009	219,132
TOTAL ASSETS AND DEFERRED OUTFLOWS OF RESOURCES	\$ 5,897,125	\$ 5,994,952

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

**SACRAMENTO MUNICIPAL UTILITY DISTRICT
CONSOLIDATED STATEMENTS OF NET POSITION**

	DECEMBER 31,	
	2015	2014 (Restated)
	(thousands of dollars)	
LIABILITIES		
LONG-TERM DEBT - net	\$ 2,674,120	\$ 2,881,701
CURRENT LIABILITIES		
Commercial paper notes	200,000	200,000
Accounts payable	68,485	75,147
Purchased power payable	21,677	21,423
Credit support collateral obligation	4,389	160
Long-term debt due within one year	152,060	170,430
Accrued decommissioning	8,822	7,879
Interest payable	37,898	42,219
Accrued salaries and compensated absences	34,034	37,715
Investment derivative instruments maturing within one year	12,579	12,295
Hedging derivative instruments maturing within one year	65,200	51,727
Customer deposits and other	44,304	42,238
Total current liabilities	649,448	661,233
NONCURRENT LIABILITIES		
Net pension liability	381,341	326,702
Accrued decommissioning	152,359	154,280
Investment derivative instruments	20,207	19,888
Hedging derivative instruments	134,422	100,306
Self insurance and other liabilities	78,815	80,340
Total noncurrent liabilities	767,144	681,516
TOTAL LIABILITIES	4,090,712	4,224,450
DEFERRED INFLOWS OF RESOURCES		
Accumulated increase in fair value of hedging derivatives	31,015	34,728
Regulatory credits	353,821	368,931
Deferred pension inflows	47,579	111,405
Financing obligation and other	231,673	242,069
Total deferred inflows of resources	664,088	757,133
NET POSITION		
Net investment in capital assets	658,199	485,358
Restricted	72,465	127,044
Unrestricted	411,661	400,967
TOTAL NET POSITION	1,142,325	1,013,369
COMMITMENTS, CLAIMS AND CONTINGENCIES (Notes 16 and 17)		
TOTAL LIABILITIES, DEFERRED INFLOWS OF RESOURCES, AND NET POSITION	\$ 5,897,125	\$ 5,994,952

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

SACRAMENTO MUNICIPAL UTILITY DISTRICT
CONSOLIDATED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

	Year Ended December 31,	
	2015	2014 (Restated)
	(thousands of dollars)	
OPERATING REVENUES		
Residential	\$ 621,830	\$ 594,644
Commercial and industrial	697,044	676,972
Street lighting and other	32,154	34,236
Wholesale	82,052	166,262
Senate Bill - 1 revenue	(4,181)	(331)
AB-32 revenue	30,214	21,393
Rate stabilization fund transfers	15,055	36,168
Total operating revenues	1,474,168	1,529,344
OPERATING EXPENSES		
Operations:		
Purchased power	288,835	316,082
Production	346,550	401,980
Transmission and distribution	73,909	63,134
Administrative, general and customer	190,013	166,503
Public good	70,122	73,171
Maintenance	95,635	97,563
Depreciation	188,928	184,810
Depletion	9,094	11,230
Regulatory amounts collected in rates	7,299	5,401
Total operating expenses	1,270,385	1,319,874
OPERATING INCOME	203,783	209,470
NON-OPERATING REVENUES AND EXPENSES		
Other revenues and (expenses):		
Interest income	7,511	7,759
Investment expense	(11,045)	(8,515)
Other income - net	38,574	79,881
Total other revenues and (expenses)	35,040	79,125
Interest charges:		
Interest on debt	111,685	123,253
Allowance for funds used during construction	(1,818)	(1,322)
Total interest charges	109,867	121,931
CHANGE IN NET POSITION	128,956	166,664
NET POSITION - BEGINNING OF YEAR	1,013,369	846,705
NET POSITION - END OF YEAR	\$ 1,142,325	\$ 1,013,369

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

**SACRAMENTO MUNICIPAL UTILITY DISTRICT
CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Year Ended December 31,	
	2015	2014 (Restated)
	(thousands of dollars)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from retail customers	\$ 1,334,961	\$ 1,302,475
Receipts from surplus power sales	56,014	83,758
Receipts from surplus gas sales	27,580	83,203
Receipts from steam sales	4,221	5,474
Settlement proceeds	22,521	53,140
Other receipts	28,767	31,804
Payments/receipts for credit support collateral	(40,471)	(4,000)
Issuance/repayment of energy efficiency loans - net	4,685	3,611
Payments to employees - payroll and other	(264,726)	(248,917)
Payments for wholesale power	(297,805)	(314,052)
Payments for gas purchases	(221,485)	(274,791)
Payments to vendors/others	(321,990)	(319,908)
Payments for decommissioning	(6,966)	(18,846)
Net cash provided by operating activities	325,306	382,951
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Repayment of debt	(23,685)	(22,380)
Receipts from federal and state grants	12,798	13,103
Pass through payments for federal and state grants	-0-	(2,188)
Interest on debt	(14,206)	(15,128)
Net cash used in noncapital financing activities	(25,093)	(26,593)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Construction expenditures	(181,849)	(142,416)
Contributions in aid of construction	14,710	11,285
Net proceeds from bond issues	223,708	-0-
Repayments and refundings of debt	(413,655)	(123,910)
Interest on debt	(110,795)	(118,645)
Net cash used in capital financing activities	(467,881)	(373,686)
CASH FLOWS FROM INVESTING ACTIVITIES		
Sales and maturities of securities	396,660	449,698
Purchases of securities	(303,985)	(483,049)
Interest and dividends received	8,089	7,772
Investment revenue/expenses - net	(10,754)	(8,572)
Net cash provided by (used in) investing activities	90,010	(34,151)
Net decrease in cash and cash equivalents	(77,658)	(51,479)
Cash and cash equivalents at the beginning of the year	337,061	388,540
Cash and cash equivalents at the end of the year	\$ 259,403	\$ 337,061
Cash and cash equivalents included in:		
Unrestricted cash and cash equivalents	\$ 214,390	\$ 237,709
Restricted and designated cash and cash equivalents	43,518	37,765
Revenue bond and debt service reserves		
(a component of the total of \$114,231 and \$130,430 at December 31, 2015 and 2014, respectively)	1,495	61,587
Cash and cash equivalents at the end of the year	\$ 259,403	\$ 337,061

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

**SACRAMENTO MUNICIPAL UTILITY DISTRICT
SUPPLEMENTAL CASH FLOW INFORMATION**

A reconciliation of the consolidated statements of cash flows operating activities to operating income as follows:

	Year Ended December 31,	
	2015	2014 (Restated)
	(thousands of dollars)	
Operating income	\$ 203,783	\$ 209,470
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	188,928	184,810
Depletion	9,094	11,230
Regulatory amortization	7,299	5,401
Amortization of advance capacity & other	1,712	929
Amortization of prepaid gas supply	24,893	22,720
Revenue recognized from regulatory credits - net	(16,213)	(33,939)
Settlement proceeds	22,521	53,140
Payments/receipts for credit support collateral - net	(40,471)	(4,000)
Other receipts/payments	2,840	2,756
Changes in operating assets, deferred outflows, liabilities and deferred inflows:		
Customer and wholesale receivables	(10,798)	558
Energy efficiency loans	4,685	3,611
Other assets	(41,646)	(58,753)
Deferred pension outflows	(4,034)	(14,842)
Payables and accruals	(11,134)	18,706
Decommissioning	(6,966)	(18,846)
Deferred pension inflows	(9,187)	-0-
Net cash provided by operating activities	\$ 325,306	\$ 382,951

The supplemental disclosure of noncash financing and investing activities is as follows:

	Year Ended December 31,	
	2015	2014
	(thousands of dollars)	
Amortization of debt related costs	\$ 8,959	\$ 8,148
Unrealized holding loss	(411)	(681)
Change in valuation of derivative financial instruments	(51,945)	(58,350)
Amortization of revenue for assets contributed in aid of construction	18,647	17,970
Allowance for funds used during construction	1,818	1,322
Construction costs included in accounts payable	19,115	16,588

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

Sacramento Municipal Utility District Notes To Consolidated Financial Statements

NOTE 1. ORGANIZATION

The Sacramento Municipal Utility District (SMUD) was formed and operates under the State of California Municipal Utility District Act (Act). The Act gives SMUD the rights and powers to fix rates and charges for commodities or services it furnishes, and to incur indebtedness and issue bonds or other obligations.

As a community-owned utility, SMUD is not subject to regulation or oversight by the California Public Utilities Commission.

SMUD is responsible for the acquisition, generation, transmission, and distribution of electric power to its service area, which includes most of Sacramento County and small adjoining portions of Placer and Yolo Counties. The Board of Directors (Board) determines SMUD's rates.

SMUD is exempt from payment of federal and state income taxes and, under most circumstances, real and personal property taxes. SMUD is not exempt from real and personal property taxes on assets it holds outside of California. In addition, SMUD is responsible for the payment of a portion of the property taxes associated with its real property in California that lies outside of its service area.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Method of Accounting. SMUD's accounting records are maintained in accordance with Generally Accepted Accounting Principles for proprietary funds as prescribed by the Governmental Accounting Standards Board (GASB). SMUD's accounting records generally follow the Uniform System of Accounts for Public Utilities and Licensees prescribed by the Federal Energy Regulatory Commission (FERC), except as it relates to the accounting for contributions of utility property in aid of construction. SMUD's Consolidated Financial Statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of the related cash flows. Electric revenues and costs that are directly related to the acquisition, generation, transmission, and distribution of electricity are reported as operating revenues and expenses. All other revenues and expenses are reported as non-operating revenues and expenses.

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 reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The Financial Reporting Entity. These Consolidated Financial Statements include SMUD and its component units. Although the component units are legally separate from SMUD, they are blended into and reported as part of SMUD because of the extent of their operational and financial relationships with SMUD. All significant inter-component transactions have been eliminated in consolidation.

Component Units. The component units include the Central Valley Financing Authority (CVFA), the Sacramento Cogeneration Authority (SCA), the Sacramento Municipal Utility District Financing Authority (SFA), the Sacramento Power Authority (SPA), and the Northern California Gas Authority No. 1 (NCGA). The primary purpose of CVFA, SCA, SFA and SPA is to own and operate electric utility plants that supply power to SMUD. The primary purpose of NCGA is to prepay for natural gas and to sell the natural gas to SMUD. SMUD's Board comprises the Commissions that govern these entities (see Note 6).

Plant in Service. Capital assets are generally defined by SMUD as tangible assets with an initial, individual cost of more than three thousand dollars and an estimated useful life in excess of two years. The cost of additions to Plant in Service and replacement property units is capitalized. Repair and maintenance costs are charged to expense when incurred. When SMUD retires portions of its Utility Plant, retirements are recorded against Accumulated Depreciation and the retired portion of Utility Plant is removed from Plant in Service. The costs of removal and the related salvage value, if any, are charged or credited as appropriate to Accumulated Depreciation. SMUD generally computes depreciation on Plant in Service on a straight-line, service-life basis. The consolidated average annual composite depreciation rates for 2015 and 2014 were 3.5 percent. Depreciation is calculated using the following estimated lives:

Generation	4 to 80 years
Transmission and Distribution	5 to 50 years
Gas Pipeline	5 to 90 years
General	5 to 60 years

Investment in Joint Powers Agency (JPA). SMUD’s investment in the Transmission Agency of Northern California (TANC) is accounted for under the equity method of accounting and is reported as a component of Plant in Service. SMUD’s share of the TANC debt service costs and operations and maintenance expense, inclusive of depreciation, is included in Transmission and Distribution expense in the Consolidated Statements of Revenues, Expenses and Changes in Net Position.

SMUD’s investment in Balancing Authority of Northern California (BANC) is accounted for under the equity method of accounting. SMUD’s share of the BANC operations and maintenance expense is included in Transmission and Distribution expense in the Consolidated Statements of Revenues, Expenses and Changes in Net Position.

Investment in Gas Properties. SMUD has an approximate 21 percent non-operating ownership interest in the Rosa Unit gas properties in New Mexico of which, SMUD's portion of the extracted gas is transported for use in its component unit natural gas-fired power plants (see Note 6). SMUD uses the successful efforts method of accounting for its investment in gas producing properties. Costs to acquire mineral interests in gas properties, to drill and equip exploratory wells that find proved reserves, and to drill and equip development wells are capitalized as a component of Plant in Service on the Consolidated Statements of Net Position. Costs to drill exploratory wells that do not find proved reserves, geological and geophysical costs, and costs of carrying and retaining unproved properties are expensed. SMUD has purchased proven reserves and has not participated in exploratory drilling. Capitalized costs of producing gas properties, after considering estimated residual salvage values, are depleted by the unit-of-production method based on the estimated future production of the proved developed producing wells. SMUD’s investment in gas properties is reported as a component of Plant in Service.

Restricted and Designated Assets. Cash, cash equivalents, and investments, which are restricted under terms of certain agreements for payments to third parties or Board actions limiting the use of such funds, are included as restricted assets. When SMUD restricts funds for a specific purpose, and both restricted and unrestricted resources are available for use, it is SMUD’s policy to use restricted resources first, then unrestricted resources as they are needed.

Restricted Bond Funds. SMUD’s Indenture Agreements (Indenture) requires the maintenance of minimum levels of reserves for debt service on the 1997 Series K Bonds and the 2003 Series R Bonds. In 2015, the 2003 Series R Bonds were paid off and only the reserve for debt service for the 1997 Series K Bonds existed at December 31, 2015.

Nuclear Decommissioning Trust Fund. SMUD made annual contributions to its Nuclear Decommissioning Trust Fund (Trust Fund) through 2008 to cover the cost of its primary decommissioning activities associated with the Rancho Seco facility. Primary decommissioning excludes activities associated with the spent fuel storage facility after 2008 and most non-radiological decommissioning tasks. SMUD determined early in 2008 that there were enough funds in the trust to complete the radiological decommissioning of the Rancho Seco nuclear plant site, and stopped contributing to the Trust Fund (see Note 12). Interest earnings on the Trust Fund assets are recorded as Interest Income and are accumulated in the Trust Fund.

Accrued Decommissioning. SMUD accrues decommissioning costs related to Utility Plant when an obligation to decommission facilities is legally required. Adjustments are made to such liabilities based on estimates by SMUD staff in accordance with FASB ASC 410, *Asset Retirement and Environmental Obligations* (FASB ASC 410). For active plants, such costs are included in the Utility Plant's cost and included as a component of Operating Expense over the Utility Plant's life. Expenditures for decommissioning activities are recorded as reductions to Accrued Decommissioning liability. Changes in the Rancho Seco decommissioning liability estimates arising from inflation, annual accretion, and other changes to the cost assumptions are recorded to Accrued Decommissioning with a corresponding adjustment to the related regulatory deferral. The current portion of the Accrued Decommissioning liability represents SMUD's estimate of actual expenditures in the next year, as set forth in the annual budget.

SMUD has identified potential retirement obligations related to certain generation, distribution and transmission facilities. SMUD's non-perpetual leased land rights generally are renewed continuously because SMUD intends to utilize these facilities indefinitely. Since the timing and extent of any potential asset retirements are unknown, the fair value of any obligations associated with these facilities cannot be reasonably estimated. Accordingly, a liability has not been recorded.

At December 31, 2015 and 2014, SMUD's Accrued Decommissioning balance in the Consolidated Statements of Net Position relating to Rancho Seco was \$150.4 million and \$152.1 million, respectively (see Note 12). The Accrued Decommissioning balance in the Consolidated Statements of Net Position relating to other electricity generation and gas production facilities totaled \$10.8 million and \$10.1 million as of December 31, 2015 and 2014, respectively.

Cash and Cash Equivalents. Cash and cash equivalents include all debt instruments purchased with an original maturity of 90 days or less, all investments in the Local Agency Investment Fund (LAIF), and money market mutual funds. LAIF has an equity interest in the State of California (State) Pooled Money Investment Account (PMIA). PMIA funds are on deposit with the State's Centralized Treasury System and are managed in compliance with the California Government Code according to a statement of investment policy which sets forth permitted investment vehicles, liquidity parameters, and maximum maturity of investments. SMUD's deposits with LAIF comprise cash representing demand deposits up to \$50.0 million maximum and cash equivalents representing amounts which may be withdrawn once per month after a thirty-day period. The debt instruments and money market mutual funds are reported at amortized cost, which approximates fair value, and the LAIF is reported at the value of its pool shares.

Investments. SMUD's investments held for more than one year are reported at fair value. Realized and unrealized gains and losses are included in Other Income – Net in the Consolidated Statements of Revenues, Expenses and Changes in Net Position. Premiums and discounts on zero coupon bonds are amortized using the effective interest method. Premiums and discounts on other securities are amortized using the straight-line method, which approximates the effective interest method.

Electric Operating Revenues. Electric revenues are billed on the basis of monthly cycle bills and are recorded as revenue when the electricity is delivered. SMUD records an estimate for unbilled revenues earned from the dates its retail customers were last billed to the end of the month. At December 31, 2015 and 2014, unbilled revenues were \$72.5 million and \$69.1 million, respectively.

Purchased Power Expenses. A portion of SMUD's power needs are provided through power purchase agreements. Expenses from such agreements, along with associated transmission costs paid to other utilities, are charged to Purchased Power expense on the Consolidated Statements of Revenues, Expenses and Changes in Net Position in the period the power is received. The costs, or credits, associated with energy swap agreements (gas and electricity) or other arrangements that affect the net cost of Purchased Power are recognized in the period in which the underlying power delivery occurs. Contract termination payments and adjustments to prior billings are included in Purchased Power expense once the payments or adjustments can be reasonably estimated.

Advanced Capacity Payments. Some long-term agreements to purchase energy or capacity from other providers call for up-front payment. Such costs are generally recorded as an asset and amortized over the length of the contract.

Credit and Market Risk. SMUD enters into forward purchase and sales commitments for physical delivery of gas and electricity with utilities and power marketers. SMUD is exposed to credit risk related to nonperformance by its wholesale counterparties under the terms of these contractual agreements. In order to limit the risk of counterparty default, SMUD has a wholesale counterparty risk policy which includes using the credit agency ratings of SMUD's counterparties and other credit services, credit enhancements for counterparties that do not meet an acceptable risk level, and the use of standardized agreements that allow for the netting of positive and negative exposures associated with a single counterparty. SMUD is also subject to similar requirements for many of its gas and power purchase agreements. SMUD uses a combination of cash and securities to satisfy its collateral requirements to counterparties. SMUD's component unit, NCGA, entered into a guaranteed investment contract and is exposed to credit risk related to nonperformance by its investment provider. The investment provider provides collateral if their credit ratings fall below agreed upon levels. At December 31, 2015 and 2014, respectively, SMUD held \$4.4 million and 0.2 million on deposit by counterparties and an investment provider. The amount is recorded as unrestricted cash and current restricted cash with an associated current liability. At December 31, 2015 and 2014, SMUD posted cash collateral of \$48.7 million and \$4.0 million, respectively, with counterparties.

Accounts Receivable and Allowance for Doubtful Accounts. Accounts Receivable is recorded at the invoiced amount and does not bear interest, except for accounts related to energy efficiency loans. SMUD recognizes an estimate of uncollectible accounts for its receivables related to electric service, energy efficiency loans, and other non-electric billings, based upon its historical experience with collections and current energy market conditions. For large wholesale receivable balances, SMUD determines its bad debt reserves based on the specific credit issues for each account. SMUD records bad debts for its estimated uncollectible accounts related to electric service as a reduction to the related operating revenues in the Consolidated Statements of Revenues, Expenses and Changes in Net Position. SMUD records bad debts for its estimated uncollectible accounts related to energy efficiency loans and other non-electric billings in Administrative, General and Customer expense in the Consolidated Statements of Revenues, Expenses and Changes in Net Position.

The summarized activity of the changes in the allowance for doubtful accounts during 2015 and 2014 is presented below:

	Balance at beginning of Year	Additions	Write-offs and (Recoveries)	Balance at end of Year
	(thousands of dollars)			
Other Non-Electric:				
December 31, 2015	\$ 1,993	\$ 691	\$ 913	\$ 1,771
December 31, 2014	\$ 2,346	\$ 623	\$ 976	\$ 1,993
Retail Customers:				
December 31, 2015	\$ 3,017	\$ 5,514	\$ 5,415	\$ 3,116
December 31, 2014	\$ 4,194	\$ 4,887	\$ 6,064	\$ 3,017
Energy Efficiency Loans:				
December 31, 2015	\$ 1,327	\$ (873)	\$ (587)	\$ 1,041
December 31, 2014	\$ 2,104	\$ (982)	\$ (205)	\$ 1,327

Regulatory Deferrals. The Board has the authority to establish the level of rates charged for all SMUD services. As a regulated entity, SMUD's financial statements are prepared in accordance with GASB Statement No. 62 (GASB No. 62), *"Codification of Accounting and financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA*

Pronouncements", which requires that the effects of the rate-making process be recorded in the financial statements. Accordingly, certain expenses and credits, normally reflected in Change in Net Position as incurred, are recognized when included in rates and recovered from, or refunded to, customers. SMUD records various regulatory assets and credits to reflect rate-making actions of the Board (see Note 8).

Materials and Supplies. Materials and supplies are stated at average cost, which approximates the first-in, first-out method.

Compensated Absences. SMUD accrues vacation leave and compensatory time when employees earn the rights to the benefits. SMUD does not record sick leave as a liability until it is taken by the employee, since there are no cash payments for sick leave made when employees terminate or retire. At December 31, 2015 and 2014, the total estimated liability for vacation and other compensated absences was \$23.9 million and \$23.0 million, respectively.

Public Good. Public Good expenses consist of non-capital expenditures for energy efficiency programs, low income subsidies, renewable energy resources and technologies, and research and development.

Gains/Losses on Bond Refundings. Gains and losses resulting from bond refundings are included as a component of Deferred Inflows of Resources or Deferred Outflows of Resources on the Consolidated Statements of Net Position and amortized as a component of Interest on Debt in the Consolidated Statements of Revenues, Expenses and Changes in Net Position over the shorter of the life of the refunded debt or the new debt using the effective interest method.

Gains/Losses on Bond Defeasances or Extinguishments. Gains and losses resulting from bond defeasances or extinguishments that were not financed with the issuance of new debt are included as a component of Interest on Debt in the Consolidated Statements of Revenues, Expenses and Changes in Net Position.

Allowance for Funds Used During Construction (AFUDC). SMUD capitalizes, as an additional cost of Construction Work In Progress (CWIP), AFUDC, which represents the cost of borrowed funds used for such purposes. The amount capitalized is determined by a formula prescribed by FERC. The AFUDC rate for 2015 and 2014 was 2.8 percent and 3.3 percent, of eligible CWIP, respectively.

Derivative Financial Instruments. SMUD records derivative financial instruments (interest rate swap and gas price swap agreements, certain wholesale sales agreements, certain power purchase agreements and option agreements) at fair value on its Consolidated Statements of Net Position. SMUD does not enter into agreements for speculative purposes. Fair market value is estimated by comparing contract prices to forward market prices quoted by third party market participants and/or provided in relevant industry publications. SMUD is exposed to risk of nonperformance if the counterparties default or if the swap agreements are terminated. SMUD reports derivative financial instruments with remaining maturities of one year or less and the portion of long-term contracts with scheduled transactions over the next twelve months as current on the Consolidated Statements of Net Position (see Note 9).

Interest Rate Swap Agreements. SMUD enters into interest rate swap agreements to modify the effective interest rates on outstanding debt (see Notes 9 and 10).

Gas and Electricity Price Swap and Option Agreements. SMUD uses forward contracts to hedge the impact of market volatility on gas commodity prices for its gas-fueled power plants and for energy prices on purchased power for SMUD's retail load (see Note 9).

Solano Wind Sale. SMUD entered into an agreement to sell the Solano Wind Phase 3 plant in December 2011 with a corresponding Power Purchase Agreement for all the output of the plant. In April 2012, under the terms of the Construction Management Agreement, SMUD, on behalf of the purchaser, completed construction of the plant, with the revenue recognition from the transaction, which was accounted for as a financing agreement, to occur over the life of the

contracts. Pursuant to the Facility Administration Agreement, SMUD will perform services at the facility under the direction and for the benefit of the purchaser. Pursuant to the ground and property lease, SMUD is leasing the site to the purchaser for a term of twenty years with an option to extend for five additional years.

The sale proceeds have been recorded as Deferred Inflows of Resources on the Consolidated Statements of Net Position and will be amortized as Purchased Power Expense on the Consolidated Statement of Revenues, Expenses, and Changes in Net Position over the life of the agreement. Sale proceeds in the amount of \$63.1 million were received in 2013. The prepayment for purchased power over the life of the contract has been recorded as Prepaid Power and Capacity on the Consolidated Statements of Net Position and will be amortized as Purchased Power Expense on the Consolidated Statement of Revenues, Expenses, and Changes in Net Position over the life of the agreement (see Note 16 for language about the Power Purchase Agreement).

Precipitation Hedge Agreements. SMUD enters into non-exchange traded precipitation hedge agreements to hedge the cost of replacement power caused by low precipitation years (Precipitation Agreements). SMUD records the intrinsic value of the Precipitation Agreements on the Consolidated Statements of Net Position. Settlement of the Precipitation Agreements is not performed until the end of the period covered (water year ended September 30). The intrinsic value of a Precipitation Agreement is the difference between the expected results from a monthly allocation of the cumulative rainfall amounts, in an average rainfall year, and the actual rainfall during the same period.

Insurance Programs. SMUD records liabilities for unpaid claims at their present value when they are probable in occurrence and the amount can be reasonably estimated. SMUD records a liability for unpaid claims associated with general, auto, workers' compensation, and short-term and long-term disability based upon estimates derived by SMUD's claims administrator or SMUD staff. The liability comprises the present value of the claims outstanding, and includes an amount for claim events incurred but not reported based upon SMUD's experience (see Note 15).

Pollution Remediation. Statement of Governmental Accounting Standards (SGAS) No. 49, "*Accounting and Financial Reporting for Pollution Remediation Obligations*", requires that a liability be recognized for expected outlays for remediating existing pollution when certain triggering events occur. In 2009, SMUD identified a pollution remediation obligation at its North City Substation. This substation was built on a former landfill, and the site requires remediation. In 2015, SMUD identified and recorded a pollution remediation obligation at its Headquarters building that it will be renovating. In addition, SMUD recorded a pollution remediation obligation at the Former Community Linen Rental Services (see Note 17). At December 31, 2015 and 2014, the total pollution remediation liability is \$19.7 million and \$12.2 million, respectively. Costs were estimated using the expected cash flow technique prescribed under GASB.

Hydro License. SMUD owns and operates the Upper American River Hydroelectric Project (UARP). The original license to construct and operate the UARP was issued in 1957 by FERC. In 2014, SMUD received a new hydro license for a term of 50 years, effective July 1, 2014. As part of the hydro licensing process, SMUD entered into four contracts with government agencies whereby SMUD makes annual payments to them for various services for the term of the license. At December 31, 2015 and 2014, the liability for these contract payments is \$55.0 million and \$56.1 million, respectively (see Note 16).

Assembly Bill 32. California Assembly Bill 32 (AB-32) is an effort by the State of California to set a 2020 greenhouse gas emissions reduction goal into law. The goal is to reach a statewide emission limit of 427 million metric tons of carbon dioxide equivalent of greenhouse gases (GHG). Central to this initiative is the implementation of a cap and trade program, which covers major sources of GHG emissions in the State including power plants. The cap and trade program includes an enforceable emissions cap that will decline over time. The State will distribute allowances, which are tradable permits, equal to the emissions allowed under the cap. Sources under the cap will need to surrender allowances and offsets equal to their emissions at the end of each compliance period. SMUD is subject to AB-32. SMUD participated in the program auctions in 2014 and 2015. In a normal water year, SMUD expects its free allocation of allowances from the Air Resources Board will cover its compliance costs associated with electricity delivered to its retail customers. SMUD expects to recover compliance

costs associated with wholesale power sales costs through its wholesale power sales revenues. SMUD is monitoring legislation and proposed programs that would impact AB-32 (see Note 8).

Net Pension Liability (NPL). SMUD implemented SGAS No. 68 “*Accounting and Financial Reporting for Pensions – An Amendment of GASB Statement No. 27*” (GASB No. 68) in 2015 (see Note 3). Under GASB No. 68, the net pension liability is the difference between the actuarial present value of projected pension benefit payments attributable to employees’ past service and the Plan’s fiduciary net position. At December 31, 2015 and 2014, the NPL was \$381.3 million and \$326.7 million, respectively.

Net Position. SMUD classifies its net position into three components as follows:

- Net investment in capital assets – This component of net position consists of capital assets, net of Accumulated Depreciation, reduced by the outstanding debt balances, net of unamortized debt expenses. Deferred inflows and outflows of resources that are attributable to the acquisition, construction or improvement of those assets or related debt are also included.
- Restricted – This component of net position consists of assets with constraints placed on their use, either externally or internally. Constraints include those imposed by debt indentures (excluding amounts considered in net capital, above), grants or laws and regulations of other governments, or by law through constitutional provisions or enabling legislation or by the Board. These restricted assets are reduced by liabilities and deferred inflows of resources related to those assets.
- Unrestricted – This component of net position consists of net amount of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources that do not meet the definition of “Net investment in capital assets” or “Restricted.”

Contributions in Aid of Construction (CIAC). SMUD records CIAC from customer contributions, primarily relating to expansions to SMUD’s distribution facilities, as Other Income - Net in the Consolidated Statements of Revenues, Expenses and Changes in Net Position. Contributions of capital are valued at estimated market cost. For rate-making purposes, the Board does not recognize such revenues when received; rather, CIAC is included in revenues as such costs are amortized over the estimated useful lives of the related distribution facilities.

Revenues and Expenses. SMUD distinguishes operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with SMUD’s principal ongoing operations. The principal operating revenues of SMUD are charges to customers for sales and services. Operating expenses include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Grants. SMUD receives grant proceeds from federal and state assisted programs for its advanced and renewable technologies, electric vehicle, and energy efficiency programs. SMUD also periodically receives grant proceeds from federal or state assistance programs as partial reimbursements for costs it has incurred as a result of storm damages. When applicable, these programs may be subject to financial and compliance audits pursuant to regulatory requirements. SMUD considers the possibility of any material disallowances to be remote. During 2015, SMUD recorded \$3.0 million of grant proceeds and recognized \$2.5 million as a component of Other Income - Net, in the Consolidated Statements of Revenues, Expenses and Changes in Net Position, and \$0.5 million as a Regulatory Credit (see Note 8). During 2014, SMUD recorded \$3.2 million of grant proceeds and recognized \$4.8 million as a component of Other Income - Net, in the Consolidated Statements of Revenues, Expenses and Changes in Net Position, \$1.6 million as a Regulatory Credit (see Note 8), and a \$3.2 million decrease in unearned revenue as a component of Customer Deposits and Other on the Consolidated Statements of Net Position.

In 2010, SMUD issued taxable Build America Bonds. SMUD receives an interest subsidy from the federal government equal to 35 percent of the interest paid (see Note 10). SMUD received reduced subsidy payments in 2015 and 2014 due to budget

sequestration by the federal government. SMUD recognized \$9.1 million in revenues in 2015 and also in 2014 for its Build America Bonds, as a component of Other Income - Net, in the Consolidated Statements of Revenues, Expenses and Changes in Net Position.

Customer Sales and Excise Taxes. SMUD is required by various governmental authorities, including states and municipalities, to collect and remit taxes on certain customer sales. Such taxes are presented on a net basis and excluded from revenues and expenses in the Consolidated Statements of Revenues, Expenses and Changes in Net Position.

Rancho Seco Litigation. In June 1983, SMUD and the U.S. Department of Energy (DOE) entered into a contract whereby the DOE would build a repository for the acceptance and disposal of SMUD's spent nuclear fuel (SNF) and/or high-level radioactive waste (HLW). SMUD paid the DOE a total of approximately \$40.0 million in fees under the contract, thus satisfying its obligation of performance under the contract. DOE did not build a repository and therefore breached its obligation under the contract to commence acceptance of SNF and HLW by January 31, 1998. As a result, SMUD incurred costs to design, license, and fabricate its own on-site storage facility for the long term dry storage of its spent fuel at Rancho Seco. SMUD filed a suit against the DOE in 1998 which covered costs incurred from 1992 through 2003 and filed another suit in 2009 which covered costs incurred from 2004 through 2009. In September 2014 and February 2015, SMUD received awards for \$53.1 million and \$22.5 million from the U. S. Court of Claims, respectively, which were recorded as Other Income – Net in the Consolidated Statements of Revenues, Expenses and Changes in Net Position. In June 2015, SMUD filed a suit against DOE which covered the costs incurred from 2010 through at least June 2015.

Subsequent Events. Subsequent events for SMUD have been evaluated through February 19, 2016, which is the date that the financial statements were available to be issued.

Reclassifications. Certain amounts in the 2014 Consolidated Financial Statements have been reclassified in order to conform to the 2015 presentation.

Recent Accounting Pronouncements. In February 2015, GASB issued SGAS No. 72, "*Fair Value Measurement and Application*" (GASB No. 72). GASB No. 72 addresses accounting and financial reporting issues related to fair value measurements. This statement requires investments to be measured at fair value, which is described as an exit price. This statement requires valuation techniques that are appropriate in the circumstances and for which sufficient data are available to be used to measure fair value. The valuation techniques should be consistent with one or more of the following approaches: the market approach, the cost approach, or the income approach. This statement establishes a hierarchy of inputs to the valuation techniques used to measure fair value. The hierarchy has three levels. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities. Level 2 inputs are inputs, other than quoted prices, included within Level 1 that are observable for the asset or liability, either directly or indirectly. Level 3 inputs are unobservable inputs, such as management assumptions. A fair value takes into account the highest and best use for a nonfinancial asset. This statement requires disclosures to be made about fair value measurements, the level of fair value hierarchy, and valuation techniques. GASB No. 72 is effective for SMUD in 2016. SMUD is currently assessing the financial statement impact of adopting this statement, but does not believe that its impact will be material.

In June 2015, GASB issued SGAS No. 75, "*Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*" (GASB No. 75). The primary objective of GASB No. 75 is to improve accounting and financial reporting by state and local governments for postemployment benefits other than pensions (other postemployment benefits or OPEB). This statement replaces the requirements of SGAS No. 45 "*Accounting and Financial Reporting by Employers for Post Employment Benefits Other Than Pensions*", as amended, and SGAS No. 57 "*OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*". This statement establishes standards for measuring and recognizing liabilities, deferred outflows and deferred inflows of resources, and expenses. For defined benefit OPEB, GASB No. 75 identifies the methods and assumptions that are required to be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. Note disclosure and required

supplementary information requirements about defined benefit OPEB also are addressed. In addition, this statement details the recognition and disclosure requirements for employers with payables to defined benefit OPEB plans that are administered through trusts that meet the specified criteria. This statement is effective for SMUD in 2018. SMUD is currently assessing the financial statement impact of adopting this statement.

In June 2015, GASB issued SGAS No. 76, *“The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments”* (GASB No. 76). GASB No. 76 established the hierarchy of GAAP for state and local governments. This statement supersedes SGAS No. 55, *“The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments”*. The GAAP hierarchy sets forth what constitutes GAAP for all state and local governmental entities. It establishes the order of priority of pronouncements and other sources of accounting and financial reporting guidance that a governmental entity should apply. Category A is comprised of GASB statements. Category B includes GASB Technical Bulletins, GASB Implementation Guides, and literature of the AICPA cleared by the GASB. GASB No. 76 is effective for SMUD in 2016. SMUD is currently assessing the financial statement impact of adopting this statement, but does not believe that its impact will be material.

NOTE 3. ACCOUNTING CHANGE

In June 2012, GASB issued GASB No. 68. The primary objective of GASB No. 68 is to improve accounting and financial reporting by state and local governments for pensions. This statement establishes standards for measuring and recognizing liabilities, deferred outflows and deferred inflows of resources, and expenses. For defined benefit pensions, this statement identifies the methods and assumptions that should be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. Note disclosure and required supplementary information requirements about pensions also are addressed.

This statement is effective for SMUD in 2015. The implementation impacted the Consolidated Statements of Net Position when the net pension liability, the corresponding deferred outflows and deferred inflows of resources, and a reduction in prepaid pension were recorded. SMUD elected to follow accounting for regulated operations under GASB No. 62 and recorded a regulatory asset as of December 31, 2014, in the amount of \$425.7 million to account for the net effect of required prior period adjustments to recognize the net pension liability. Amortization of the regulatory asset will begin in 2018. The implementation also impacted the Consolidated Statements of Revenues, Expenses and Changes in Net Position as a reduction in pension expense was also recorded. SMUD restated the December 31, 2014 Consolidated Statement of Net Position and Consolidated Statement of Revenues, Expenses and Changes in Net Position to reflect the changes for comparative purposes. SMUD has updated Note 13 Pension Plans to include the requirements of GASB No. 68.

In November 2013, GASB issued SGAS No. 71, *“Pension Transition for Contributions Made Subsequent to the Measurement Date, an amendment of GASB Statement No. 68”* (GASB No. 71). GASB No. 71 addresses an issue regarding application of the transition provisions of GASB No. 68. The issue relates to amounts associated with contributions, if any, made by a state or local government employer or nonemployer contributing entity to a defined benefit pension plan after the measurement date of the government’s beginning net pension liability. GASB No. 71 amends paragraph 137 of GASB No. 68 to require that, at transition, a government recognize a beginning deferred outflow of resources for its pension contributions, if any, made subsequent to the measurement date of the beginning net pension liability. This statement is effective for SMUD in 2015 and SMUD has applied it simultaneously with the implementation of GASB No. 68.

SMUD has restated amounts of the affected balances within the financial statements for the period ended December 31, 2014, as follows:

CONSOLIDATED STATEMENT OF NET POSITION

	<u>December 31,</u>	
	<u>2014 (Restated)</u>	<u>2014</u>
	(thousands of dollars)	
Current Assets		
Prepayments	\$ 17,708	\$ 28,952
Noncurrent Assets		
Regulatory costs for future recovery	608,473	182,793
Deferred Outflows of Resources		
Deferred pension outflows	27,269	-0-
Noncurrent Liabilities		
Net pension liability	326,702	-0-
Deferred Inflows of Resources		
Deferred pension inflows	111,405	-0-
Net Position		
Unrestricted	400,967	397,369

CONSOLIDATED STATEMENT OF REVENUE, EXPENSES AND CHANGES IN NET POSITION

	<u>December 31,</u>	
	<u>2014 (Restated)</u>	<u>2014</u>
	(thousands of dollars)	
Operating Expenses		
Operations:		
Production	\$ 401,980	\$ 402,310
Transmission and distribution	63,134	63,475
Administrative, general and customer	166,503	168,353
Public good	73,171	73,315
Maintenance	97,563	98,496
Change in Net Position	166,664	163,066

NOTE 4. UTILITY PLANT

The summarized activity of SMUD's utility plant during 2015 is presented below:

	Balance December 31, <u>2014</u>	<u>Additions</u>	Transfers and <u>Disposals</u>	<u>Reclassifications</u>	Balance December 31, <u>2015</u>
	(thousands of dollars)				
Nondepreciable Utility Plant:					
Land and land rights	\$ 127,914	\$ 2,142	\$ (4)	\$ -0-	\$ 130,052
CWIP	<u>111,594</u>	<u>185,219</u>	<u>(120,742)</u>	<u>-0-</u>	<u>176,071</u>
Total nondepreciable utility plant	<u>239,508</u>	<u>187,361</u>	<u>(120,746)</u>	<u>-0-</u>	<u>306,123</u>
Depreciable Utility Plant:					
Generation	1,632,980	15,917	2,918	-0-	1,651,815
Transmission	292,920	7,849	1,175	-0-	301,944
Distribution	2,052,254	64,313	(4,031)	-0-	2,112,536
Investment in gas properties	206,198	381	-0-	-0-	206,579
Investment in JPAs	14,165	2,283	-0-	-0-	16,448
Intangibles	346,268	11,925	(910)	-0-	357,283
General	<u>902,314</u>	<u>20,562</u>	<u>(61,884)</u>	<u>-0-</u>	<u>860,992</u>
	5,447,099	123,230	(62,732)	-0-	5,507,597
Less: accumulated depreciation and depletion	(2,349,241)	(197,462)	62,597	-0-	(2,484,106)
Less: accumulated amortization on JPAs	<u>(5,401)</u>	<u>(313)</u>	<u>-0-</u>	<u>-0-</u>	<u>(5,714)</u>
	(2,354,642)	(197,775)	62,597	-0-	(2,489,820)
Total depreciable plant	<u>3,092,457</u>	<u>(74,545)</u>	<u>(135)</u>	<u>-0-</u>	<u>3,017,777</u>
Total Utility Plant – Net	<u>\$ 3,331,965</u>	<u>\$ 112,816</u>	<u>\$ (120,881)</u>	<u>\$ -0-</u>	<u>\$ 3,323,900</u>

SMUD is planning a major renovation of its Headquarters building. In 2015, the building was vacated and SMUD retired many of the assets related to this building in the amount of \$50.9 million. The retired assets were removed from Plant in Service and recorded against Accumulated Depreciation.

The summarized activity of SMUD's utility plant during 2014 is presented below:

	Balance December 31, 2013	Additions	Transfers and Disposals	Reclassifications	Balance December 31, 2014
	(thousands of dollars)				
Nondepreciable Utility Plant:					
Land and land rights	\$ 118,532	\$ 9,382	\$ -0-	\$ -0-	\$ 127,914
CWIP	<u>135,385</u>	<u>197,090</u>	<u>(220,881)</u>	<u>-0-</u>	<u>111,594</u>
Total nondepreciable utility plant	<u>253,917</u>	<u>206,472</u>	<u>(220,881)</u>	<u>-0-</u>	<u>239,508</u>
Depreciable Utility Plant:					
Generation	1,654,315	5,079	(26,414)	-0-	1,632,980
Transmission	290,431	2,907	(418)	-0-	292,920
Distribution	1,943,217	71,192	(6,490)	44,335	2,052,254
Investment in gas properties	206,158	40	-0-	-0-	206,198
Investment in JPAs	14,841	-0-	(676)	-0-	14,165
Intangibles	237,314	109,101	(147)	-0-	346,268
General	<u>888,904</u>	<u>24,960</u>	<u>(11,550)</u>	<u>-0-</u>	<u>902,314</u>
	5,235,180	213,279	(45,695)	44,335	5,447,099
Less: accumulated depreciation and depletion	(2,161,032)	(195,939)	52,065	(44,335)	(2,349,241)
Less: accumulated amortization on JPAs	<u>(5,088)</u>	<u>(313)</u>	<u>-0-</u>	<u>-0-</u>	<u>(5,401)</u>
	(2,166,120)	(196,252)	52,065	(44,335)	(2,354,642)
Total depreciable plant	<u>3,069,060</u>	<u>17,027</u>	<u>6,370</u>	<u>-0-</u>	<u>3,092,457</u>
Total Utility Plant – Net	<u>\$ 3,322,977</u>	<u>\$ 223,499</u>	<u>\$ (214,511)</u>	<u>\$ -0-</u>	<u>\$ 3,331,965</u>

NOTE 5. INVESTMENT IN JOINT POWERS AGENCY

TANC. SMUD and fourteen other California municipal utilities are members of TANC, a JPA. TANC, along with the other California municipal utilities, own and operate the California-Oregon Transmission Project (COTP), a 500-kilovolt transmission line between central California and southern Oregon. SMUD is obligated to pay approximately 39.0 percent of TANC's COTP debt service and operations costs in exchange for entitlement to approximately 536 megawatts (MW) of TANC's 1,390 MW transfer capability. Additionally, SMUD has a 48 MW share of TANC's 300 MW firm, bi-directional transmission over Pacific Gas and Electric's (PG&E) system between PG&E's Tesla and Midway substations (SOT). The total entitlement shares for the COTP and SOT described above include the long-term agreements listed below.

In 2009, SMUD entered into a 15-year long-term layoff agreement with TANC and certain members, expiring January 31, 2024. This agreement provides for the assignment of all rights and obligations of City of Palo Alto and City of Roseville related to their COTP and SOT entitlements. This agreement increased SMUD's COTP entitlement by 36 MW and SOT entitlement by 2MW. Effective July 1, 2014, an amendment provides for the return to City of Roseville of all rights and obligations related to the COTP entitlements, which decreased SMUD's COTP entitlement by 13 MW.

In 2014, SMUD entered into a 25-year long-term layoff agreement with TANC and certain members effective July 1, 2014. This agreement provides for the assignment of all rights and obligations of Northern California Power Agency and

partial rights and obligations of the City of Santa Clara related to their COTP entitlements. This agreement increased SMUD's COTP entitlements by 130 MW.

The long-term debt of TANC, which totals \$284.0 million (unaudited) at December 31, 2015, is collateralized by a pledge and assignment of net revenues of TANC supported by take or pay commitments of SMUD and other members. Should other members default on their obligations to TANC, SMUD would be required to make additional payments to cover a portion of such defaulted payments, up to 25 percent of its current obligation.

Copies of the TANC annual financial reports may be obtained from SMUD at 6201 S Street, P.O. Box 15830, Sacramento, California 95852.

SMUD recorded transmission expenses related to TANC of \$24.5 million and \$20.6 million in 2015 and 2014, respectively.

Summary financial information for TANC is presented below:

	<u>December 31,</u>	
	2015	2014
	<u>(Unaudited)</u>	<u>(Unaudited)</u>
	(thousands of dollars)	
Total Assets	\$ 388,977	\$ 399,873
Total Deferred Outflows of Resources	<u>3,262</u>	<u>3,987</u>
Total Assets and Deferred Outflows of Resources	<u>\$ 392,239</u>	<u>\$ 403,860</u>
Total Liabilities	\$ 377,157	\$ 390,574
Total Deferred Inflows of Resources	44	226
Total Net Position	<u>15,038</u>	<u>13,060</u>
Total Liabilities, Inflows of Resources and Net Position	<u>\$ 392,239</u>	<u>\$ 403,860</u>
Changes in Net Position for the Six Months Ended December 31	<u>\$ -0-</u>	<u>\$ 2</u>

BANC. SMUD, City of Redding, City of Roseville, Modesto Irrigation District (MID), City of Shasta Lake, and Trinity Public Utilities District are members of BANC, a JPA formed in 2009. In 2011, operational control of Balancing Authority (BA) operations was transferred from SMUD to BANC. BANC performs FERC approved BA reliability functions that are managed by North American Electric Reliability Corporation (NERC), nationally, and by Western Electricity Coordinating Council functions in the west.

Copies of the BANC annual financial reports may be obtained from SMUD at 6201 S Street, P.O. Box 15830, Sacramento, California 95852.

SMUD recorded expenses related to BANC of \$1.6 million in 2015 and \$0.8 million in 2014.

Summary financial information for BANC is presented below:

	December 31,	
	2015 (Unaudited)	2014 (Audited)
	(thousands of dollars)	
Total Assets	\$ 824	\$ 543
Total Liabilities	\$ 824	\$ 543
Total Net Position	-0-	-0-
Total Liabilities and Net Position	\$ 824	\$ 543
Changes in Net Position for the Year Ended December 31	\$ -0-	\$ -0-

NOTE 6. COMPONENT UNITS

CVFA Carson Cogeneration Project. CVFA is a JPA formed by SMUD and the Sacramento Regional County Sanitation District. CVFA operates the Carson Project, a 65 MW (net) natural gas-fired cogeneration facility and a 43 MW (net) natural gas-fired simple cycle peaking plant. The revenue stream to pay the CVFA bonds’ debt service is provided by a “take-or-pay” power purchase agreement between SMUD and CVFA.

SCA Procter & Gamble Cogeneration Project. SCA is a JPA formed by SMUD and the SFA. SCA operates the Procter & Gamble Project, a 136 MW (net) natural gas-fired cogeneration facility and a 50 MW (net) natural gas-fired simple cycle peaking plant. The revenue stream to pay the SCA bonds’ debt service is provided by a “take-or-pay” power purchase agreement between SMUD and SCA.

SFA Cosumnes Power Plant Project. SFA is a JPA formed by SMUD and MID. SFA operates the Cosumnes Power Plant Project, a 501 MW (net) natural gas-fired, combined cycle facility. The revenue stream to pay the SFA bonds’ debt service is provided by a “take-or-pay” power purchase agreement between SMUD and SFA.

SPA Campbell Soup Cogeneration Project. SPA is a JPA formed by SMUD and the SFA. SPA operates the Campbell Soup Project, a 160 MW (net) natural gas-fired cogeneration facility, and the McClellan Project, a 72 MW (net) natural gas-fired simple cycle peaking plant.

NCGA. NCGA is a JPA formed by SMUD and the SFA. NCGA has a prepaid gas contract with Morgan Stanley Capital Group (MSCG) expiring in 2027, which is financed primarily by NCGA revenue bonds. SMUD has contracted with NCGA to purchase all of the gas delivered by MSCG to NCGA, based on market prices. NCGA is obligated to pay the principal and interest on the bonds. Neither SMUD nor SFA is obligated to make debt service payments on the bonds. NCGA can terminate the prepaid gas contract under certain circumstances, including a failure by MSCG to meet its gas delivery obligation to NCGA or a drop in MSCG’s credit rating below a specified level. If this occurs, MSCG will be required to make a termination payment to NCGA based on the unamortized prepayment proceeds received by MSCG.

As described in Note 2, all of the activities and balances of the component units are blended into and reported as part of SMUD because of the extent of their operational and financial relationships with SMUD. Copies of CVFA’s, SCA’s, SFA’s, SPA’s and NCGA’s annual financial reports may be obtained from their Executive Office at 6201 S Street, P.O. Box 15830, Sacramento, California 95852 or online at SMUD.org.

The summarized activity of SMUD's component units for 2015 is presented below:

CONDENSED STATEMENTS OF NET POSITION
December 31, 2015
(thousands of dollars)

	<u>CVFA</u>	<u>SCA</u>	<u>SFA</u>	<u>SPA</u>	<u>NCGA</u>
Assets					
Electric Utility Plant - Net	\$ 53,394	\$ 80,484	\$ 244,251	\$ 71,838	\$ -0-
Current Assets	16,183	26,373	57,170	20,190	51,507
Noncurrent Assets	<u>123</u>	<u>179</u>	<u>1,414</u>	<u>3</u>	<u>289,108</u>
Total Assets	69,700	107,036	302,835	92,031	340,615
Deferred Outflows of Resources	<u>775</u>	<u>1,071</u>	<u>4,098</u>	<u>-0-</u>	<u>-0-</u>
Total Assets and Deferred Outflows of Resources	<u>\$ 70,475</u>	<u>\$ 108,107</u>	<u>\$ 306,933</u>	<u>\$ 92,031</u>	<u>\$ 340,615</u>
Liabilities					
Long-Term Debt - Net	\$ 20,828	\$ 31,316	\$ 198,415	\$ -0-	\$ 292,870
Current Liabilities	10,680	14,666	56,363	8,831	33,524
Noncurrent Liabilities	<u>9,071</u>	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>
Total Liabilities	40,579	45,982	254,778	8,831	326,394
Net Position	<u>29,896</u>	<u>62,125</u>	<u>52,155</u>	<u>83,200</u>	<u>14,221</u>
Total Liabilities and Net Position	<u>\$ 70,475</u>	<u>\$ 108,107</u>	<u>\$ 306,933</u>	<u>\$ 92,031</u>	<u>\$ 340,615</u>

CONDENSED STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
December 31, 2015
(thousands of dollars)

	<u>CVFA</u>	<u>SCA</u>	<u>SFA</u>	<u>SPA</u>	<u>NCGA</u>
Operating Revenues	\$ 35,390	\$ 61,255	\$ 214,564	\$ 55,209	\$ 38,871
Operating Expenses	<u>33,678</u>	<u>54,535</u>	<u>197,697</u>	<u>54,610</u>	<u>25,122</u>
Operating Income	1,712	6,720	16,867	599	13,749
Non-Operating Revenues and Expenses					
Other Revenues	1	2	183	24	649
Interest Charges and Other	<u>(1,401)</u>	<u>(1,856)</u>	<u>(7,198)</u>	<u>(1,314)</u>	<u>(13,965)</u>
Change in Net Position Before Distributions and Contributions	312	4,866	9,852	(691)	433
Distribution to Member	-0-	(800)	(62,000)	(6,000)	(698)
Member Contributions and Adjustments	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>	<u>28,200</u>	<u>102</u>
Change in Net Position	312	4,066	(52,148)	21,509	(163)
Net Position – Beginning of Year	<u>29,584</u>	<u>58,059</u>	<u>104,303</u>	<u>61,691</u>	<u>14,384</u>
Net Position – End of Year	<u>\$ 29,896</u>	<u>\$ 62,125</u>	<u>\$ 52,155</u>	<u>\$ 83,200</u>	<u>\$ 14,221</u>

CONDENSED STATEMENTS OF CASH FLOWS
December 31, 2015
(thousands of dollars)

	<u>CVFA</u>	<u>SCA</u>	<u>SFA</u>	<u>SPA</u>	<u>NCGA</u>
Net Cash Provided by Operating Activities	\$ 7,674	\$ 14,269	\$ 36,251	\$ 8,453	\$ 38,755
Net Cash Provided by (Used in) Noncapital Financing Activities	-0-	(800)	(62,000)	52,105	(38,589)
Net Cash Used in Capital Financing Activities	(6,675)	(9,851)	(37,294)	(74,998)	-0-
Net Cash Provided by Investing Activities	<u>1</u>	<u>1</u>	<u>14,861</u>	<u>6,581</u>	<u>649</u>
Net Increase (Decrease) in Cash and Cash Equivalents	1,000	3,619	(48,182)	(7,859)	815
Cash and Cash Equivalents at the Beginning of the Year	<u>5,372</u>	<u>8,621</u>	<u>69,880</u>	<u>12,016</u>	<u>15,042</u>
Cash and Cash Equivalents at the End of the Year	<u>\$ 6,372</u>	<u>\$ 12,240</u>	<u>\$ 21,698</u>	<u>\$ 4,157</u>	<u>\$ 15,857</u>

The summarized activity of SMUD's component units for 2014 is presented below:

CONDENSED STATEMENTS OF NET POSITION
December 31, 2014
(thousands of dollars)

	<u>CVFA</u>	<u>SCA</u>	<u>SFA</u>	<u>SPA</u>	<u>NCGA</u>
Assets					
Electric Utility Plant - Net	\$ 57,861	\$ 84,537	\$ 253,204	\$ 77,544	\$ -0-
Restricted and Designated Assets	-0-	-0-	69,887	11,810	-0-
Current Assets	14,660	23,422	49,463	54,081	43,479
Noncurrent Assets	<u>158</u>	<u>218</u>	<u>3,468</u>	<u>797</u>	<u>316,997</u>
Total Assets	72,679	108,177	376,022	144,232	360,476
Deferred Outflows of Resources	<u>1,095</u>	<u>1,430</u>	<u>-0-</u>	<u>1,597</u>	<u>-0-</u>
Total Assets and Deferred Outflows of Resources	<u>\$ 73,774</u>	<u>\$ 109,607</u>	<u>\$ 376,022</u>	<u>\$ 145,829</u>	<u>\$ 360,476</u>
Liabilities					
Long-Term Debt - Net	\$ 25,563	\$ 36,885	\$ 228,928	\$ 35,151	\$ 318,795
Current Liabilities	10,167	14,663	42,791	48,987	27,297
Noncurrent Liabilities	<u>8,460</u>	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>
Total Liabilities	44,190	51,548	271,719	84,138	346,092
Net Position	<u>29,584</u>	<u>58,059</u>	<u>104,303</u>	<u>61,691</u>	<u>14,384</u>
Total Liabilities and Net Position	<u>\$ 73,774</u>	<u>\$ 109,607</u>	<u>\$ 376,022</u>	<u>\$ 145,829</u>	<u>\$ 360,476</u>

CONDENSED STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
December 31, 2014
(thousands of dollars)

	<u>CVFA</u>	<u>SCA</u>	<u>SFA</u>	<u>SPA</u>	<u>NCGA</u>
Operating Revenues	\$ 32,983	\$ 59,378	\$ 231,388	\$ 54,645	\$ 37,912
Operating Expenses	<u>32,035</u>	<u>53,837</u>	<u>206,429</u>	<u>52,649</u>	<u>22,927</u>
Operating Income	948	5,541	24,959	1,996	14,985
Non-Operating Revenues and Expenses					
Other Revenues	1	1	151	45	621
Interest Charges and Other	<u>(1,593)</u>	<u>(2,082)</u>	<u>(10,895)</u>	<u>(3,744)</u>	<u>(14,901)</u>
Change in Net Position Before Distributions and Contributions	(644)	3,460	14,215	(1,703)	705
Distribution to Member	-0-	(2,000)	(4,500)	-0-	(671)
Member Contributions and Adjustments	<u>-0-</u>	<u>-0-</u>	<u>-0-</u>	<u>29,905</u>	<u>82</u>
Change in Net Position	(644)	1,460	9,715	28,202	116
Net Position – Beginning of Year	<u>30,228</u>	<u>56,599</u>	<u>94,588</u>	<u>33,489</u>	<u>14,268</u>
Net Position – End of Year	<u>\$ 29,584</u>	<u>\$ 58,059</u>	<u>\$ 104,303</u>	<u>\$ 61,691</u>	<u>\$ 14,384</u>

CONDENSED STATEMENTS OF CASH FLOWS
December 31, 2014
(thousands of dollars)

	<u>CVFA</u>	<u>SCA</u>	<u>SFA</u>	<u>SPA</u>	<u>NCGA</u>
Net Cash Provided by Operating Activities	\$ 6,510	\$ 11,557	\$ 44,003	\$ 8,581	\$ 37,891
Net Cash Used in Noncapital Financing Activities	-0-	(2,000)	(4,500)	-0-	(38,180)
Net Cash Used in Capital Financing Activities	(5,894)	(7,676)	(23,206)	(11,469)	-0-
Net Cash Provided by Investing Activities	<u>1</u>	<u>2</u>	<u>282</u>	<u>1,098</u>	<u>621</u>
Net Increase (Decrease) in Cash and Cash Equivalents	617	1,883	16,579	(1,790)	332
Cash and Cash Equivalents at the Beginning of the Year	<u>4,755</u>	<u>6,738</u>	<u>53,301</u>	<u>13,806</u>	<u>14,710</u>
Cash and Cash Equivalents at the End of the Year	<u>\$ 5,372</u>	<u>\$ 8,621</u>	<u>\$ 69,880</u>	<u>\$ 12,016</u>	<u>\$ 15,042</u>

NOTE 7. CASH, CASH EQUIVALENTS, AND INVESTMENTS

Cash Equivalents and Investments. SMUD’s investment policy is governed by the California State and Municipal Codes and its Indenture, which allow SMUD’s investments to include: obligations which are unconditionally guaranteed by the United States (U.S.) Government or its agencies or instrumentalities; direct and general obligations of the State or any local agency within the State; bankers’ acceptances; commercial paper; certificates of deposit; repurchase agreements; corporate notes; and taxable government and tax-exempt money market portfolios. SMUD’s investment policy includes restrictions for investments relating to maximum amounts invested as a percentage of total portfolio and with a single issuer, maximum maturities, and minimum credit ratings.

Credit Risk. This is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. To mitigate this risk, SMUD limits investments to those rated, at a minimum, “A-1” or equivalent for commercial paper and “A” or equivalent for medium-term corporate notes by a nationally recognized rating agency.

Custodial Credit Risk. This is the risk that, in the event of the failure of a depository financial institution or counterparty to a transaction, SMUD’s deposits may not be returned or SMUD will not be able to recover the value of its deposits, investments or collateral securities that are in the possession of another party. SMUD does not have a deposit policy for custodial credit risk.

As of December 31, 2015 and 2014, \$23.2 million and \$9.7 million in deposits were uninsured, respectively. The bank balance is also, per a depository pledge agreement between SMUD and SMUD’s bank, collateralized at 117 percent and 132 percent of the collective funds on deposit (increased by the amount of accrued but uncredited interest, reduced by deposits covered by FDIC) at December 31, 2015 and 2014, respectively. At December 31, 2015 and 2014, SMUD had money market deposit accounts and mutual funds of \$109.3 million and \$161.1 million which were uninsured, respectively. SMUD’s investments and money market mutual funds are held in SMUD’s name.

Concentration of Credit Risk. This is the risk of loss attributed to the magnitude of an entity’s investment in a single issuer. SMUD places no limit on the amounts invested in any one issuer for repurchase agreements and federal agency securities. The following are the concentrations of risk greater than five percent in either year:

Investment Type:	December 31,	
	2015	2014
Federal National Mortgage Association (Fannie Mae)	0%	7%
Federal Home Loan Banks	21%	23%
Freddie Mac	24%	21%
Federal Farm Credit Bank	7%	7%
Corporate Note – Bank of New York	7%	7%
Corporate Note – Wells Fargo & Company	9%	7%

Interest Rate Risk. This is the risk of loss due to the fair value of an investment falling due to interest rates rising. Though SMUD has restrictions as to the maturities of some of the investments, it does not have a formal policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

The following schedules indicate the credit and interest rate risk at December 31, 2015 and 2014. The credit ratings listed are from Standard & Poors (S&P). (N/A is defined as not applicable to the rating disclosure requirements).

At December 31, 2015, SMUD’s cash, cash equivalents, and investments consist of the following:

Description	Credit Rating	Remaining Maturities (in years)			Total Fair Value
		Less Than 1	1-5	More than 5	
(thousands of dollars)					
Cash and Cash Equivalents:					
Cash	N/A	\$ 16,681	\$ -0-	\$ -0-	\$ 16,681
LAIF	Not Rated	119,223	-0-	-0-	119,223
Money Market Mutual Funds	AAAm/NR	72,102	-0-	-0-	72,102
Money Market Deposit Account	N/A	37,490	-0-	-0-	37,490
Deposit at Notice	N/A	1,593	-0-	-0-	1,593
Commercial Paper	A-1	<u>12,314</u>	<u>-0-</u>	<u>-0-</u>	<u>12,314</u>
Total cash and cash equivalents		259,403	-0-	-0-	259,403
Investments:					
Federal Farm Credit Bank	AA+	14,934	15,505	-0-	30,439
Federal Home Loan Bank	AA+	74,975	19,880	-0-	94,855
Freddie Mac	AA+	-0-	104,759	-0-	104,759
US Treasury	N/A	8,197	14,945	-0-	23,142
Corporate Notes	AA+/AA/A+/A	109,796	66,643	-0-	176,439
Municipal Bonds	AA/AA-	<u>1,500</u>	<u>23,745</u>	<u>-0-</u>	<u>25,245</u>
Total investments		<u>209,402</u>	<u>245,477</u>	<u>-0-</u>	<u>454,879</u>
Total cash, cash equivalents, and investments		<u>\$ 468,805</u>	<u>\$ 245,477</u>	<u>\$ -0-</u>	<u>\$ 714,282</u>

At December 31, 2014, SMUD's cash, cash equivalents, and investments consist of the following:

<u>Description</u>	<u>Credit Rating</u>	<u>Remaining Maturities (in years)</u>			<u>Total Fair Value</u>
		<u>Less Than 1</u>	<u>1-5</u>	<u>More than 5</u>	
(thousands of dollars)					
Cash and Cash Equivalents:					
Cash	N/A	\$ 4,350	\$ -0-	\$ -0-	\$ 4,350
LAIF	Not Rated	150,745	-0-	-0-	150,745
Money Market Mutual Funds	AAAm/N/A	124,990	-0-	-0-	124,990
Money Market Deposit Account	N/A	36,390	-0-	-0-	36,390
Deposit at Notice	N/A	9,319	-0-	-0-	9,319
Commercial Paper	A-1	<u>11,267</u>	<u>-0-</u>	<u>-0-</u>	<u>11,267</u>
Total cash and cash equivalents		337,061	-0-	-0-	337,061
Investments:					
Fannie Mae	AA+	20,248	19,962	-0-	40,210
Federal Farm Credit Bank	AA+	32,057	5,545	-0-	37,602
Federal Home Loan Bank	AA+	47,899	75,843	-0-	123,742
Freddie Mac	AA+	19,968	95,484	-0-	115,452
US Treasury	N/A	3,055	13,142	-0-	16,197
Corporate Notes	AA+/AA/A+/A/A-	100,476	83,325	-0-	183,801
Municipal Bonds	A+/AA	2,502	1,501	-0-	4,003
Commercial Paper	A-1+	<u>26,954</u>	<u>-0-</u>	<u>-0-</u>	<u>26,954</u>
Total investments		<u>253,159</u>	<u>294,802</u>	<u>-0-</u>	<u>547,961</u>
Total cash, cash equivalents, and investments		<u>\$ 590,220</u>	<u>\$ 294,802</u>	<u>\$ -0-</u>	<u>\$ 885,022</u>

SMUD's cash, cash equivalents, and investments are classified in the Consolidated Statements of Net Position as follows:

	<u>December 31,</u>	
	<u>2015</u>	<u>2014</u>
(thousands of dollars)		
Total Cash, Cash Equivalents, and Investments:		
Revenue bond reserve and debt service funds:		
Revenue bond reserve fund	\$ 7,395	\$ 8,659
Debt service fund	67,545	67,551
Component unit bond reserve and debt service funds	<u>39,291</u>	<u>54,220</u>
Total revenue bond reserve and debt service funds	114,231	130,430
Nuclear decommissioning trust fund	8,292	8,250
Rate stabilization fund	30,251	45,306
Component unit other restricted funds	4,228	65,198
Escrow fund	1,200	900
Other restricted funds	654	654
Unrestricted funds	<u>555,426</u>	<u>634,284</u>
Total cash, cash equivalents, and investments	<u>\$ 714,282</u>	<u>\$ 885,022</u>

NOTE 8. REGULATORY DEFERRALS

The Board has taken various regulatory actions that result in differences between the recognition of revenues and expenses for rate-making purposes and their treatment under generally accepted accounting principles for non-regulated entities. These actions result in regulatory assets and liabilities, which are summarized in the tables below. Changes to these balances, and their inclusion in rates, occur only at the direction of the Board.

Regulatory Assets (Costs)

Decommissioning. SMUD's regulatory asset relating to the unfunded portion of its decommissioning liability is being collected through interest earnings on the Trust Fund. Nuclear fuel storage costs and non-radiological decommissioning costs have been collected in rates since 2009.

Derivative Financial Instruments. SMUD's regulatory costs and/or credits relating to Investment Derivative Instruments are intended to defer the net difference between the fair value of derivative instruments and their cost basis, if any. Investment Derivative Instruments are reflected in rates at contract cost and as such, the balance is charged or credited into rates as the related asset or liability is utilized (see Note 9).

Senate Bill 1. SMUD implemented a per kilowatt hour solar surcharge, effective January 1, 2008 in order to fund investments in solar required by Senate Bill 1 (SB-1). The difference between the surcharge revenues received and the funds spent on solar initiatives will be recognized or deferred into future years. SMUD has spent more than it has collected in SB-1 revenues and has recorded a regulatory asset.

Debt Issuance Costs. SMUD established a regulatory asset for costs incurred in connection with the issuance of debt obligations, principally underwriter fees and legal costs. The regulatory asset will be collected in rates over the life of the bonds. Debt issuance costs after December 31, 2013 are expensed.

Pension. SMUD established a regulatory asset for pension costs related to the implementation of GASB No. 68 which requires SMUD to record a net pension liability. Amortization of the regulatory asset will begin in 2018 as part of the next rate case.

SMUD's total regulatory costs for future recovery are presented below:

	<u>December 31,</u>	
	<u>2015</u>	<u>2014 (restated)</u>
	(thousands of dollars)	
Regulatory Costs:		
Decommissioning	\$ 149,192	\$ 149,337
Derivative financial instruments	32,787	32,144
Senate Bill 1	3,217	7,398
Debt Issuance Costs	13,300	14,752
Pension	<u>425,680</u>	<u>425,680</u>
Total regulatory costs	624,176	629,311
Less: regulatory costs to be recovered within one year	<u>(21,242)</u>	<u>(20,838)</u>
Total regulatory costs for future recovery - net	<u>\$ 602,934</u>	<u>\$ 608,473</u>

Regulatory Credits

CIAC. In 2015 and 2014 SMUD added CIAC totaling \$16.9 million and \$20.2 million, respectively, to Regulatory Credits in the Consolidated Statements of Net Position and recorded \$10.9 million and \$10.4 million of amortization, respectively, to Other Income - Net in the Consolidated Statements of Revenues, Expenses and Changes in Net Position. SMUD's regulatory credit relating to CIAC is intended to offset the revenue and expense associated with this accounting treatment. Thus, this

regulatory credit is being amortized into rates over the depreciable lives of the related assets in order to offset the earnings effect of these non-exchange transactions.

Rate Stabilization. SMUD’s regulatory credit relating to Rate Stabilization is intended to defer the need for future rate increases when costs exceed existing rates. At the direction of the Board, amounts may be either transferred into this fund (which reduces revenues), or amounts are transferred out of this fund (which increases revenues). The Board authorizes Rate Stabilization Fund (RSF) transfers on an event driven basis. In 2015, \$12.0 million was transferred from the RSF to revenue as a result of lower than budgeted energy deliveries from Western Area Power Administration (Western).

Hydro Rate Stabilization. The Hydro Rate Stabilization Fund (HRSF) was established through the Hydro Generation Adjustment (HGA) mechanism, which helps manage volatility in energy costs. The HGA mechanism applies a formula based on precipitation and wholesale electricity prices to calculate needed withdrawals from or deposits to the HRSF. The maximum balance of the HRSF is 5 percent of the budgeted retail revenue and the maximum annual transfer in or out of the HRSF is 4 percent of budgeted retail revenue. If the HRSF is depleted SMUD will apply a hydro rate surcharge to customers’ bills up to 4 percent. When the HRSF is fully replenished, a wet year can trigger a hydro rebate or credit on the customers’ bills. In 2015, \$3.1 million was transferred from the HRSF to revenue as a result of below average precipitation. In April 2015, the HRSF was depleted and a hydro rate surcharge was implemented.

Assembly Bill 32. SMUD participated in the carbon allowance auctions under AB-32, the Global Warming Solutions Act (see Note 2). In 2012, the Board authorized the deferral of AB-32 auction proceeds to match the revenue recognition with the related expenses. The difference between the auction proceeds received and the funds spent on AB-32 programs are deferred into future years. At December 31, 2015, all proceeds have been spent.

Grant Revenues. In 2009, SMUD was awarded several large grants under the ARRA, which provided large amounts of reimbursements for capital expenditures. In 2010, the Board authorized the deferral of grant income for capital expenditures as regulatory liabilities. Thus, this regulatory credit will be deferred to match the depreciable lives of the related capital assets in order to offset the earnings effect of these non-exchange transactions.

TANC Operations Costs. SMUD’s regulatory asset relating to deferred TANC costs comprises the difference between its cash payments made to TANC and its share of TANC’s accrual-based costs of operations. This regulatory asset is being collected in rates over the life of TANC’s assets during the period that cash payments to TANC exceed TANC’s accrual-based costs. SMUD’s cash payments to TANC exceeded TANC’s accrual-based costs and has recorded a regulatory credit.

SMUD’s total regulatory credits for future revenue recognition are presented below:

	<u>December 31,</u>	
	<u>2015</u>	<u>2014</u>
	(thousands of dollars)	
Regulatory Credits:		
CIAC	\$ 247,413	\$ 241,427
Rate stabilization	30,251	42,251
Hydro rate stabilization	-0-	3,055
Assembly Bill 32	-0-	5,339
Grant revenues	59,949	69,172
TANC operations costs	<u>16,208</u>	<u>7,687</u>
Total regulatory credits	<u>\$ 353,821</u>	<u>\$ 368,931</u>

NOTE 9. DERIVATIVE FINANCIAL INSTRUMENTS

To help provide stable electric rates and to meet the forecasted power needs of its retail customers reliably, SMUD enters into various physical and financial fixed price purchase contracts for electricity and natural gas. These fixed price contracts and swap agreements are intended to hedge the exposure due to highly volatile commodity prices. SMUD also enters into interest rate swap agreements to reduce interest rate risk, or to enhance the relationship between the risk and return regarding SMUD's assets or debt obligations. SMUD utilizes these derivative financial instruments to mitigate its exposure to certain market risks associated with ongoing operations. SMUD has established policies set by an executive committee for the use of derivative financial instruments for trading purposes. These contracts are evaluated pursuant to SGAS No. 53 "***Accounting and Financial Reporting for Derivative Instruments***" (GASB No. 53) to determine whether they meet the definition of derivative instruments, and if so, whether they effectively hedge the expected cash flows associated with interest rate and commodity price risk exposures.

SMUD applies hedge accounting for derivatives that are deemed effective hedges. Under hedge accounting, the increase or (decrease) in the fair value of a hedge is reported as a Deferred Inflow or Deferred Outflow on the Consolidated Statements of Net Position. Derivatives that do not meet the effectiveness tests are deferred for rate-making purposes as regulatory assets or liabilities on the Consolidated Statements of Net Position (see Note 8).

During 2015 and 2014, SMUD executed numerous new gas and power related purchase agreements, some of which are recorded as hedging or investment derivatives and are therefore included in the following table. All hedging or investment derivatives are recorded at fair value on the Consolidated Statements of Net Position.

For electricity and gas derivatives, fair values are estimated by comparing contract prices to forward market prices quoted by an independent external pricing service. When external quoted market prices are not available for derivative contracts, SMUD uses an internally developed valuation model utilizing short term observable inputs. For interest rate derivatives, SMUD subscribes to a financial information service that it uses to verify fair value estimates obtained from its counterparties.

The following is a summary of the fair values, changes in fair value and notional amounts of derivative instruments, grouped by trading strategy, outstanding at December 31, 2015 (amounts in thousands; gains shown as positive amounts, losses as negative):

	2015 Changes in Fair Value		Fair Value at December 31, 2015		Notional
	Current Amount	Noncurrent Amount	Current Amount	Noncurrent Amount	
<u>Cash Flow Hedges:</u>					
(thousands of dollars)					
(thousands of Dekatherms (Dth))					
<u>Asset: Investment Derivative Instruments</u>					
Gas – Transportation	\$ (39)	\$ -0-	\$ -0-	\$ -0-	
Total Investment					
Derivative Instruments	\$ (39)	\$ -0-	\$ -0-	\$ -0-	
<u>Asset: Hedging Derivative Instruments</u>					
Gas – Basis	\$ (237)	\$ (179)	\$ 323	\$ -0-	1,830 Dth
Gas – Commodity	(56)	-0-	804	-0-	1,293 Dth
Gas – Storage	3	-0-	45	-0-	233 Dth
Gas – Transportation	(739)	(149)	284	-0-	1,830 Dth
Interest Rate	(256)	(2,100)	6,284	23,275	\$131,030
Total Hedging					
Derivative Instruments	\$ (1,285)	\$ (2,428)	\$ 7,740	\$ 23,275	
<u>Liability: Investment Derivative Instruments</u>					
Gas – Basis	\$ 331	\$ -0-	\$ -0-	\$ -0-	
Gas – Commodity	(2,455)	(2,976)	7,044	7,204	10,443 Dth
Interest Rate	1,840	2,657	5,535	13,003	\$192,430
Total Investment					
Derivative Instruments	\$ (284)	\$ (319)	\$ 12,579	\$ 20,207	
<u>Liability: Hedging Derivative Instruments</u>					
Gas – Basis	\$ 2,127	\$ -0-	\$ 163	\$ -0-	465 Dth
Gas – Commodity	(15,079)	(34,116)	64,449	134,422	111,609 Dth
Gas – Storage	(363)	-0-	381	-0-	1,835 Dth
Gas – Transportation	(158)	-0-	207	-0-	1,240 Dth
Total Hedging					
Derivative Instruments	\$ (13,473)	\$ (34,116)	\$ 65,200	\$ 134,422	

The following is a summary of the fair values, changes in fair value and notional amounts of derivative instruments, grouped by trading strategy, outstanding at December 31, 2014 (amounts in thousands; gains shown as positive amounts, losses as negative):

	2014 Changes in Fair Value		Fair Value at December 31, 2014		Notional
	Current Amount	Noncurrent Amount	Current Amount	Noncurrent Amount	
<u>Cash Flow Hedges:</u>					
(thousands of dollars)					
(thousands of Dekatherms (Dth))					
<u>Asset: Investment Derivative Instruments</u>					
Gas – Commodity	\$ (272)	\$ (147)	\$ -0-	\$ -0-	
Gas – Storage	(7)	-0-	-0-	-0-	
Gas – Transportation	39	-0-	39	-0-	380 Dth
Total Investment					
Derivative Instruments	\$ (240)	\$ (147)	\$ 39	\$ -0-	
<u>Asset: Hedging Derivative Instruments</u>					
Gas – Basis	\$ 37	\$ (476)	\$ 560	\$ 179	9,860 Dth
Gas – Commodity	(1,115)	(176)	860	-0-	893 Dth
Gas – Storage	21	-0-	42	-0-	528 Dth
Gas – Transportation	688	(826)	1,023	149	10,955 Dth
Interest Rate	(485)	1,477	6,540	25,375	\$131,030
Total Hedging					
Derivative Instruments	\$ (854)	\$ (1)	\$ 9,025	\$ 25,703	
<u>Liability: Investment Derivative Instruments</u>					
Gas – Basis	\$ (331)	\$ -0-	\$ 331	\$ -0-	300 Dth
Gas – Commodity	(4,552)	(3,914)	4,589	4,228	10,510 Dth
Gas – Storage	2	-0-	-0-	-0-	
Interest Rate	1,649	(285)	7,375	15,660	\$227,190
Total Investment					
Derivative Instruments	\$ (3,232)	\$ (4,199)	\$ 12,295	\$ 19,888	
<u>Liability: Hedging Derivative Instruments</u>					
Gas – Basis	\$ (2,290)	\$ -0-	\$ 2,290	\$ -0-	2,140 Dth
Gas – Commodity	(33,552)	(14,162)	49,370	100,306	101,268 Dth
Gas – Storage	376	-0-	18	-0-	288 Dth
Gas – Transportation	(49)	-0-	49	-0-	3,270 Dth
Total Hedging					
Derivative Instruments	\$ (35,515)	\$ (14,162)	\$ 51,727	\$ 100,306	

Objectives and Terms of Hedging Derivative Instruments. The objectives and terms of SMUD’s hedging derivative instruments that were outstanding at December 31, 2015 are summarized in the table below. The table is aggregated by the trading strategy. Credit ratings of SMUD’s counterparties can be found in the table under Credit Risk. Details of SMUD’s interest rate derivative instruments can be found in Note 10.

	<u>Notional Amount Dth</u>	<u>Beginning Date</u>	<u>Ending Date</u>	<u>Minimum Price/Dth</u>	<u>Maximum Price/Dth</u>
Gas – Basis	2,295	01/01/16	12/31/16	\$ (0.82)	\$ (0.25)
Gas – Commodity	123,345	01/01/08	12/31/22	2.82	7.17
Gas – Storage	2,068	01/01/16	12/31/16	.15	.62
Gas – Transportation	3,070	01/01/16	12/31/16	(0.19)	.29

The objectives and terms of SMUD’s hedging derivative instruments that were outstanding at December 31, 2014 are summarized in the table below. The table is aggregated by the trading strategy.

	<u>Notional Amount Dth</u>	<u>Beginning Date</u>	<u>Ending Date</u>	<u>Minimum Price/Dth</u>	<u>Maximum Price/Dth</u>
Gas – Basis	12,300	01/01/15	12/31/16	\$ (0.82)	\$ 3.39
Gas – Commodity	112,671	01/01/08	12/31/22	3.15	7.17
Gas – Storage	816	01/01/15	03/31/15	.25	.40
Gas – Transportation	14,605	01/01/15	12/31/16	(0.36)	(0.13)

SMUD hedges its interest costs. The interest rate swaps are designed to synthetically fix the cash flows associated with variable rate bonds (see Note 10).

SMUD hedges its power and natural gas costs so that it can offer predictable rates to its retail electric customers and support its credit rating. SMUD maintains a risk management program to control the price, credit, and operational risks arising from its power and natural gas market activities. Under the program, authorized SMUD employees assemble a portfolio of swaps, futures, and forward contracts over time with the goal of making SMUD’s purchased power and fuel budget more predictable.

These hedged risks include those related to interest rate and commodity price fluctuations associated with certain forecasted transactions, including interest rate risk on long-term debt, and forward purchases of gas and electricity to meet load.

Derivatives Not Designated as Hedging Instruments

Gas and Electric Contracts. SMUD utilizes certain gas swap and electric swap agreements under GASB No. 53 not designated as hedging derivative instruments to mitigate exposure to changes in the market price of natural gas and electricity. The fair value of each agreement, excluding the actual settlements to be paid or received as of the end of the period, is recorded in either Current or Noncurrent Assets, Investment Derivative Instruments on the Consolidated Statements of Net Position if in an asset position or Current or Noncurrent Liabilities, Investment Derivative Instruments on the Consolidated Statements of Net Position if in a liability position. An offsetting amount is included in Current or Noncurrent Regulatory Costs or Regulatory Credits for future recovery in the Consolidated Statements of Net Position. The actual settlement payable is recorded in Accounts Payable on the Consolidated Statements of Net Position, and the actual settlement receivable is recorded in Receivables – Net: Other on the Consolidated Statements of Net Position. The payments and receipts of the actual settlement are recorded as Investment Expense in the Consolidated Statements of Revenues, Expenses and Changes in Net Position.

Interest Rate Contracts. SMUD utilizes certain interest rate swap agreements not designated as hedging derivative instruments under GASB No. 53 to mitigate exposure to changes in the fair value of variable rate debt resulting from fluctuations in interest rates. The fair value of each agreement, excluding the balance of interest to be paid or received as of

the end of the period, is recorded in either Current or Noncurrent Assets, Investment Derivative Instruments on the Consolidated Statements of Net Position if in an asset position or Current or Noncurrent Liabilities, Investment Derivative Instruments on the Consolidated Statements of Net Position if in a liability position. An offsetting amount is included in Current or Noncurrent Regulatory Costs or Deferred Outflows or Inflows of Resources in the Consolidated Statements of Net Position. The interest receivable is recorded in Receivables – Net: Other on the Consolidated Statements of Net Position, and the accrued interest is recorded in Interest Payable on the Consolidated Statements of Net Position. The payments or receipts of the actual settlement are recorded as Investment Expense in the Consolidated Statements of Revenues, Expenses and Changes in Net Position.

The Board has deferred recognition of the effects of reporting the fair value of Investment Derivative Instruments for rate-making purposes, and maintains regulatory accounts to defer the accounting impact of these accounting adjustments (see Note 8). Market values may have changed significantly since December 31, 2015.

Interest Rate Risk. This is the risk that changes in interest rates will adversely affect the fair values of SMUD’s interest rate swaps. SMUD is exposed to interest rate risk on its interest rate swaps.

Basis Risk. This is the risk that arises when a hedged item and a derivative that is attempting to hedge that item are based on different indices. SMUD is exposed to basis risk when it hedges its natural gas purchases, which are priced at various locations, with NYMEX futures contracts, which settle based on the price in Henry Hub, Louisiana. SMUD enters into basis swaps to hedge against this risk.

Termination Risk. This is the risk that a derivative will terminate prior to its scheduled maturity due to a contractual event. Contractual events include bankruptcy, illegality, default, credit events upon merger, and other events. One aspect of termination risk is that SMUD would lose the hedging benefit of a derivative that becomes subject to a termination event. Another aspect of termination risk is that, if at the time of termination the mark to market value of the derivative was a liability to SMUD, SMUD could be required to pay that amount to the counterparty. Termination risk is associated with all of SMUD’s derivatives up to the fair value amounts.

Credit Risk. This is the risk of loss resulting when the counterparty is unable or unwilling to fulfill its present and future financial obligations. SMUD can be exposed to significant counterparty credit risk on all derivative instruments. SMUD seeks to minimize credit risk by transacting with creditworthy counterparties. SMUD has established and maintained strict counterparty credit guidelines. SMUD continuously monitors counterparty credit risk and utilizes numerous counterparties to diversify the exposure to potential defaults. Under certain conditions as outlined in SMUD’s credit risk management policy, SMUD may require additional credit support under its trading agreements.

Some of SMUD’s derivative master agreements contain credit contingent provisions that enable SMUD to maintain unsecured credit as a result of positive investment quality credit ratings from each of the major credit rating agencies. If SMUD’s credit rating were to be downgraded, there could be a step-down in SMUD’s unsecured credit thresholds, and SMUD’s counterparties would require additional collateral. If SMUD’s credit rating were to decrease below investment grade, SMUD’s unsecured credit thresholds would be reduced to zero, and counterparties to the derivative instruments would demand ongoing full collateralization on derivative instruments in net out of the money positions (See Note 2).

The counterparties' current credit rating at December 31, 2015 is shown in the table below. The credit ratings listed are from S&P or Moody's:

<u>Counterparty Gas Contracts:</u>	<u>Counterparty Credit Rating</u>
Barclays Bank PLC	A-
Bank of Montreal	A+
Cargill Inc.	A
Citigroup Inc.	BBB+
J.P. Morgan Ventures Energy Corp.	A-
Macquarie Bank Limited	A
Merrill Lynch	Baa1
Morgan Stanley Capital Group, Inc.	BBB+
 <u>Interest Rate Contracts:</u>	
Goldman Sachs Capital Markets, L.P.	BBB+
Goldman Sachs Mitsui Marine Derivative Products L.P.	AA+
Morgan Stanley Capital Services, Inc.	BBB+

NOTE 10. LONG-TERM DEBT

SMUD's total long-term debt is presented below:

	<u>December 31,</u>	
	<u>2015</u>	<u>2014</u>
	(thousands of dollars)	
Electric revenue bonds, 3.0%-6.32%, 2016-2041	\$ 1,786,080	\$ 1,873,105
Subordinated electric revenue bonds, index rates, 2016-2041	<u>344,850</u>	<u>347,850</u>
Total electric revenue bonds	2,130,930	2,220,955
Component unit project revenue bonds, 2.0%-5.25%, 2016-2030	253,375	373,670
Gas supply prepayment bonds, index rates, 2016-2027	<u>318,795</u>	<u>342,480</u>
Total long-term debt outstanding	2,703,100	2,937,105
Bond premiums - net	<u>123,080</u>	<u>115,026</u>
Total long-term debt	2,826,180	3,052,131
Less: amounts due within one year	<u>(152,060)</u>	<u>(170,430)</u>
Total long-term debt - net	<u>\$ 2,674,120</u>	<u>\$ 2,881,701</u>

The summarized activity of SMUD's long-term debt during 2015 is presented below:

	December 31, 2014	Additions	Payments or Amortization	December 31, 2015	Amounts Due Within One Year
(thousands of dollars)					
Electric revenue bonds	\$ 1,873,105	\$ -0-	\$ (87,025)	\$ 1,786,080	\$ 90,685
Subordinate electric revenue bonds	347,850	-0-	(3,000)	344,850	3,000
Component unit project revenue bonds	373,670	193,335	(313,630)	253,375	32,450
Gas supply prepayment bonds	<u>342,480</u>	<u>-0-</u>	<u>(23,685)</u>	<u>318,795</u>	<u>25,925</u>
Total	2,937,105	193,335	(427,340)	2,703,100	<u>\$ 152,060</u>
Unamortized premiums - net	<u>115,026</u>	<u>30,373</u>	<u>(22,319)</u>	<u>123,080</u>	
Total long-term debt	<u>\$ 3,052,131</u>	<u>\$ 223,708</u>	<u>\$ (449,659)</u>	<u>\$ 2,826,180</u>	

The summarized activity of SMUD's long-term debt during 2014 is presented below:

	December 31, 2013	Additions	Payments or Amortization	December 31, 2014	Amounts Due Within One Year
(thousands of dollars)					
Electric revenue bonds	\$ 1,971,390	\$ -0-	\$ (98,285)	\$ 1,873,105	\$ 87,025
Subordinate electric revenue bonds	347,850	-0-	-0-	347,850	3,000
Component unit project revenue bonds	399,295	-0-	(25,625)	373,670	56,720
Gas supply prepayment bonds	<u>364,860</u>	<u>-0-</u>	<u>(22,380)</u>	<u>342,480</u>	<u>23,685</u>
Total	3,083,395	-0-	(146,290)	2,937,105	<u>\$ 170,430</u>
Unamortized premiums - net	<u>130,007</u>	<u>-0-</u>	<u>(14,981)</u>	<u>115,026</u>	
Total long-term debt	<u>\$ 3,213,402</u>	<u>\$ -0-</u>	<u>\$ (161,271)</u>	<u>\$ 3,052,131</u>	

At December 31, 2015 scheduled annual principal maturities and interest are as follows:

	Principal	Interest	Total
(thousands of dollars)			
2016	\$ 152,060	\$ 119,671	\$ 271,731
2017	160,585	112,541	273,126
2018	150,010	105,421	255,431
2019	155,345	100,062	255,407
2020	139,445	93,896	233,341
2021 – 2025 (combined)	719,755	382,713	1,102,468
2026 – 2030 (combined)	565,175	232,726	797,901
2031 – 2035 (combined)	424,135	118,388	542,523
2036 – 2040 (combined)	206,955	22,950	229,905
2041	<u>29,635</u>	<u>1,155</u>	<u>30,790</u>
Total Requirements	<u>\$ 2,703,100</u>	<u>\$ 1,289,523</u>	<u>\$ 3,992,623</u>

Interest in the preceding table includes interest requirements for fixed rate debt at their stated rates, variable rate debt covered by interest rate swaps at their fixed rate, and variable rate debt not covered by interest rate swaps using the debt interest rate of .01 percent in effect at December 31, 2015 for the issues.

The following bonds have been issued and are outstanding at December 31, 2015:

<u>Date</u>	<u>Issue</u>	<u>Final Maturity</u>	<u>Interest Rate</u>	<u>Original Amount</u>	<u>Outstanding Amount</u>
<u>Electric Revenue Bonds</u>					
06/15/1997	1997 Series K Bonds	07/01/2024	5.25% - 5.9%	\$ 131,030,000	\$ 131,030,000
06/09/2008	2008 Series U Bonds	08/15/2028	3.0% - 5.0%	521,730,000	431,780,000
05/15/2009	2009 Series V Bonds	05/15/2036	6.322%	200,000,000	200,000,000
07/29/2010	2010 Series W Bonds	05/15/2036	6.156%	250,000,000	250,000,000
10/04/2011	2011 Series X Bonds	08/15/2028	1.5% - 5.0%	325,550,000	302,555,000
05/31/2012	2012 Series Y Bonds	08/15/2033	3.0% - 5.0%	196,945,000	193,200,000
05/21/2013	2013 Series A Bonds	08/15/2041	3.75% - 5.0%	132,020,000	132,020,000
05/21/2013	2013 Series B Bonds	08/15/2033	3.0% - 5.0%	118,615,000	118,615,000
08/20/2013	2013 Series C Bonds	08/15/2017	5.0%	57,780,000	26,880,000
<u>JPA Electric Revenue Bonds</u>					
08/19/2009	2009 CVFA Bonds	07/01/2020	2.25% - 5.25%	\$ 48,920,000	\$ 24,790,000
08/19/2009	2009 SCA Bonds	07/01/2021	4.0% - 5.25%	57,530,000	35,250,000
06/03/2015	2015 SFA Bonds	07/01/2030	2.0% - 5.0%	193,335,000	193,335,000
05/31/2007	2007B NCGA#1 Bonds	07/01/2027	Index Rate	668,470,000	318,795,000
<u>Subordinated Electric Revenue Bonds</u>					
08/14/2008	2008 Series J Bonds	08/15/2028	Index Rate	\$ 120,000,000	\$ 120,000,000
08/14/2008	2008 Series K Bonds	08/15/2028	Index Rate	77,850,000	77,850,000
02/29/2012	2012 Series L Bonds	08/15/2041	Index Rate	75,000,000	73,500,000
02/29/2012	2012 Series M Bonds	08/15/2041	Index Rate	75,000,000	73,500,000

2015 Bond Refunding. In June 2015, SFA issued \$193.3 million of 2015 Series Cosumnes Project Revenue Refunding Bonds. Proceeds from the 2015 Series Bonds and \$24.8 million of available funds were used to refund \$233.2 million of the outstanding 2006 Series Bonds through a legal defeasance, and accordingly, the liability for the defeased bonds has been removed from Long-Term Debt in the Statements of Net Position. The refunding resulted in the recognition of a deferred accounting loss of \$4.4 million, which is being amortized over the life of the refunding issue, and a current period loss of \$0.03 million which is included in Interest on Debt in the Statement of Revenues, Expenses, and Changes in Net Assets. The 2015 refunding reduced future aggregate debt service payments by \$46.7 million and resulted in a total economic gain of \$35.5 million, which is the difference between the present value of the old and new debt service payments.

2015 Bond Redemptions. In January and July 2015, SPA redeemed \$29.9 million and the remaining \$33.8 million of 2005 Series Bonds maturing July 2016 through July 2022, along with the accrued interest, respectively. The redemptions resulted in a current accounting loss of \$0.2 million, which is included in Interest on Debt in the Statements of Revenues, Expenses, and Changes in Net Position.

2014 Bond Redemption. In December 2014, SMUD redeemed \$8.7 million of 2004 Series T Electric Revenue Refunding Bonds. The redemption resulted in a current accounting gain of \$23 thousand, which is included in Interest on Debt in the Consolidated Statements of Revenues, Expenses, and Changes in Net Position. Redeeming the bonds will reduce the aggregate future debt service payments by \$11.0 million.

Interest Rate Swap Agreements. A summary of SMUD’s three interest rate swap agreements are as follows. The credit ratings listed are from S&P:

Notional Amount (thousands)	SMUD Pays	Fixed Rate	Floating Rate	Termination Date	Counterparty Credit Rating
\$ 131,030	Variable	5.154%	SIFMA	07/01/24	BBB+
86,555	Fixed	4.345%	70% of LIBOR	08/15/18	AA+
105,875	Fixed	2.894%	63% of LIBOR	08/15/28	BBB+

SMUD has a fixed-to-variable interest rate swap agreement with a notional amount of \$131.0 million, which is equivalent to the principal amount of SMUD’s 1997 Series K Electric Revenue Bonds. Under this swap agreement, SMUD pays a variable rate equivalent to the SIFMA Index (0.01 percent at December 31, 2015) and receives fixed rate payments of 5.154 percent. In connection with the swap agreement, SMUD has a put option agreement, also with a notional amount of \$131.0 million, which gives the counterparty the right to sell to SMUD, at par, either the 1997 Series K Bonds, or a portfolio of securities sufficient to defease the 1997 Series K Bonds. The exercise of the option terminates the swap at no cost to SMUD. The term of both the swap and the put is equal to the maturity of the 1997 Series K Bonds.

Additionally, SMUD has two variable-to-fixed interest rate swap agreements with a combined notional amount of \$192.4 million originally entered into for the purpose of fixing the effective interest rate associated with certain of its subordinated bonds that were refunded during 2008. The notional values of the two swaps are amortized over the life of the respective swap agreements. SMUD can terminate all swap agreements at any time, with payment or receipt of the fair market value of the swaps as of the date of termination. The obligations of SMUD under the swap agreements are not secured by a pledge of revenues of SMUD’s electric system or any other property of SMUD.

Component Unit Interest Rate Swap Agreements. NCGA has three interest rate swap agreements, which are summarized as follows. The credit ratings listed are from S&P:

Notional Amount (thousands)	NCGA Pays	Fixed Rate	Floating Rate	Termination Date	Credit Support Provider Credit Rating
\$ 54,320	Fixed	4.062%	67% of LIBOR +.60%	07/01/17	BBB+
65,865	Fixed	4.144%	67% of LIBOR +.63%	07/01/19	BBB+
198,610	Fixed	4.304%	67% of LIBOR +.72%	07/01/27	BBB+

At December 31, 2015 NCGA has three variable-to-fixed interest rate swap agreements with a counterparty for the purpose of fixing the effective interest rate associated with the 2007 Series B Bonds. NCGA pays the counterparty a fixed rate on the notional amount and receives a floating rate equal to 67 percent of the three month LIBOR (0.61 percent at December 31, 2015) plus an interest rate spread, as specified in each swap agreement. The total notional amount of the three swaps at December 31, 2015 was \$318.8 million and was equivalent to the outstanding principal balance on the NCGA Bonds. The swaps are amortized over the life of their respective swap agreements in a manner corresponding to the principal repayment schedule of the NCGA Bonds. Early termination of the swaps would occur upon termination of the prepaid agreement for any reason. Upon early termination, the swaps would have no value to either party.

Subordinated Electric Revenue Bonds. Payment of and interest on the Subordinated Electric Revenue Bonds is subordinate to the payment of the principal and interest on SMUD’s Electric Revenue Bonds.

Variable Rate Bonds. SMUD’s Variable Rate Bonds bear interest at weekly rates, .01 percent at December 31, 2015. SMUD can elect to change the interest rate period or fix the interest rate, with certain limitations. SMUD’s Variable Rate

Bonds can be put to SMUD's Trustee by the bondholders; however, if the bonds can't be remarketed, SMUD has in place reimbursement agreements with Bank of America, State Street, and US Bank to enable SMUD to pay off the bonds over five years. Accordingly, SMUD has recorded such bonds as Long-Term Debt, less amounts scheduled for redemption within one year.

Component Unit Bonds. The component units of SMUD have each issued bonds to finance their respective projects. The revenue stream to pay CVFA, SCA, and SFA bonds' debt service is provided by "take-or-pay" power purchase agreements, and is therefore not dependent on the successful operation of the projects. SMUD guarantees to make payments sufficient to pay principal and interest and all other payments required to be made under the CVFA, SCA, and SFA's indenture of trust. CVFA, SCA, and SFA are not required to repay SMUD for any amounts paid under this guarantee. The revenue stream to pay NCGA bonds' debt service is provided by a "take-and-pay" purchase agreement. Therefore, principal and interest associated with these bonds are paid solely from the revenues and receipts collected in connection with the operation of the project. Most operating revenues earned by NCGA are collected from SMUD in connection with the sale of gas to SMUD. The ability for NCGA to service debt is dependent on various parties (particularly MSCG, as gas supplier) meeting their contractual obligations.

Callable Bonds. SMUD has \$794.9 million of Electric Revenue Bonds that are currently callable, \$450.0 million of which are fixed rate Build America Bonds debt and \$344.9 million of subordinate Variable Rate Demand Notes. SMUD also has \$860.8 million of bonds that become callable from 2018 through 2024, and these bonds can be called until maturity.

Collateral. The principal and interest on SMUD's bonds are payable exclusively from, and are collateralized by a pledge of, the net revenues of SMUD's electric system. Neither the credit nor the taxing power of SMUD is pledged to the payment of the bonds and the general fund of SMUD is not liable for the payment thereof.

Covenants. SMUD's bond resolutions contain various covenants that include requirements to maintain minimum debt service coverage ratios, certain other financial ratios, stipulated minimum funding of revenue bond reserves, and various other requirements including a rate covenant to raise rates to maintain minimum debt service coverage.

SMUD has pledged future net electric revenues, component unit net project revenues, and net gas supply prepayment revenues to repay, in electric revenue, component unit project revenue, and gas supply prepayment revenue bonds issued from 1997 through 2015. Proceeds from the bonds provided financing for various capital improvement projects, component unit capital projects, and the prepayment of a twenty-year supply of natural gas. The bonds are payable solely from the net revenues generated by SMUD's electrical sales, component unit project revenues, and gas supply prepayment revenues and are payable through 2041 at December 31, 2015.

GASB Statement No. 48, “*Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*”, disclosures for pledged revenues are as follows:

	December 31,	
	2015	2014
	(thousands of dollars)	
Pledged future revenues	\$ 2,703,100	\$ 2,937,105
Principal and interest payments for the year ended	\$ 255,471	\$ 271,373
Total net revenues for the year ended	\$ 814,911	\$ 834,442
Total remaining principal and interest to be paid	\$ 3,992,623	\$ 4,390,382
Annual principal and interest payments as a percent of net revenues		
For the year ended	31%	33%

NOTE 11. COMMERCIAL PAPER NOTES

SMUD issues Commercial Paper Notes (Notes) to finance or reimburse capital expenditures. At December 31, 2015 and 2014 Notes outstanding totaled \$200.0 million. The interest rate for the Notes outstanding at December 31, 2015 was .03 percent and the average term was 49 days. SMUD has a \$204.9 million letter of credit agreement, and there have not been any term advances under it.

The summarized activity of SMUD’s Notes during 2015 and 2014 is presented below:

	Balance at Beginning of Year	Additions		Reductions		Balance at End of Year
		(thousands of dollars)				
December 31, 2015	\$ 200,000	\$ -0-	\$ -0-	\$ -0-	\$ -0-	\$ 200,000
December 31, 2014	\$ 200,000	\$ -0-	\$ -0-	\$ -0-	\$ -0-	\$ 200,000

NOTE 12. RANCHO SECO DECOMMISSIONING LIABILITY

Background. The Rancho Seco decommissioning liability relates to the nuclear decommissioning of the former 913 MW nuclear power plant, which terminated commercial operations in 1989 and the separately licensed Independent Spent Fuel Storage Facility (ISFSI). Nuclear decommissioning is the process of safely removing nuclear facilities from service and reducing residual radioactivity to a level that permits termination of the Nuclear Regulatory Commission (NRC) license, and release of the property for unrestricted use. The NRC has approved SMUD’s decommissioning plan for the nuclear power plant, which delineates a phased process, and the first phase of physical work was completed in 2008. Decommissioning of the ISFSI will occur after the DOE removes the spent nuclear fuel and high level waste from the site.

In 2009, the NRC released all of the land formerly under the Part 50 license for unrestricted use with the exception of the 1 acre fenced area around the Interim Onsite Storage Building that was previously used to store low-level radioactive waste produced during the decommissioning of the nuclear reactor facility. This waste was disposed of in 2014. The decommissioning of that remaining facility began in 2015 and when completed, will result in termination of the former operating license issued under Part 50.

The DOE, under the Nuclear Waste Policy Act of 1982, is responsible for permanent disposal of spent nuclear fuel and high-level radioactive waste which are currently in storage at the ISFSI. SMUD has a contract with the DOE for the removal and disposal of spent nuclear fuel and high-level (greater than class “C”: GTCC) radioactive waste. All of SMUD’s spent fuel and GTCC waste are currently stored in sealed canisters in the ISFSI. However, the date when fuel and GTCC waste removal will be complete is uncertain. In 2010, the DOE formally withdrew the application for licensing of Yucca Mountain as a high-

level waste repository, essentially removing Yucca Mountain as an option for disposal of SMUD’s used nuclear fuel. The DOE also announced in January 2010 the creation of a Blue Ribbon Commission to study alternatives for developing a repository for the nation’s used nuclear fuel. The Commission provided a final report on alternatives in January 2012. The DOE evaluated the recommendations and published the report “Strategy for the Management and Disposal of Used Nuclear Fuel and High-Level Radioactive Waste” in January 2013. The next phase of the process will be for Congress and the President of the United States to consider the recommendations and enact legislation to implement the recommendations. At this time, there is no credible information available to determine when the DOE would remove the used nuclear fuel from the Rancho Seco facility. The ISFSI will remain under the regulation of the NRC until the nuclear fuel and GTCC radioactive waste are removed and the site is decommissioned.

Asset Retirement Obligations (ARO). These financial statements reflect SMUD’s current estimate of its obligation for the cost of decommissioning (including the cost of managing the Storage Facility until it can be decommissioned) under the requirements of FASB ASC 410, based on studies completed each year. Each year, SMUD evaluates the estimate of costs of decommissioning and there was a decrease in costs in the 2015 study. The ARO estimate assumes all spent nuclear fuel will be removed from the site by 2035.

Rancho Seco’s ARO is presented below:

	<u>December 31,</u>	
	<u>2015</u>	<u>2014</u>
	(thousands of dollars)	
Active decommissioning	\$ 15,696	\$ 16,067
Spent fuel management	<u>134,676</u>	<u>136,010</u>
Total ARO	\$ 150,372	\$ 152,077
Less: current portion	<u>(8,822)</u>	<u>(7,879)</u>
Total non-current portion of ARO	<u>\$ 141,550</u>	<u>\$ 144,198</u>

The summarized activity of the Rancho Seco ARO during 2015 and 2014 are presented below. The annual adjustments include a savings computed as the difference between the fair value of the obligation as if the decommissioning activities were performed by a third party and the amount actually incurred by SMUD performing the decommissioning activities.

	<u>December 31,</u>	
	<u>2015</u>	<u>2014</u>
	(thousands of dollars)	
ARO at beginning of year	\$ 152,077	\$ 169,124
Accretion	7,510	8,291
Expenditures	(7,408)	(27,587)
Change in Study	(1,108)	(399)
Annual adjustments	<u>(699)</u>	<u>2,648</u>
ARO at end of year	<u>\$ 150,372</u>	<u>\$ 152,077</u>

NOTE 13. PENSION PLANS

Summary of Significant Accounting Policies. For purposes of measuring net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the pension plan (Plan) and additions to/deductions from the Plan’s fiduciary net position have been determined on the same basis as they are reported by the California Public Employees’ Retirement System (PERS) Financial Office. For this purpose, benefit payments (including refunds of employee contributions) are recognized when currently due and payable in accordance with the benefit terms. Investments are reported at fair value.

GASB No. 68 requires that the reported results must pertain to liability and asset information within certain defined timeframes. The following timeframes are used for the year ended:

	December 31,	
	2015	2014
Valuation date	June 30, 2014	June 30, 2013
Measurement date	June 30, 2015	June 30, 2014

Plan Description and Benefits Provided. SMUD participates in PERS, an agent multiple-employer public employee defined benefit pension plan. PERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. PERS acts as a common investment and administrative agent for participating public entities within the State. Benefit provisions and all other requirements are established by State statute and SMUD policies. The pension plan provides retirement benefits, survivor benefits, and death and disability benefits based upon employee’s years of credited service, age, and final compensation. A full description of the pension plan regarding number of employees covered, benefit provision, assumptions (for funding, but not accounting purposes), and membership information are included in the annual actuarial valuation reports as of June 30, 2014 and June 30, 2013. These reports and the PERS’ audited financial statements are publicly available and can be obtained at the PERS’ website at www.calpers.ca.gov.

Employees Covered by Benefit Terms. The following employees were covered by the benefit terms for the year ended:

	December 31,	
	2015	2014
Inactive employees or beneficiaries currently receiving benefit payments	2,657	2,580
Inactive employees entitled to but not yet receiving benefit payments	940	955
Active employees	1,974	1,945
	5,571	5,480

Contributions. Section 20814(c) of the California Public Employees’ Retirement Law requires that the employer contribution rates for all public employers be determined on an annual basis by the actuary and shall be effective on the July 1 following notice of a change in the rate. The total plan contributions are determined through PERS’ annual actuarial valuation process. The actuarially determined rate is the estimated amount necessary to finance the costs of benefits earned by employees during the year, with an additional amount to finance any unfunded accrued liability. The employer is required to contribute the difference between the actuarially determined rate and the contribution rate of employees. For the PERS fiscal year ended June 30, 2015 and 2014, the average active employee contribution rate is 6.9 percent of annual pay, and the employer’s contribution rate is 12.0 percent and 10.9 percent of annual payroll, respectively. Employer contribution rates may change if plan contracts are amended. For the year ended December 31, 2015 and 2014, SMUD made contributions recognized by the pension plan in the amount of \$30.5 million and \$31.4 million, which includes \$8.0 million and \$9.9 million of employer paid employee contributions, respectively.

Net Pension Liability. SMUD's NPL at December 31, 2015 and 2014 was measured at June 30, 2015 and 2014, respectively. The total pension liability used to calculate the NPL was determined by actuarial valuations as of June 30, 2014 and 2013 rolled forward using generally accepted actuarial procedures to the June 30, 2015 and 2014 measurement dates.

Actuarial Methods and Assumptions. The actuarial methods and assumptions used for the December 31, 2015 and December 31, 2014 total pension liabilities are as follows:

Actuarial Cost Method	Entry age normal
Discount rate	7.65% (2015), 7.5% (2014)
Inflation	2.75%
Salary increases	Varies by entry age and service
Investment rate of return	7.65%, net of pension plan investment; includes inflation (2015) 7.5%, net of pension plan investment and administrative expenses; includes inflation (2014)
Mortality Rate Table	The mortality table used was developed based on PERS' specific data. The table includes 20 years of mortality improvements using Society of Actuaries Scale BB.
Post Retirement Benefit Increase	Contract COLA up to 2.75% until Purchase Power Protection Allowance Floor on Purchasing Power applies, 2.75% thereafter

All other actuarial assumptions used for both years were based on the results of an actuarial experience study for the period from 1997 to 2011, including updates to salary increase, mortality and retirement rates.

Discount Rates. The discount rates used to measure the total pension liability for the year ended December 31, 2015 and 2014 was 7.65 percent and 7.5 percent, respectively. To determine whether the municipal bond rate should be used in the calculation of a discount rate for each plan, PERS stress tested plans that would most likely result in a discount rate that would be different from the actuarially assumed discount rate. Based on the testing, none of the tested plans run out of assets. Therefore, the 7.65 percent and 7.5 percent discount rates used for the respective valuations are adequate and the use of the municipal bond rate calculation is not necessary. The long-term expected discount rates of 7.65 percent and 7.5 percent for the respective valuations are applied to all plans in the Public Employees Retirement Fund.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. Using historical returns of all the funds' asset classes, expected compound (geometric) returns were calculated over the short-term (first 10 years) and the long-term (11-60 years) using a building-block approach.

The table below reflects long-term expected real rate of return by asset class. The rate of return was calculated using the capital market assumptions applied to determine the discount rate and asset allocation. The target allocation shown below was adopted by the PERS' Board effective on July 1, 2014.

<u>Asset Class</u>	<u>Current Target Allocation</u>	<u>Real Return Years 1-10</u>	<u>Real Return Years 11+</u>
Global Equity	51.0%	5.25%	5.71%
Global Fixed Income	19.0%	.99%	2.43%
Inflation Sensitive	6.0%	.45%	3.36%
Private Equity	10.0%	6.83%	6.95%
Real Estate	10.0%	4.5%	5.13%
Infrastructure and Forestland	2.0%	4.5%	5.09%
Liquidity	2.0%	(.55%)	(1.05%)

Changes in the NPL:

The following table shows the changes in NPL recognized over the year ended December 31, 2015:

	<u>Total Pension Liability (a)</u>	<u>Increase (Decrease) Plan Fiduciary Net Position (b)</u>	<u>Net Pension Liability (a) – (b)</u>
	(thousands of dollars)		
Balance at December 31, 2014	\$ 1,940,486	\$ 1,613,784	\$ 326,702
Changes recognized for the measurement period:			
Service cost	27,991	-0-	27,991
Interest	142,468	-0-	142,468
Differences between expected and actual experience	(10,613)	-0-	(10,613)
Changes of assumptions	(34,228)	-0-	(34,228)
Contributions – employer	-0-	30,481	(30,481)
Contributions – employee	-0-	6,521	(6,521)
Net investment income	-0-	35,797	(35,797)
Benefit payments	(94,636)	(94,636)	-0-
Administrative expense	-0-	(1,795)	1,795
Other	-0-	(25)	25
Net changes	<u>30,982</u>	<u>(23,657)</u>	<u>54,639</u>
Balances at December 31, 2015	<u>\$ 1,971,468</u>	<u>\$ 1,590,127</u>	<u>\$ 381,341</u>

The following table shows the changes in NPL recognized over the year ended December 31, 2014:

	<u>Total Pension Liability (a)</u>	<u>Increase (Decrease) Plan Fiduciary Net Position (b)</u>	<u>Net Pension Liability (a) – (b)</u>
	(thousands of dollars)		
Balance at December 31, 2013	\$ 1,864,945	\$ 1,423,471	\$ 441,474
Changes recognized for the measurement period:			
Service cost	28,170	-0-	28,170
Interest	137,546	-0-	137,546
Contributions – employer	-0-	31,366	(31,366)
Contributions – employee	-0-	5,491	(5,491)
Net investment income	-0-	245,659	(245,659)
Benefit payments	(90,175)	(90,175)	-0-
Administrative expense	-0-	(2,028)	2,028
Net changes	<u>75,541</u>	<u>190,313</u>	<u>(114,772)</u>
Balances at December 31, 2014	<u>\$ 1,940,486</u>	<u>\$ 1,613,784</u>	<u>\$ 326,702</u>

Sensitivity of the NPL to Changes in the Discount Rate. The following presents the NPL of the Plan as of the measurement date, calculated using the current discount rate, as well as what the net pension liability would be if it were calculated using a discount rate that is 1 percentage-point lower or 1 percentage-point higher than the current discount rate:

	<u>1% Decrease</u> <u>(6.65%)</u>	<u>Current Discount</u> <u>Rate (7.65%)</u>	<u>1% Increase</u> <u>(8.65%)</u>
		(thousands of dollars)	
Plan's NPL, December 31, 2015	\$ 638,876	\$ 381,341	\$ 167,583

	<u>1% Decrease</u> <u>(6.5%)</u>	<u>Current Discount</u> <u>Rate (7.5%)</u>	<u>1% Increase</u> <u>(8.5%)</u>
		(thousands of dollars)	
Plan's NPL, December 31, 2014	\$ 572,793	\$ 326,703	\$ 121,406

Pension Plan Fiduciary Net Position. Detailed information about the pension plan's fiduciary net position is available in the separately issued Plan financial statements.

Pension Expense and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions. For the year ended December 31, 2015 and 2014, SMUD recognized pension expense of \$21.4 million and \$27.7 million, respectively.

At December 31, 2015 and December 31, 2014, SMUD reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	<u>December 31,</u>	
	<u>2015</u>	<u>2014</u>
	(thousands of dollars)	
Deferred outflows of resources		
Employer's contributions to the Plan subsequent to the measurement of total pension liability	\$ 31,303	\$ 27,269
Total deferred outflows of resources	<u>\$ 31,303</u>	<u>\$ 27,269</u>
Deferred inflows of resources		
Differences between expected and actual experience	\$ (7,580)	\$ -0-
Changes in assumptions	(24,448)	-0-
Differences between projected and actual earnings on pension plan investments	<u>(15,551)</u>	<u>(111,405)</u>
Total deferred inflows of resources	<u>\$ (47,579)</u>	<u>\$ (111,405)</u>

Amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Year ended December 31:	
2016	\$ 7,641
2017	(23,662)
2018	(17,256)
2019	17,001
2020	-0-
Thereafter	-0-

Other Plans. SMUD provides its employees with two cash deferred compensation plans: one pursuant to Internal Revenue Code (IRC) Section 401(k) [401(k) Plan] and one pursuant to IRC Section 457 (457 Plan) (collectively, the Plans). The Plans are contributory plans in which SMUD's employees contribute the funds. Each of SMUD's eligible full-time or permanent part-time employees may participate in either or both Plans, and amounts contributed are vested immediately. Such funds are held by a Trustee in trust for the employees upon retirement from SMUD service and, accordingly, are not subject to the general claims of SMUD's creditors. SMUD is responsible for ensuring compliance with IRC requirements concerning the Plans and has the fiduciary duty of reasonable care in the selection of investment alternatives, but neither SMUD, nor its Board or officers have any liability for market variations in the Plans' asset values. SMUD employees are responsible for determining how their funds are to be invested and pay all ongoing fees related to the Plans. The Plans are currently not subject to discrimination testing, nor the requirements of the Employee Retirement Income Security Act of 1974. SMUD employees participating in the Plans are allowed to contribute a portion of their gross income not to exceed the annual dollar limits prescribed by the IRC.

SMUD makes annual contributions to the 401(k) Plan on behalf of certain employees pursuant to a memorandum of understanding with both of its collective bargaining units. SMUD also matches non-represented employee contributions to the 401(k) Plan up to a set amount. SMUD made contributions into the 401(k) Plan of \$3.5 million in 2015 and \$2.9 million in 2014. SMUD does not match employee contributions, nor make contributions on behalf of its employees to the 457 Plan. Participating employees made contributions into both Plans totaling \$18.5 million in 2015 and \$16.8 million in 2014.

NOTE 14. OTHER POSTEMPLOYMENT BENEFITS

SMUD provides postemployment healthcare benefits, in accordance with SMUD policy and negotiated agreements with employee representation groups in a single employer defined benefit plan, to all employees who retire from SMUD, and their dependents. SMUD also provides postemployment healthcare benefits to covered employees who are eligible for disability retirement. SMUD contributes the full cost of coverage for retirees hired before January 1, 1991, and a portion of the cost based on credited years of service for retirees hired after January 1, 1991. SMUD also contributes a portion of the costs of coverage for these retirees' dependents. Retirees are required to contribute the portion that is not paid by SMUD. The benefits, benefit levels, retiree contributions and employer contributions are governed by SMUD and can be amended by SMUD through its personnel manual and union contracts. At June 30, 2015, 4,962 postemployment participants, including retirees, spouses of retirees, surviving spouses, and eligible dependents, were eligible to participate in SMUD's healthcare benefits program.

OPEB arises from an exchange of salaries and benefits for employee services rendered, and refers to postemployment benefits other than pension benefits such as postemployment healthcare benefits. SMUD considers the following benefits to be OPEB: Medical, Dental and Long-Term Disability.

Plan Description. SMUD is a member of the California Employers Retiree Benefit Trust (CERBT) for prefunding of OPEB obligations. The CERBT Fund is an IRC Section 115 Trust set up for the purpose of receiving employer contributions to prefund health and other postemployment benefits for retirees and their beneficiaries. The plan is an agent multiple employer plan administered by PERS, which provides medical, dental and long-term disability benefits for retirees and their beneficiaries. Any changes to these benefits would be approved by SMUD's Board and union contracts. To obtain a CERBT report, please contact PERS at 888-CALPERS.

The funding of a plan occurs when the following events take place: the employer makes payments of benefits directly to or on behalf of a retiree or beneficiary; the employer makes premium payments to an insurer; or the employer irrevocably transfers assets to a trust or other third party acting in the role of trustee, where the plan assets are dedicated to the sole purpose of the payments of the plan benefits, and creditors of the government do not have access to those assets.

Funding Policy. SMUD has elected to net fund to PERS, so the contributions are the Annual Required Contribution (ARC) less the estimated cash flow for retiree benefit costs for each year. SMUD can elect to put in additional contributions into the trust, and in 2015 and 2014 funded an additional \$22.0 million and \$40.0 million to the CERBT, respectively. In 2015 and 2014, the net ARC contribution to the CERBT was \$6.6 million and \$6.8 million, respectively. During 2015 and 2014, SMUD made healthcare benefit contributions by paying actual medical costs of \$17.4 million and \$23.6 million, respectively.

Funding Status and Funding Progress. At June 30, 2015 and 2014, SMUD estimates that the actuarially determined accumulated postemployment benefit obligation was approximately \$319.4 million and \$505.1 million, respectively. At June 30, 2015 and 2014, the plan was 55.2 and 25.6 percent funded, respectively. The covered payroll (annual payroll of active employees covered by the plan) at June 30, 2015 and 2014, was \$191.4 million and \$187.2 million, respectively. The ratio of the UAAL to covered payroll was 74.8 percent at June 30, 2015.

Annual OPEB Cost. The annual OPEB cost (expense) is calculated based on the ARC of the employer, an amount actuarially determined in accordance with the parameters of SGAS No. 45, “*Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*”. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover the normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years. For 2015, SMUD’s annual OPEB Cost (expense) was \$27.7 million.

The following table shows the components of SMUD’s annual OPEB cost for the year, the amount actually paid in premiums, and changes in the net OPEB obligation:

	<u>Year Ended December 31,</u>	
	<u>2015</u>	<u>2014</u>
	(thousands of dollars)	
Annual required contribution	\$ 28,815	\$ 29,833
Interest on net OPEB obligation	(5,720)	(2,704)
Annual required contribution adjustment	<u>4,595</u>	<u>2,251</u>
Annual OPEB cost	27,690	29,380
Contributions made	<u>(46,047)</u>	<u>(70,361)</u>
Increase / (Decrease) in net OPEB obligation	(18,357)	(40,981)
Net OPEB (asset), beginning of year	<u>(77,723)</u>	<u>(36,742)</u>
Net OPEB (asset), end of year	<u>\$ (96,080)</u>	<u>\$ (77,723)</u>

SMUD’s Net OPEB Obligation (asset) is recorded as a component of Prepayments and other on the Consolidated Statements of Net Position.

SMUD’s annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for 2015 and the two preceding years is as follows:

<u>Year Ending</u>	<u>Annual OPEB Cost</u>	<u>Percentage of Annual OPEB Cost Contributed</u>	<u>Net OPEB (Asset)</u>
	(thousands of dollars)		
December 31, 2015	\$27,690	166%	\$(96,080)
December 31, 2014	\$29,380	239%	\$(77,723)
December 31, 2013	\$29,147	106%	\$(36,742)

Actuarial Methods and Assumptions. Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing the 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.

The entry age normal was used in the June 30, 2015 and 2014 actuarial valuation. The actuarial assumptions used for the June 30, 2015 and 2014 valuations were 7.25 percent and 7.36 investment rate of return (net of administrative expenses), respectively, and a 3.0 percent inflation assumption for both years. The actuarial assumptions for an annual healthcare cost trend growth rate for 2015 and 2016 was based on actual premiums and ranged from 7.0 to 7.2 percent for 2017. The UAAL will be amortized as a percentage of payroll over a closed 30-year period. At June 30, 2015 and 2014 the actuarial value of the assets was \$176.2 and \$129.5 million, respectively.

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 trends. Amounts determined regarding the funded status of the plan and the ARC of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as RSI following the notes to the financial statements, presents multiyear trend information that shows whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

NOTE 15. INSURANCE PROGRAMS AND CLAIMS

SMUD is exposed to various risks of loss related to torts, theft of and destruction to assets, errors and omissions, and natural disasters. In addition, SMUD is exposed to risks of loss due to injuries to, and illnesses of, its employees. SMUD carries commercial insurance coverage to cover most claims in excess of specific dollar thresholds, which range from \$5 thousand to \$2.5 million per claim with total excess liability insurance coverage limits for most claims of \$140.0 million. SMUD’s property insurance coverage is based on the replacement value of the asset. There have been no significant reductions in insurance coverage, and in some cases, certain coverages increased. In 2015, 2014 and 2013, the insurance policies in effect have adequately covered all settlements of the claims against SMUD. No claims have exceeded the limits of property or liability insurance in any of the past three years.

The claims liability is included as a component of Self Insurance, Unearned Revenue and Other in the Consolidated Statements of Net Position.

SMUD’s total claims liability, comprising claims received and claims incurred but not reported, at December 31, 2015, 2014 and 2013 is presented below:

	<u>2015</u>	<u>2014</u>	<u>2013</u>
		(thousands of dollars)	
Workers’ compensation claims	\$ 10,983	\$ 11,220	\$ 11,291
General and auto claims	698	825	669
Short and long-term disability claims	<u>343</u>	<u>121</u>	<u>391</u>
Claims liability	<u>\$ 12,024</u>	<u>\$ 12,166</u>	<u>\$ 12,351</u>

Changes in SMUD’s total claims liability during 2015, 2014, and 2013 are presented below:

	<u>2015</u>	<u>2014</u>	<u>2013</u>
	(thousands of dollars)		
Claims liability, beginning of year	\$ 12,166	\$ 12,351	\$ 10,093
Add: provision for claims, current year	1,827	2,122	4,105
Increase in provision for claims in prior years	2,782	2,930	3,433
Less: payments on claims attributable to current and prior years	<u>(4,751)</u>	<u>(5,237)</u>	<u>(5,280)</u>
Claims liability, end of year	<u>\$ 12,024</u>	<u>\$ 12,166</u>	<u>\$ 12,351</u>

NOTE 16. COMMITMENTS

Electric Power and Gas Supply Purchase Agreements. SMUD has numerous power purchase agreements with other power producers to purchase capacity, transmission, and associated energy to supply a portion of its load requirements. SMUD has minimum take-or-pay commitments for energy on some contracts. SMUD has numerous long-term natural gas supply, gas transportation and gas storage agreements with Canadian and U.S. companies to supply a portion of the consumption needs of SMUD’s natural gas-fired power plants, which expire through 2040.

At December 31, 2015, the approximate minimum obligations for the “take-or-pay” contracts over the next five years are as follows:

	<u>Electric</u>	<u>Gas</u>
	(thousands of dollars)	
2016	\$ 36,901	\$ 14,846
2017	36,392	15,074
2018	35,383	15,382
2019	35,607	15,714
2020	33,847	16,088

At December 31, 2015, the approximate minimum obligations for the remaining contracts, assuming the energy or gas is delivered over the next five years, are as follows:

	<u>Electric</u>	<u>Gas</u>
	(thousands of dollars)	
2016	\$ 127,593	\$ 121,861
2017	135,101	109,437
2018	170,075	111,652
2019	177,030	107,108
2020	185,130	106,640

Contractual Commitments beyond 2020 – Electricity. Several of SMUD’s purchase power and transmission contracts extend beyond the five-year summary presented above. These contracts expire between 2021 and 2043 and provide for power under various terms and conditions. SMUD estimates its annual minimum commitments under the take or pay contracts ranges between \$27.4 million in 2021 and \$0.0 million 2033. SMUD estimates its annual minimum commitments under the remaining contracts, assuming the energy is delivered, ranges between \$188.0 million in 2021 and \$0.2 million in 2043. SMUD’s largest purchase power source (in volume) is the Western Base Resource contract, whereby SMUD receives 25.4

percent of the amount of energy made available by Western, which equals an equal share of their revenue requirement. The Western contract expires on December 31, 2024.

Contractual Commitments beyond 2020 - Gas. Several of SMUD's natural gas supply, gas transportation and gas storage contracts extend beyond the five-year summary presented above. These contracts expire between 2021 and 2040 and provide for transportation and storage under various terms and conditions. SMUD estimates its annual minimum commitments under the take or pay contracts ranges between \$16.4 million in 2021 and \$8.9 million in 2040. SMUD estimates its annual minimum commitments under the remaining contracts, assuming the gas is delivered, ranges between \$97.9 million in 2020 and \$16.2 million in 2040.

Solano Wind. In December 2011, SMUD entered into an agreement to sell the Solano Wind Phase 3 project (see Note 2). SMUD will buy all output from the plant under the terms of the Power Purchase Agreement. The plant began commercial operation in April 2012 and SMUD receives all output generated. Under the terms of the various agreements, SMUD has the option to buy the plant back upon the sixth, eighth, or fifteenth anniversary of the commercial operation date or the end of the delivery term.

Gas Price Swap Agreements. SMUD has entered into numerous variable to fixed rate swaps with notional amounts totaling 127,727,500 Dths for the purpose of fixing the rate on SMUD's natural gas purchases for its gas-fueled power plants and gas indexed electric contracts. These gas price swap agreements result in SMUD paying fixed rates ranging from \$2.82 to \$7.17 per Dth. The swap agreements expire periodically from January 2016 through December 2022.

Gas Transport Capacity Agreements. SMUD has numerous long-term natural gas transport capacity agreements with Canadian and U.S. companies to transport natural gas to SMUD's natural gas-fired power plants from the supply basins in Alberta to the California-Oregon border and from supply basins in the southwest and Rocky Mountains to the Southern California border. These gas transport capacity agreements provide for the delivery of gas into SMUD-owned pipeline capacity within California. The gas transport capacity agreements provide SMUD with 56,600 Dth per day (Dth/d) of natural gas pipeline capacity from the North, including the Canadian Basins through 2023 and 54,000 Dth/d from the Southwest or Rocky Mountain Basins through at least 2018.

Gas Storage Agreements. SMUD also has an agreement for the storage of up to 2.0 million Dth of natural gas at regional facilities through March 2016, dropping to 1.0 million Dth through March 2018.

Hydro License Agreements. SMUD has a hydro license for a term of 50 years effective July 1, 2014 (see Note 2). SMUD entered into four contracts with government agencies whereby SMUD makes annual payments to them for various services for the term of the license. Each contract is adjusted annually by an inflation index. The present value of the sum of the annual payments is \$55.0 million at December 31, 2015.

NOTE 17. CLAIMS AND CONTINGENCIES

FERC Administrative Proceedings. SMUD is involved in a number of FERC administrative proceedings related to the operation of wholesale energy markets, regional transmission planning, gas transportation, and the development of NERC reliability standards. While these proceedings are complex and numerous, they generally fall into the following categories: (i) filings initiated by the California Independent System Operator Corporation (CAISO) (or other market participants) to adopt/modify the CAISO Tariff and/or establish market design and behavior rules; (ii) filings initiated by existing transmission owners (i.e. PG&E and the other Investor Owned Utilities) to pass-through costs to their existing wholesale transmission customers; (iii) filings initiated by FERC or market participants to establish market design and behavior rules or to complain about or investigate market behavior by certain market participants; (iv) filings initiated by transmission owners under their transmission owner tariffs for the purpose of establishing a regional transmission planning process; (v) filings initiated by providers of firm gas transportation service under the Natural Gas Act; and (vi) filings initiated by NERC to develop reliability

standards applicable to owners, users, and operators of the bulk electric system. SMUD's management believes that the ultimate resolution of these matters will not have a material adverse effect on SMUD's financial position, liquidity or results of operations.

Construction Matters. SMUD contracts with various firms to design and construct facilities for SMUD. Currently, SMUD is party to various claims, legal actions and complaints relating to such construction projects. SMUD's management believes that the ultimate resolution of these matters will not have a material adverse effect on SMUD's financial position, liquidity or results of operations.

Environmental Matters. SMUD was one of many potentially responsible parties that had been named in a number of actions relating to environmental claims and/or complaints. SMUD has resolved these environmental claims and/or complaints and entered into settlement agreements and/or consent orders. These settlement agreements and consent orders have statutory reopener provisions which allow regulatory agencies to seek additional funds for environmental remediation under certain limited circumstances. While SMUD believes it is unlikely that any of the prior settlement agreements or consent orders will be reopened, the possibility exists. If any of the settlement agreements or consent orders is reopened, SMUD management does not believe that the outcome will have a material adverse impact on SMUD's financial position, liquidity or results of operations.

North City Remediation. In 1950, SMUD purchased property (North City Site) from the City of Sacramento and the Western Railroad Company. Portions of the North City Site prior to the sale had been operated as a municipal landfill by the City of Sacramento. SMUD currently operates a bulk substation on the North City Site. SMUD intends to assure compliance with State standards at closed landfill sites and is in the process of determining the appropriate remediation for the North City Site. In 2009, SMUD recorded a liability related to the investigation, design and remediation necessary for the North City Site in the amount of \$12.0 million estimated for the entire project. As the owner of the North City Site, SMUD will have a role in the remediation selection and activities, as may those who operated or used the North City Site for landfill purposes. SMUD has estimated its exposure to such costs based on its proportionate share of the remedy. However, should others become unable to participate due to insolvency or otherwise unable to pay their share of the costs, SMUD's share of remediation costs would increase. SMUD's management does not believe this will occur. Even if SMUD were to ultimately be responsible for all remediation costs associated with the North City Site, SMUD management believes that the outcome of these remediation costs will not have a material adverse impact on SMUD's financial position, liquidity or results of operations.

Former Community Linen Rental Services (Community) Property. In 1981, SMUD purchased property from Community located at 1824 and 1826 61st Street (Site). That same year, Community sold its linen business and equipment to Mission Laundry (Mission). SMUD continued to lease portions of the property to Mission until 1985. SMUD settled with these businesses and waived a potential future legal claim for cleanup funding. The property to the north of the Site was owned by Kramer Carton Company (Kramer) and used for 60 years as a carton manufacturing facility. In 2009, Kramer filed for bankruptcy protection from its creditors. The Kramer property was encumbered by a first and second deed of trust, where the second deed of trust was held by Willamette Capital Management, Ltd. (Willamette). Willamette purchased the note on the first deed of trust. In 2011, Willamette foreclosed on the Kramer property and now holds title to the Kramer property. Based on environmental investigations, it has been determined that there is contamination at the Kramer property, at the Site, and at areas south of the Kramer property. The contamination appears to emanate primarily from the Site, with some, albeit minor, contribution from the Kramer property. Preliminary environmental investigations of the Kramer property, the Site and areas south of the Kramer property indicate that total remediation costs will likely exceed \$2.0 million. SMUD has recorded a liability for the estimated costs of the remediation. Although SMUD does not believe that it is the source of the contamination, it appears that one or more of its predecessors in interest may be the cause of most of the contamination. Moreover, since Kramer is bankrupt and Willamette contends it is exempt from liability under a secured creditor exemption, it is unclear whether it would be beneficial for SMUD to take legal action for contribution. SMUD has made an offer to purchase the Kramer property at a cost reflecting the proportionate share of the parties' predecessors' respective contributions to the contamination, giving SMUD an asset with value that will materialize after the cleanup. Even if SMUD were to

ultimately be responsible for all remediation costs associated with the Site, SMUD's management believes that the remediation of the Site will not have a material adverse impact on SMUD's financial position, liquidity or results of operations.

Buena Vista Biomass Power LLC. On October 2, 2015, SMUD informed Buena Vista Biomass Power, LLC (Buena Vista) of its intent to terminate its existing power purchase agreement (PPA) in accordance with the terms of the PPA, due to Buena Vista's failure to meet its contractual obligations. On December 4, Buena Vista informed SMUD that it disputed SMUD's right to terminate, and threatened to pursue arbitration if it were forced to shut down the Project. On December 21, SMUD issued Buena Vista a termination notice, effective December 31, 2015. At the same time, the parties entered into a short term power purchase agreement effective January 1, 2016, while the parties attempted to negotiate a longer term arrangement on commercial terms acceptable to both parties. The short term agreement will expire on February 29, 2016. SMUD is unable to predict at this time whether Buena Vista will bring a claim under the terminated PPA, to the extent that the parties are not successful in negotiating a replacement PPA. However, SMUD management does not believe that the outcome will have a material adverse impact on SMUD's financial position, liquidity or results of operations.

Patua Project LLC. In 2010, SMUD entered into a power purchase agreement with Patua Project LLC, a subsidiary at the time of Vulcan Power Company, to deliver 116 MW of geothermal power in three phases from a geothermal resource area east of Reno, Nevada. The project was soon sold to Gradient Resources (Gradient). The project subsequently experienced technical difficulties stemming from poor permeability of the subterranean resource that led to repeated delays and eventual downsizing of the project to no more than 38.67 MW in two phases. Gradient finally achieved commercial operation of Phase 1 more than a year behind schedule and well below the intended capacity, which led to insolvency. Consequently, the project was sold to Cyrq Energy (Cyrq) in November 2015. Soon after closing, SMUD discovered that Gradient delivered a portion of non-renewable power to SMUD in breach of the PPA, and has made claims upon Cyrq damages. In response, Cyrq has pressed several of its own financial claims that potentially exceed SMUD's. The parties are now engaged in settlement discussions, which if unsuccessful, could lead to arbitration. Even if Cyrq is successful in arbitration, SMUD management does not believe that the outcome will have a material adverse impact on SMUD's financial position, liquidity or results of operations.

Other Matters. Currently, SMUD is party to various claims, legal actions and complaints relating to its operations, including but not limited to: property damage and personal injury, contract disputes, torts, and employment matters. SMUD's management believes that the ultimate resolution of these matters will not have a material adverse effect on SMUD's financial position, liquidity or results of operations.

REQUIRED SUPPLEMENTARY INFORMATION (UNAUDITED)

**Schedule of Changes in Net Pension Liability and Related Ratios
During the Measurement Period**

Pension. The schedule of changes in NPL and related ratios is presented below for the years for which SMUD has available data. SMUD will add to this schedule each year and when it reaches 10 years it will contain the last 10 years data which will then be updated each year going forward.

	December 31,	
	2015	2014
	(thousands of dollars)	
Total pension liability:		
Service cost	\$ 27,991	\$ 28,170
Interest	142,468	137,546
Differences between expected and actual experience	(10,613)	-0-
Changes of assumptions	(34,228)	-0-
Benefit payments, including refunds of employee contributions	<u>(94,636)</u>	<u>(90,175)</u>
Net change in total pension liability	30,982	75,541
Total pension liability, beginning of year	<u>1,940,486</u>	<u>1,864,945</u>
Total pension liability, end of year (a)	<u>\$ 1,971,468</u>	<u>\$ 1,940,486</u>
Plan fiduciary net position:		
Contributions – employer	\$ 30,481	\$ 31,366
Contributions – employee	6,521	5,491
Net investment income	35,797	245,659
Benefit payments, including refunds of employee contributions	(94,636)	(90,175)
Administrative expense	(1,795)	(2,028)
Other changes	<u>(25)</u>	<u>-0-</u>
Net change in plan fiduciary net position	(23,657)	190,313
Plan fiduciary net position, beginning of year	<u>1,613,784</u>	<u>1,423,471</u>
Plan fiduciary net position, end of year (b)	<u>\$ 1,590,127</u>	<u>\$ 1,613,784</u>
Net pension liability, end of year (a)-(b)	<u>\$ 381,341</u>	<u>\$ 326,702</u>
Plan fiduciary net position as a percentage of the total pension liability	80.7%	83.2%
Covered-employee payroll	\$ 219,590	\$ 208,863
Net pension liability as a percentage of covered-employee payroll	173.7%	156.4%

Notes to Schedule

Benefit Changes: The figures above do not include any liability impact that may have resulted from plan changes which occurred after the June 30, 2014 valuation date. This applies for voluntary benefit changes as well as any offers of two years additional service credit.

Changes in Assumptions: The discount rate was changed from 7.5 percent (net of administrative expense) to 7.65 percent.

Schedule of Plan Contributions

Pension. The schedule of pension contributions is presented below for the years for which SMUD has available data. SMUD will add to this schedule each year and when it reaches 10 years it will contain the last 10 years data which will then be updated each year going forward.

	December 31,	
	2015	2014
	(thousands of dollars)	
Actuarially determined contribution	\$ 22,499	\$ 21,511
Contributions in relation to the actuarially determined contribution	(22,499)	(21,511)
Contribution deficiency (excess)	\$ -0-	\$ -0-
 Covered-employee payroll	 \$ 219,590	 \$ 208,863
 Contributions as a percentage of covered-employee payroll	 10.3%	 10.3%

Notes to Schedule

The actuarial methods and assumptions used to set the actuarially determined contributions for the years ended December 31, 2015 and 2014 were derived from the June 30, 2012 and 2011 funding valuation reports.

Actuarial cost method	Entry age normal
Amortization method/period	For details, see June 30, 2012 and 2011 Funding Valuation Reports
Asset valuation method	Actuarial value of assets. For details, see June 30, 2012 and 2011 Funding Valuation Reports
Inflation	2.75%
Salary increases	Varies by entry age and service
Payroll growth	3.0%
Investment rate of return	7.5% Net of Pension Plan Investment and Administrative expenses; includes inflation
Retirement age	The probabilities of retirement are based on the 2010 PERS Experience Study for the period from 1997 to 2007
Mortality	The probabilities of mortality are based on the 2010 PERS Experience Study for the period from 1997 to 2007. Pre-retirement and post-retirement mortality rates include 5 years of projected mortality improvement using Scale AA published by the Society of Actuaries.

There were no changes in methods or assumptions used to determine the actuarially determined contributions for the years reported above.

Schedule of Funding Progress

OPEB. The schedule of funding progress for the other postemployment benefit healthcare plan is presented below for the three recent years for which SMUD has available data:

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
(thousands of dollars)						
06/30/2015	\$ 176,239	\$ 319,431	\$ 143,192	55.2%	\$ 191,414	74.8%
06/30/2014	\$ 129,493	\$ 505,142	\$ 375,649	25.6%	\$ 187,151	200.7%
06/30/2013	\$ 103,251	\$ 492,651	\$ 389,400	21.0%	\$ 179,733	216.7%