Director of Research and Technical Activities, Project No. 3-24E  
Governmental Accounting Standards Board  
401 Merritt 7  
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Norwalk, CT 06856-5116

Sent by e-mail to director@gasb.org

Re: Comments on Exposure Draft of a proposed Statement of the Governmental Accounting Standards Board on *Leases* Project No. 3-24E

Dear Director of Research and Technical Activities,

Thank you for the opportunity to comment on the Governmental Accounting Standards Board’s (GASB) Exposure Draft on *Leases* (Project No. 3-24E). The Sacramento Municipal Utility District (SMUD) has reviewed the Exposure Draft and is providing comments in this letter.

SMUD is located in Sacramento, California and is responsible for the acquisition, generation, transmission, and distribution of electric power to approximately 600,000 customers within its service area, which includes most of Sacramento County and a small adjoining portion of Placer County. SMUD was formed by a vote of electors in 1923, under the provisions of the State of California Municipal Utility District Act, and began electric operations in 1947. SMUD owns and operates multiple generation assets, including natural gas, hydro, solar, and wind. SMUD also owns the decommissioned Rancho Seco nuclear power plant. SMUD is governed by an elected Board of Directors. SMUD’s Board of Directors has autonomous authority to establish rates charged for all SMUD services. Changes in such rates require formal action, after public hearing, by the Board of Directors.

As a municipal utility, SMUD is a special-purpose Government engaged only in stand-alone Business-type Activities. SMUD has the following comments based on its review of the Exposure Draft document:

1. As an electric utility, SMUD enters into many Power Purchase Agreements (PPA) to purchase electricity generated from both fossil fuel and renewable resources to help meet its customer load. These contracts can have both fixed and variable payment components (for example, fuel) in the same contract. SMUD does not always contract for the full capacity of an electric generation plant. We do not see a PPA (or any similar contract) listed in the examples of nonfinancial assets in paragraph 4, or any mention of a PPA in the entire exposure draft document. Would a PPA scope out under paragraph 5? If not, then what criteria would we use to determine if a PPA meets the definition of a lease? Paragraph 3 does not provide enough guidance to determine if a PPA gives SMUD “the legal right to use the underlying asset” at the beginning of the contract term, or if it meets “the foundational principle that leases are financings” (paragraph B2). A flow chart with
more details and decision points to help determine if a contract meets the definition of a lease (similar to the flowchart FASB provided in ASC 842-10-55-1) may be helpful. Adding some case study examples (such as FASB Example 9 – Contract for Energy/Power Cases A, B and C beginning with ASC 842-10-55-108) would be useful to assist preparers in determining if a contract contains a lease.

2. Paragraph 5b refers to “leases of biological assets.” Can GASB provide a definition of a “biological asset” or reference where it is defined, as done in paragraph 5c? SMUD leases some of its land at its wind farm for livestock grazing and farming activities and is trying to determine if these leases would scope out under paragraph 5b. SMUD still has use of the land for its wind turbines.

3. We recognize that, as stated in paragraph B53, the Board considers the disclosures for lessees to be essential. However, we still have concerns that the notes to financial statements for lessees required in paragraph 31 are too detailed and onerous so we think they should be pared down. In paragraph 31a the requirement for a general description of leasing arrangements and the requirements of paragraphs 31b, 31d, 31e, 31f, 31g, and 31h are all reasonable requirements that provide essential information. But we believe the additional requirements specified in paragraph 31a(1) and 31a(2) are not essential and would make the notes lengthy. Paragraph 31c which requires “the amount of lease assets by major classes of underlying assets” is too detailed and some leases may have more than one major class of underlying assets which makes this requirement onerous to maintain.

In paragraph B49, “to provide information to users about the full cost of leases”, what does the Board mean by “full cost of leases”? Is this the amounts for amortization expense, interest expense and outflows of resources for variable payments? Or is this the cash amount paid for leases during the year? Amortization expense and interest expense on the face of the financial statements could include items other than leases. Also, amortization expense could be different from the fixed lease payment amounts if the useful life of the asset is shorter than the lease term and therefore the lease asset is amortized over the useful life of the asset instead of the lease term. We are uncertain if a financial statement user could get to the “full cost of the leases”, whatever that means, from the note disclosures and what is shown on the face of the financial statements.

4. We also recognize that, as stated in paragraph B81, the Board considers the disclosures for lessors to be essential. However, as with the lessee notes, we still have concerns that the notes to financial statements for lessors required in paragraph 49 are too detailed and onerous so we think they should also be pared down. In paragraph 49a the requirement for a general description of the leasing arrangements and the requirements of paragraphs 49c and 49e are all reasonable requirements that provide essential information. But we believe the additional requirements in paragraph 49a of “including the basis, terms, and conditions on which any variable lease payments not included in the lease receivable are determined” are not essential. In Paragraph 49b the requirement to report “the carrying amount of assets on lease or held for leasing, by major classes of assets” is too detailed and some leases may have more than one major class of underlying assets which makes this requirement onerous to maintain. Also, only a portion of an asset may be under a
lease (for example, a portion of a piece of land is leased to a solar developer for a solar array and the electricity produced is sold to SMUD through a PPA). A manual process would be required to pro-rate a portion of the cost of the land to the part that is under lease. Then if the PPA is determined to be a lease for SMUD, it would be like leasing the land to itself. For paragraph 49d, it appears that these amounts would be included in “any other lease-related inflows” specified in paragraph 49c. We propose eliminating paragraph 49d and disclosing all amounts of inflows of resources from leases under paragraph 49c.

5. Paragraph 25 states that “the amortization of the lease asset should be reported as an outflow of resources (for example, amortization expense), which may be combined with depreciation expense related to other capital assets for financial reporting purposes.” We recognize that the Board considers this consistent with the foundational principle that a lease is a financing, but we have concerns about the changes this would cause to the operating expense presentation on the Statement of Revenues, Expenses and Changes in Net Assets. For example, if a PPA is recorded as a lease asset then this requirement would cause fixed payments currently classified as purchased power expense to be classified as amortization expense. This could be a material amount that would be changing its geography on the Statement of Revenues, Expenses and Changes in Net Position from purchased power expense to depreciation expense. In 2015, SMUD’s purchased power expense was $289 million and its depreciation expense was $189 million of total operating expenses of $1.27 billion. In addition, the presentation in the Statement of Revenues, Expenses and Changes in Net Assets for lease payments would be parsed out between a fixed portion recorded as amortization expense and interest expense and any variable portions recorded as an outflow of resources (operating expense). Currently the lease payments all go to one place. We believe this could create confusion for some users of the financial statements. We did not see any guidance on where to classify these different items in the Statement of Cash Flows.

6. Paragraph 76 provides the guidance for “Intra-Entity Leases” but it only refers to leases between blended component units and does not address leases between the primary government and its blended component unit. SMUD, as the primary government, has land leases and possibly other leases (for example, a PPA) with its blended component units. SMUD would have a lease asset and a lease liability and the component unit would have a lease receivable and a deferred inflow of resources, for which eliminations would be required. SMUD would have to figure out how to eliminate a lease asset against a deferred inflow of resources and additional computer programming would be needed.

7. On the Summary page iv, under Lease Accounting the last sentence of the first paragraph says that the lease asset would include any payments for “indirect costs.” Does the GASB intend “indirect costs” to be “initial direct costs” instead? Paragraph 24c refers to “initial direct costs” and does not mention “indirect costs.”

Thank you again for the opportunity to provide comments. If you have any questions regarding this comment letter, please do not hesitate to contact me at sandra.moorman@smud.org or (916)732-6957.
Sincerely yours,

[Signature]
Sandra Moorman
Director, Accounting and Controller