

# **Knoxville Utilities Board**

**Consolidated Financial Statements and  
Supplemental Information  
June 30, 2013 and 2012**

# Knoxville Utilities Board

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June 30, 2013 and 2012

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## Independent Auditors' Report

To the Board of Commissioners  
Knoxville Utilities Board - Consolidated  
Knoxville, Tennessee

### **Report on the Consolidated Financial Statements**

We have audited the accompanying consolidated financial statements of the Knoxville Utilities Board ("KUB"), an independent agency reported as a component unit for financial reporting purposes only, of Knoxville, Tennessee, as of and for the years ended June 30, 2013 and 2012 and the related notes to the consolidated financial statements, which collectively comprise KUB's basic consolidated financial statements as listed in the table of contents.

### **Management's Responsibility for the Consolidated 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 financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditors' Responsibility**

Our responsibility is to express opinions on these consolidated financial statements based on our audit. We conducted our audit 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 auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to KUB'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 KUB's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

### **Opinions**

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the respective financial position of KUB of Knoxville, Tennessee, as of June 30, 2013 and 2012, the respective changes in financial position, and cash flows, for the years then ended in accordance with accounting principles generally accepted in the United States of America.

### **Other Matters**

#### **Required Supplementary Information**

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and Schedule of Funding Progress on pages 3-19 and 45 be presented to supplement the basic consolidated financial statements. Such information, although not a part of the basic 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 basic 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 basic consolidated financial statements, and other knowledge we obtained during our audit of the basic 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 Information**

Our audit was conducted for the purpose of forming opinions on the consolidated financial statements that collectively comprise KUB's basic consolidated financial statements. The supplemental schedules on pages 47-48 are presented for the purpose of additional analysis and are not a required part of the basic consolidated financial statements. The schedule of expenditures of federal awards on page 46 is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is also not a required part of the basic consolidated financial statements.

The schedule of expenditures of federal awards is the responsibility of management and was derived from and relate directly to the underlying accounting and other records used to prepare the basic consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic consolidated financial statements or to the basic consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic consolidated financial statements as a whole.

The supplemental schedules have not been subjected to the auditing procedures applied in the audit of the basic consolidated financial statements and, accordingly, we do not express an opinion or provide any assurance on them.

#### **Other Reporting Required by Government Auditing Standards**

In accordance with *Government Auditing Standards*, we have also issued our report dated October 22, 2013, on our consideration of KUB's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering KUB's internal control over financial reporting and compliance.

*Rodden Moss & Co, PLLC*

Knoxville, Tennessee  
October 22, 2013

# **Knoxville Utilities Board**

## **Management's Discussion and Analysis**

### **June 30, 2013 and 2012**

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Knoxville Utilities Board (KUB), comprised of the Electric Division, Gas Division, Water Division, and Wastewater Division (Divisions), is reported as a component unit enterprise fund in the financial statements of the City of Knoxville. KUB's responsibility is to oversee the purchase, production, distribution, and processing of electricity, water, natural gas, and wastewater services. A seven-member Board of Commissioners governs KUB. The Board has all powers to construct, acquire, expand, or operate the Divisions. It has full control and complete jurisdiction over the management and operation of the Divisions including setting rates. KUB's accounts are maintained in conformity with the Uniform System of Accounts of the Federal Energy Regulatory Commission (FERC), the Uniform System of Accounts of the National Association of Regulatory Utility Commissioners (NARUC), and the Governmental Accounting Standards Board (GASB), as applicable.

This discussion and analysis is designed to (a) assist the reader in focusing on significant financial issues, (b) provide an overview of KUB's financial activity, (c) identify major changes in KUB's financial position, and (d) identify any financial concerns.

The Management Discussion and Analysis ("MD&A") focuses on the fiscal year ending June 30, 2013 activities, resulting changes and current known facts, and should be read in conjunction with KUB's consolidated financial statements.

## **Consolidated Highlights**

### **System Highlights**

As of June 30, 2013, KUB served 444,375 customers. 1,875 new customers were added in fiscal year 2013, representing growth of less than 1 percent.

Colder winter temperatures resulted in higher energy sales compared to fiscal year 2012. The winter heating season was 30 percent colder in fiscal year 2013, driving up gas sales 13.8 percent and electric sales 1.1 percent over last year.

Water sales volumes were lower in fiscal year 2013, due in large part to higher than normal precipitation levels. Water and wastewater sales volumes declined 4.3 percent and 2.4 percent, respectively.

The second in a series of electric and water rate increases previously adopted by the KUB Board of Commissioners in 2011 went into effect in fiscal year 2013. The one percent electric rate increase, effective October 2012, and five percent water rate increase, effective January 2013, will provide additional revenue to help fund each system's respective Century II infrastructure program. The KUB Board of Commissioners also adopted a twelve percent wastewater system rate increase, effective on October 2012 customer bills, to help fund requirements of the federal Consent Decree.

In December 2012, KUB sold \$110 million of new revenue bonds to fund capital system improvements, including \$65 million for the wastewater system, \$35 million for the electric system, and \$10 million for the gas system.

KUB sold \$143.9 million in revenue refunding bonds for all four systems for the purpose of refinancing outstanding bonds sold in 2005 and 2006 at lower interest rates. The refundings will provide debt service savings of \$24.6 million over the life of the bonds.

Two historic storm events, with a combined cost of \$8.4 million, impacted the electric system during fiscal year 2011. KUB received \$0.2 million in reimbursements from the Federal Emergency Management Agency (FEMA) during fiscal year 2013. KUB anticipates an additional \$1.6 million in reimbursements from FEMA in fiscal year 2014.

## **Knoxville Utilities Board Management's Discussion and Analysis June 30, 2013 and 2012**

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KUB was awarded a grant from the Department of Energy in October 2009 under DOE's Smart Grid Investment Grant Program. The grant, which totaled \$3.58 million, will be used to help fund a smart grid pilot project in the University of Tennessee and surrounding areas. The pilot project includes the installation of over 6,000 digital electronic smart meters and an advanced metering infrastructure (AMI) communications backbone, which will provide coverage for KUB's entire service territory. The communications infrastructure will enable KUB to remotely read the meters, and also provide remote service connection/disconnection capabilities. The term of the pilot is approximately three years. During fiscal year 2013, KUB's Smart Grid project deployed three additional communication towers and successfully integrated smart grid technology into multiple enterprise systems (customer billing, outage management and SCADA). The grant funded \$0.5 million of the communications infrastructure installed this fiscal year.

During fiscal year 2013, KUB continued to construct upgrades to its Kuwahee and Fourth Creek wastewater treatment facilities in order to comply with the requirements of the Federal Consent Decree. KUB's treatment plants continue to meet high standards of operation. Each of KUB's four wastewater treatment plants won an Operational Excellence award from the Tennessee Kentucky Water Environment Association. Each wastewater plant was also awarded the National Association of Clean Water Agencies Peak Performance award for outstanding compliance within the permitted limits.

### **Century II Infrastructure Program**

In 2007 KUB launched Century II, a new infrastructure management program, which included the assessment of each utility system's infrastructure and the appropriateness of current life cycle replacement programs. KUB placed its electric and water Century II programs on hold in 2009 in response to the economic recession in an effort to help customers struggling in a difficult economy. Although major increases to infrastructure replacement funding were delayed, significant investments were made to maintain reliability and system integrity. In April 2011, management provided an updated assessment of the overall condition of each utility system's infrastructure to the KUB Board of Commissioners. The assessment concluded that current funding levels were appropriate to support the natural gas system infrastructure replacement program and the wastewater capital program, however, given the critical infrastructure needs of the electric and water distribution systems, management recommended the KUB Board endorse a plan to resume the Century II electric and water programs in fiscal year 2012. A ten-year funding plan was developed to support the implementation of the electric and water Century II programs, including a combination of rate increases and debt issues to fully fund the programs for the next ten years.

In September 2011, the Board adopted a resolution, which endorsed the Century II electric and water programs and the associated ten-year funding plans. The resolution also adopted the initial three electric and water rate increases, the first two of which were effective October 1, 2011 and 2012, and January 1, 2012 and 2013, respectively. Each of the electric rate increases will generate an additional \$4.8 million in annual electric sales revenue. For residential electric customers this will result in an increase of \$1 in their monthly electric bills for each of the rate increases. Each of the water rate increases will generate an additional \$1.7 million in annual water sales revenue. For residential water customers this will result in an increase of \$1 in their monthly water bills for each of the rate increases.

With Board approval, KUB immediately began implementing the accelerated pace of infrastructure replacement for the electric and water systems. For the fiscal year ended June 30, 2013, KUB exceeded its target replacement levels for the majority of its Century II programs, while maintaining its overall Century II capital budget. For the electric system, 3,164 poles were replaced, exceeding the target level of 2,600; 14.8 miles of underground electric cable were replaced, exceeding the target level of 14 miles. KUB did not meet its goal related to substation improvements, due to timing issues on a particular substation. A portion of the capital budget for substation improvements was reallocated to the replacement of poles and underground electric cable. For the water system, 12.5 miles of galvanized

## **Knoxville Utilities Board Management's Discussion and Analysis June 30, 2013 and 2012**

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water main were replaced, exceeding the target level of 12 miles; 5.2 miles of cast iron water main were replaced, exceeding the target level of 5 miles. For the natural gas system, 8.2 miles of cast iron/ductile iron gas main were replaced, exceeding the target level of 8 miles. For the wastewater system, 25.3 miles of wastewater system main were rehabilitated or replaced, exceeding the target level of 25 miles.

### **Consent Decree**

In February 2005, a Consent Decree was entered into federal court regarding the operation of KUB's wastewater system. Under the terms of the Consent Decree, the remediation of identified sanitary sewer overflows ("SSOs") on KUB's wastewater system must be completed by June 30, 2016. KUB anticipates the Division will spend approximately \$530 million in capital investments through its PACE 10 program in order to comply with the terms of the Consent Decree related to the collection system. PACE 10 is an accelerated ten-year program to help improve Knoxville's waterways, the quality of life, and the economic well being of the community. The Consent Decree also required KUB to perform an evaluation of the wet-weather performance and capacity of its wastewater treatment plants.

In July 2007, KUB submitted a Composite Correction Plan (CCP) for its wastewater treatment plants to EPA for review. The development and filing of the CCP was a requirement of the federal order of February 2005. The CCP includes recommended improvements to KUB's Kuwahee and Fourth Creek treatment plants to address wet weather capacity issues noted in prior assessments. The EPA approved the CCP in January 2009 including a recommended schedule of plant improvements that extends beyond the expiration date of the original Consent Decree. An amendment to the Consent Decree incorporating and establishing this schedule was agreed to by all parties and was entered on June 23, 2009. The purpose of the Amendment is to allow KUB to complete a portion of work outlined in the CCP after the Consent Decree deadline of June 30, 2016. The CCP provides for a biologically enhanced high-rate clarification (the "BEHRC") secondary treatment system to be installed at the Fourth Creek treatment plant by June 30, 2018 and at the Kuwahee treatment plant by June 30, 2021. The total cost of such improvements is estimated to be approximately \$120 million.

KUB's total estimated capital investment to comply with the terms of the Consent Decree is \$650 million.

During fiscal year 2006, KUB launched the Private Lateral Program (PLP), as required by the Consent Decree, under which KUB tests private collection system laterals on its wastewater system over a ten-year period. Defective laterals and improper connections can introduce rainwater overloading the wastewater system and add pollution to area waterways. If a private lateral fails the respective inspection test, then the customer is required to have the lateral repaired/replaced within a specified time period. The \$2 million SEP provided funding for lateral repairs/replacements for eligible low-income customers. All of the SEP funds were disbursed as of April 2012.

KUB's funding plan for the Consent Decree includes long-term bonds and a series of rate increases phased in over the term of the order. Bond proceeds fund all wastewater capital projects, the majority of which are related to the Consent Decree. As of June 30, 2013, the Wastewater Division had issued \$425 million in bonds to fund system capital improvements since the inception of the Consent Decree. The KUB Board of Commissioners approved two 50 percent rate increases, which went into effect in April 2005 and January 2007, respectively. The Board also approved an 8 percent rate increase, which was effective in September 2008, and two 12 percent rate increases, which were effective in April 2011 and October 2012, respectively. KUB anticipates additional bond issues and rate increases over the next decade to help fund wastewater capital improvements.

KUB continues to be in compliance with Consent Decree requirements. As part of the PACE 10 program, KUB has installed storage tanks providing 34 million gallons of wastewater storage to control wet-weather overflows and rehabilitated or replaced approximately 228 miles of collection system pipe. KUB also continues to maintain a proactive operations and maintenance plan for the wastewater collection system

# **Knoxville Utilities Board**

## **Management's Discussion and Analysis**

### **June 30, 2013 and 2012**

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including inspection, cleaning, grease control, and private lateral enforcement. The result of the PACE 10 program has been a substantial reduction in sanitary sewer overflows.

During fiscal year 2013, the Wastewater Division incurred \$61.9 million in total expenditures related to Consent Decree requirements, including \$3.9 million for operating costs and \$58 million in capital improvements which included the rehabilitation or replacement of 25 miles of wastewater main. During the fiscal year, \$15.1 million was spent on sewer mini-basin rehab and replacement. Trunk line replacement and rehabilitation accounted for \$11.8 million of capital expenditures during the fiscal year. Also, pump station improvements accounted for \$5.6 million of annual capital expenditures. Upgrades completed at the Kuwahee wastewater treatment plant and currently in progress at the Fourth Creek treatment facility accounted for \$16 million of fiscal year 2013 capital expenditures.

As of June 30, 2013, the Wastewater Division had completed its ninth full year under the Consent Decree, spending \$429.5 million on capital investments to meet Consent Decree requirements. KUB remains on time and on budget in meeting the requirements of the Consent Decree.

### **Financial Highlights**

KUB's consolidated net position increased \$28.3 million in fiscal year 2013, compared to a \$26.3 million increase last fiscal year.

Operating revenue increased \$49.7 million or 7.2 percent, the result of higher electric and natural gas sales volumes and additional revenue from electric, water, and wastewater rate increases. Purchased energy expense (power and natural gas) increased \$33.3 million or 7.3 percent, reflecting increased customer demand in fiscal year 2013. Margin from sales (operating revenue less purchased energy expense) was up \$16.4 million or 6.9 percent compared with the prior fiscal year.

Operating expenses (excluding purchased power and purchased gas expense) increased \$10.2 million, or 5.7 percent. Operating and maintenance (O&M) expenses was \$4 million or 3.7 percent higher than the previous year. Depreciation and amortization expense increased \$4.8 million or 10 percent. Taxes and tax equivalents increased \$1.5 million or 6 percent.

Lower interest rates on investments resulted in a \$0.5 million decrease in interest income. Interest expense increased \$1.2 million or 3.5 percent, due to the issuance of \$110 million in electric, gas, and wastewater revenue bonds during the fiscal year and a full year of interest on \$25 million of water system bonds issued the previous year. The rise in interest expense was partially reduced by debt refunding in the current and previous fiscal years. These items contributed to a net decrease in non-operating revenues (expenses) of \$1.5 million compared to the prior year.

Capital contributions decreased \$2.7 million, the result of a decline in contributed assets from developers.

Total plant assets (net) increased \$98.2 million or 7.2 percent over the last fiscal year.

Long-term debt represented 49.3 percent of KUB's capital structure, compared to 47 percent last year. Capital structure equals long-term debt (including the current portion of revenue bonds and notes, as applicable, due to be retired next fiscal year), plus net position.



# Knoxville Utilities Board

## Management's Discussion and Analysis

### June 30, 2013 and 2012

#### Cash Budget Appropriations

KUB's Board of Commissioners adopted a total cash budget of \$840.5 million for fiscal year 2013. At fiscal year end, cash expenditures were \$22.3 million under budget. Purchased energy was \$15.5 million under budget, reflecting lower than anticipated wholesale rates. O&M expenditures were \$1.4 million under budget, reflecting labor-related savings. Capital expenditures were \$7 million under budget due to timing of fleet purchases, IT projects, and facilities-related projects. Bond proceeds of \$124.9 million were transferred to the general fund for reimbursements of capital expenditures during fiscal year 2013. The amount transferred was \$3.1 million more than expected, due to the timing of capital projects during fiscal year 2012. KUB's general fund balance was \$31.1 million higher than anticipated at year-end. The numbers below are presented on a cash basis.

#### KUB Consolidated Cash Report As of June 30, 2013

<i>(in thousands of dollars)</i>	<b>FY 2013 Budget</b>	<b>FY 2013 Actual FYTD</b>	<b>Dollar Variance*</b>	<b>Percent Variance</b>
Beginning Balance General Fund	\$100,358	\$100,358		
Operating Receipts	747,645	748,186	541	0.1%
Disbursements				
Purchased Energy Expense	480,604	465,133	15,471	3.2%
Operation & Maintenance Expense	116,467	115,037	1,430	1.2%
Capital Expenditures	158,093	151,097	6,996	4.4%
Debt Service & Taxes	85,360	86,937	(1,577)	-1.8%
Total Disbursements	840,524	818,204	22,320	2.7%
Bond Proceeds	121,754	124,857	3,103	2.5%
Net Flow-throughs and Transfers	(7,153)	(1,974)	5,179	72.4%
Ending General Fund Balance	<u>\$ 122,080</u>	<u>153,223</u>	<u>\$ 31,143</u>	<u>25.5%</u>

*\*Impact to Cash; (-) indicates a decrease or negative impact to cash*

#### Knoxville Utilities Board Consolidated Financial Statements

KUB's financial performance is reported under three basic consolidated financial statements: the Statement of Net Position; the Statement of Revenues, Expenses and Changes in Net Position; and the Statement of Cash Flows.

#### Statement of Net Position

KUB reports its assets, deferred outflows of resources, liabilities, deferred inflows of resources and net position in the Statement of Net Position. Assets are classified as current, restricted, plant in service, or other assets.

Liabilities are classified as current, other, or long-term debt. Net position is classified as net investment in capital assets; restricted; or unrestricted. Net position tells the user what KUB has done with its accumulated earnings, not just the balance.

# **Knoxville Utilities Board**

## **Management's Discussion and Analysis**

### **June 30, 2013 and 2012**

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Net investment in capital assets, reflects the book value of all capital assets less the outstanding balances of debt used to acquire, construct, or improve those assets.

Restricted net position includes assets that have been limited to specific uses by KUB's bond covenants or through resolutions passed by the KUB Board of Commissioners.

Unrestricted net position is a residual classification; the amount remaining after reporting net position as either invested in capital or restricted is reported there.

#### **Statement of Revenues, Expenses and Changes in Net Position**

KUB reports its revenues and expenses (both operating and non-operating) on the Statement of Revenues, Expenses and Changes in Net Position. In addition, any capital contributions or assets donated by developers are reported on this statement.

Total revenue less total expense equals the change in net position for the reporting period. Net position at the beginning of the period is increased or decreased, as applicable, by the change in net position for the reporting period.

The change in net position for the reporting period is added to the net position segment of the Statement of Net Position.

#### **Statement of Cash Flows**

KUB reports cash flows from operating activities, capital and related-financing activities, and investing activities on the Statement of Cash Flows. This statement tells the user the sources and uses of cash during the reporting period.

The statement indicates the beginning cash balance and ending cash balance and the means by which it was either increased or decreased during the reporting period.

The statement also reconciles cash flow to operating income as it appears on the Statement of Revenues, Expenses and Changes in Net Position.

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**Management's Discussion and Analysis**  
**June 30, 2013 and 2012**

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**Condensed Financial Statements**

**Statement of Net Position**

The following table reflects the condensed consolidated Statement of Net Position for KUB compared to the prior year.

<b>Statements of Net Position</b>			
<b>As of June 30</b>			
<i>(in thousands of dollars)</i>		<b>2013</b>	<b>2012</b>
Current and other assets	\$	370,932	\$ 334,984
Capital assets, net		1,465,671	1,367,479
Deferred outflows of resources		13,002	3,647
Total assets and deferred outflows of resources		<u>1,849,605</u>	<u>1,706,110</u>
Current and other liabilities		163,262	144,589
Long-term debt outstanding		815,340	720,575
Deferred inflows of resources		7,358	5,639
Total liabilities and deferred inflows of resources		<u>985,960</u>	<u>870,803</u>
Net position			
Net investment in capital assets		630,793	621,993
Restricted		12,372	11,228
Unrestricted		220,480	202,086
Total net position	\$	<u><u>863,645</u></u>	\$ <u><u>835,307</u></u>

**Normal Impacts on Statement of Net Position**

The following is a description of activities which will normally impact the comparability of the Statement of Net Position presentation.

- Change in net position (from Statement of Revenues, Expenses and Changes in Net Position): impacts (increase/decrease) current and other assets and/or capital assets and unrestricted net position.
- Issuing debt for capital: increases deferred inflows/outflows of resources and long-term debt.
- Spending debt proceeds on new capital: reduces current assets and increases capital assets.
- Spending of non-debt related current assets on new capital: (a) reduces current assets and increases capital assets and (b) reduces unrestricted net position and increases net investment in capital assets.
- Principal payment on debt: (a) reduces current and other assets and reduces long-term debt and (b) reduces unrestricted net position and increases net investment in capital assets.
- Reduction of capital assets through depreciation: reduces capital assets and net investment in capital assets.

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## **Management's Discussion and Analysis**

### **June 30, 2013 and 2012**

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#### **Current Year Impacts and Analysis**

##### **Current and Other Assets**

Current and other assets increased \$35.9 million or 10.7 percent. General fund cash (including cash and cash equivalents, short-term investments, and long-term investments) increased \$55.9 million as KUB used bond proceeds to fund a large portion of capital expenditures in fiscal year 2013 rather than cash generated from operations. Accounts receivable was \$8.7 million or 12.6 percent higher than last year, partially due to strong winter sales in the Gas and Electric Divisions compared to the prior year.

KUB recovered the prior year's under recovered purchased power costs of \$17.7 million from its customers through its electric rates as adjusted by the Purchased Power Adjustment.

The Gas Division under recovered \$0.8 million in wholesale gas costs from its customers through its gas rates in fiscal year 2013, as compared to a \$2.8 million under recovery in fiscal year 2012. This under recovery of purchased gas costs will be collected from customers next fiscal year through adjustments to gas rates via the Purchased Gas Adjustment. The net effect was a \$2 million reduction in assets. Gas in storage decreased \$4.5 million due to a 30.3 percent decrease in storage volumes compared to last June, reflecting a greater usage of natural gas in storage to meet the increased customer demand in fiscal year 2013.

KUB contributed \$3.2 million to operating contingency reserves from the general fund in order to maintain the required balance in the funds. In addition, \$1 million was contributed to the rainy day reserves for each of the Gas, Water, and Wastewater Divisions.

##### **Capital Assets**

Capital assets (net) increased \$98.2 million or 7.2 percent. Major plant expenditures (reflected in both plant additions and work in progress) during fiscal year 2013 included \$38.4 million for PACE 10 projects for the wastewater collection system, \$16 million for Composite Correction Plan projects for the wastewater system, \$23.6 million for electric distribution system improvements, \$12.8 million for gas main replacement and construction of new gas mains, \$11.5 million for water main replacement, \$10.1 million for water plant and system improvements, and \$8.9 million for pole replacements for the electric system.

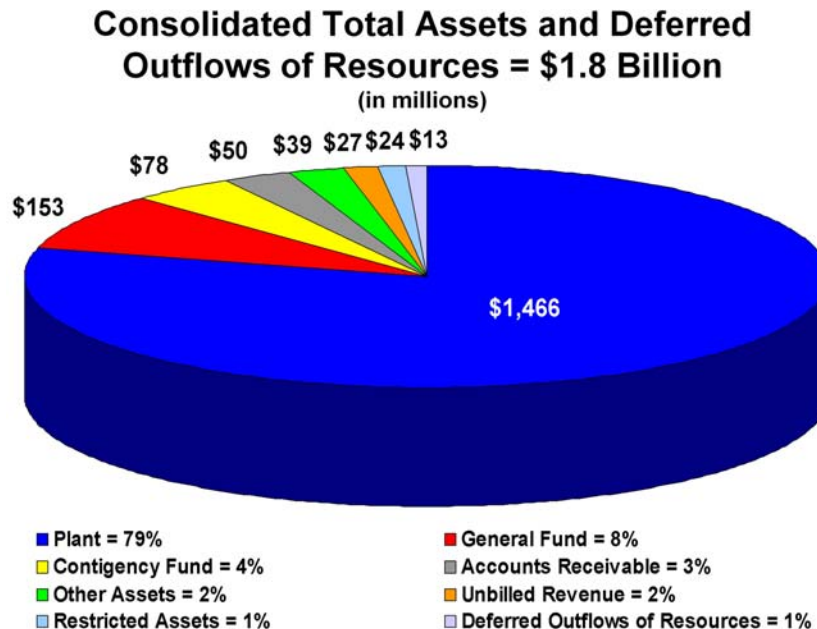
##### **Deferred Outflows of Resources**

Deferred outflows of resources increased \$9.4 million compared to the prior year, reflecting unamortized bond refunding costs from the refunding of long term debt in March 2013.

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**Current and Other Liabilities**

Current and other liabilities increased \$18.7 million or 12.9 percent, partially due to a \$4.9 million over recovery of purchased power expenses from KUB's electric customers in fiscal year 2013. This over recovery of purchased power costs will be refunded to KUB's electric customers through future adjustments to electric rates via the Purchased Power Adjustment. Accounts payable rose \$8.4 million due to higher contractor costs from Century II projects for June 2013 compared to the same month last year. In addition, the liability for the current portion of debt related to bonds rose \$2.3 million compared to the prior year.

**Long-term Debt**

Long-term debt increased \$94.8 million or 13.2 percent. During the fiscal year, \$21.6 million of bond debt was repaid. In December 2012, KUB sold \$110 million in revenue bonds to fund capital improvements for the electric, gas, and wastewater systems. In March 2013, KUB sold \$143.9 million of refunding bonds.

**Deferred Inflows of Resources**

The net unamortized cost of debt increased \$1.7 million reflecting premiums received in the refunding of long term debt in March 2013.

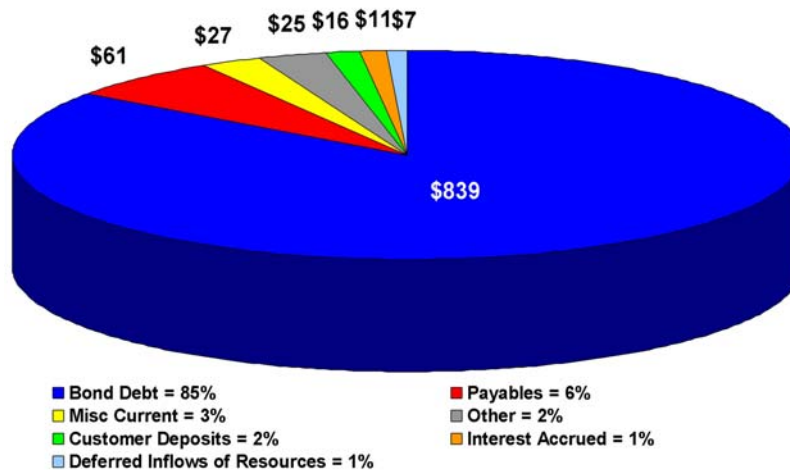
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**Consolidated Total Liabilities and Deferred  
Inflows of Resources = \$986 Million**

(in millions)



**Net Position**

Net position increased by \$28.3 million this fiscal year. Net investment in capital assets increased \$8.8 million or 1.4 percent. Restricted net position increased \$1.1 million compared to the prior year. Unrestricted net position increased \$18.4 million or 9.1 percent, reflecting the increase in general fund cash compared to the previous fiscal year end.

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**Statement of Revenues, Expenses and Changes in Net Position**

The following table reflects the condensed consolidated Statement of Revenues, Expenses and Changes in Net Position for KUB compared to the prior year.

<b>Statements of Revenues, Expenses and Changes in Net Position</b>			
<b>For the Years Ended June 30</b>			
<i>(in thousands of dollars)</i>	<b>2013</b>		<b>2012</b>
Operating revenues	\$	743,249	\$ 693,531
Less: Purchased energy expense		489,322	456,038
Margin from sales		<u>253,927</u>	<u>237,493</u>
Operating expenses			
Treatment		13,280	12,624
Distribution and collection		57,052	53,940
Customer service		11,991	11,100
Administrative and general		30,402	31,066
Depreciation and amortization		52,364	47,613
Taxes and tax equivalents		26,032	24,552
Total operating expenses		<u>191,121</u>	<u>180,895</u>
Operating income		62,806	56,598
Interest income		1,032	1,504
Interest expense		(35,266)	(34,077)
Other income/(expense)		(612)	(767)
Change in net position before capital contributions		<u>27,960</u>	<u>23,258</u>
Capital contributions		378	3,081
Change in net position	\$	<u>28,338</u>	\$ <u>26,339</u>

**Normal Impacts on Statement of Revenues, Expenses and Changes in Net Position**

The following is a description of activities which will normally impact the comparability of the Statement of Revenues, Expenses and Changes in Net Position presentation.

- Operating revenue is largely determined by volume of sales for the fiscal year. Any change (increase/decrease) in retail rates would also be a cause of change in operating revenue.
- Purchased energy expense is determined by volume of power purchases from TVA and volume of natural gas purchases for the fiscal year. Also, any change (increase/decrease) in wholesale power and/or gas rates would result in a change in purchased energy expense.
- Operating expenses (distribution, customer service, administrative and general) are normally impacted by changes in areas including, but not limited to, labor cost (staffing, wage rates), active employee and retiree medical expenses, and system maintenance.
- Depreciation expense is impacted by plant additions and retirements during the fiscal year.
- Taxes and equivalents are impacted by plant additions/retirements, changes in property tax rates, and gross margin levels.

# **Knoxville Utilities Board**

## **Management's Discussion and Analysis**

### **June 30, 2013 and 2012**

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- Interest income is impacted by level of interest rates and investments.
- Interest expense on debt is impacted by level of outstanding debt and the interest rate(s) on the outstanding debt.
- Other income/(expenses) is impacted by non-operating revenues, netted against miscellaneous non-operating expenses.
- Capital contributions are impacted by a donation of facilities/infrastructure to KUB by developers and governmental agencies. The contributions are recognized as revenue and recorded as plant in service based on the fair market value of the asset(s).

### **Current Year Impacts and Analysis**

KUB's consolidated net position increased \$28.3 million, compared to a \$26.3 million increase last fiscal year.

Operating revenue was \$49.7 million or 7.2 percent higher than the previous fiscal year. Electric Division operating revenue increased \$27.4 million, primarily due to a 1.1 percent increase in sales volumes and additional revenue from electric rate increases. Gas Division revenue increased \$17.7 million or 20.1 percent for the fiscal year, the result of a 13.7 percent rise in natural gas sales volumes. Water Division revenue increased \$0.5 million or 1.4 percent, the result of additional revenue from water rate increases. Wastewater Division revenue was \$4.1 million higher than the previous year, reflecting a partial year of revenue from a twelve percent rate increase effective October 2012.

Wholesale energy expense increased \$33.3 million or 7.3 percent. Purchased power expense increased \$21.3 million compared to last year, the result of higher sales volumes. Purchased gas costs were \$12 million higher, due to the impact of higher customer demand.

Margin from sales (operating revenue less purchased energy expense) increased \$16.4 million compared to the previous year, reflecting a higher level of energy sales volumes, a full year of margin from the electric and water rate increases, and a partial year's revenue from the wastewater rate increase.

### **Operating Expenses**

Operating expenses (excluding wholesale purchased energy expense) increased \$10.2 million or 5.7 percent compared to last fiscal year. Operating expenses are categorized as the following:

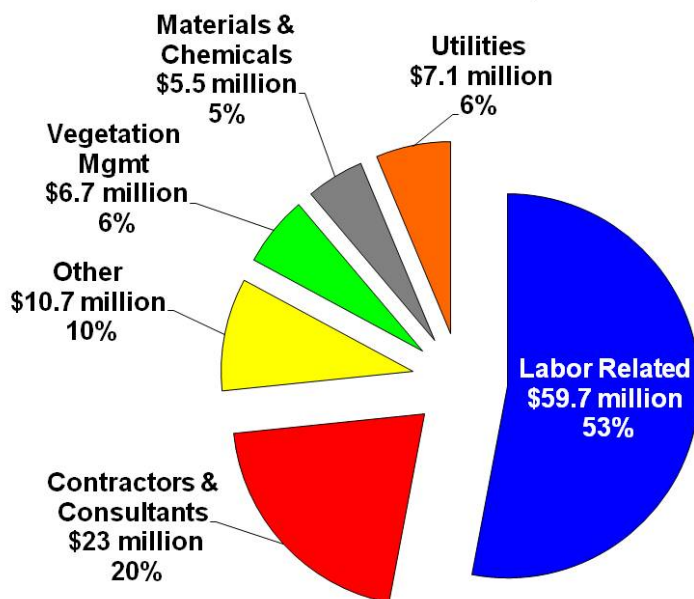
- Treatment expenses were \$0.7 million or 5.2 percent higher than the prior year, reflecting an increase in utility usage by water and wastewater treatment plants.
- Distribution and collection expenses increased \$3.1 million or 5.8 percent, the result of higher outside contractor and consultant expenses related to electric substation maintenance, transformer testing and an assessment of the gas distribution system.
- Customer service expenses rose \$0.9 million or 8 percent, partially due to a \$0.4 million increase in meter reading expenses compared with the prior year.
- Administrative and general expenses decreased \$0.7 million or 2.1 percent, reflecting a \$0.4 million decline in labor-related expenses compared with the prior year.



**Knoxville Utilities Board**  
**Management's Discussion and Analysis**  
**June 30, 2013 and 2012**

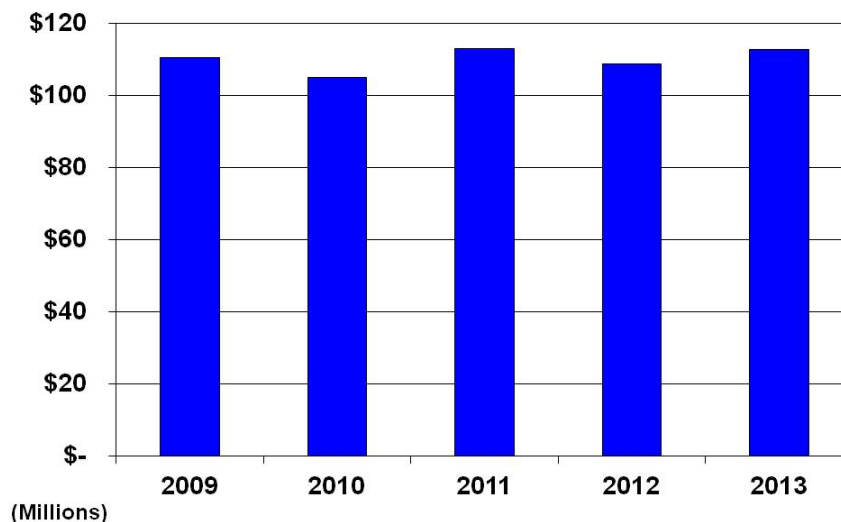
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**FY 2013 Consolidated O & M Expense = \$112.7 million**



Operation and Maintenance (O&M) expenses have increased at an annual rate of 0.6 percent over the past five years. The relatively low level of cost growth reflects cost management initiatives implemented by KUB, including a reduction in full-time staffing from 951 full-time employees in 2009 to 873 by June 30, 2013.

**Consolidated Operation & Maintenance Expense**



- Depreciation and amortization expense increased \$4.8 million or 10 percent. KUB added \$104.9 million in assets during fiscal year 2012. A full year of depreciation expense was recorded on these capital investments during fiscal year 2013 and a partial year of

# Knoxville Utilities Board

## Management's Discussion and Analysis

### June 30, 2013 and 2012

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- depreciation expense was incurred on \$146.1 million in assets placed in service during fiscal year 2013.
- Taxes and tax equivalents increased \$1.5 million or 6 percent. Tax equivalent payments to taxing jurisdictions in which KUB's utility systems are located are based on a combination of net plant values and margin from sales. This increase was primarily due to the rise in KUB's plant values in fiscal year 2012.

Interest income decreased \$0.5 million or 31.4 percent due to less interest earned on investments, the result of lower interest rates.

Interest expense increased \$1.2 million or 3.5 percent, reflecting interest expense on \$110 million in bonds sold in December 2012 and \$25 million in bonds sold in December 2011.

Other income (net) increased \$0.2 million. The market value of contingency fund investments increased \$0.1 million.

Capital contributions were \$2.7 million lower than last fiscal year. Capital contributions for the electric, water, and wastewater systems declined, however the largest reduction of \$1.7 million was reflected in the wastewater system.

## Capital Assets and Debt Administration

### Capital Assets

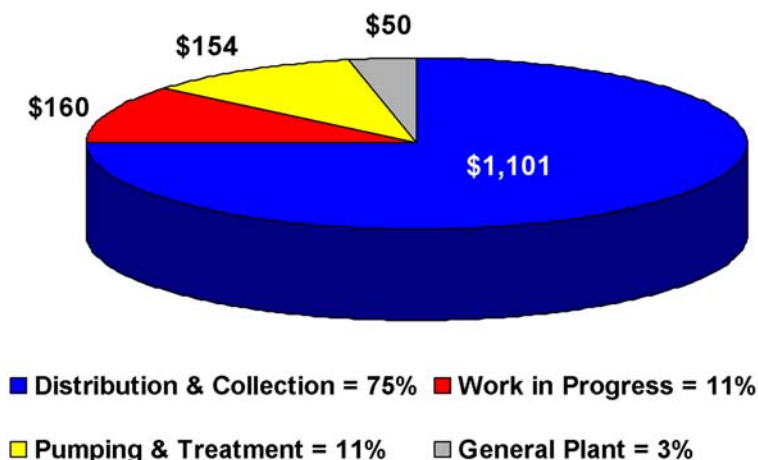
As of June 30, 2013, KUB had \$1.5 billion invested in capital assets, as reflected in the schedule below, which represents a net increase (including additions, retirements, and depreciation) of \$98.2 million or 7.2 percent over the end of the last fiscal year.

<b>Capital Assets</b> <b>As of June 30</b> <b>(Net of Depreciation)</b>			
<i>(in thousands of dollars)</i>		<b>2013</b>	<b>2012</b>
Production plant	\$	90	\$ 103
Pumping & treatment plant		154,157	145,983
Distribution & collection plant:			
Mains		612,433	563,475
Services and meters		83,278	81,478
Electric station equipment		30,227	25,181
Poles, towers and fixtures		72,274	63,621
Overhead conductors		67,449	69,161
Line transformers		52,503	48,486
Others		182,765	172,735
Total distribution & collection plant		1,100,929	1,024,137
General plant		50,398	49,208
Total plant		1,305,574	1,219,431
Work in progress		160,098	148,048
Total net plant	\$	<u>1,465,672</u>	\$ <u>1,367,479</u>

**Knoxville Utilities Board**  
**Management's Discussion and Analysis**  
**June 30, 2013 and 2012**

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**Consolidated Capital Assets = \$1.5 Billion**  
(in millions)



Major capital asset additions during the year were as follows:

- \$38.4 million related to PACE 10 projects.
  - \$15.1 million for sewer mini-basin rehab and replacement
  - \$11.8 million for sewer trunk line replacement and rehabilitation
  - \$5.6 million for pump station design and construction
  - \$5.5 million for collection system improvements
- \$16 million for Composite Correction Plan projects.
  - \$3.1 million for upgrades to the Kuwahee Wastewater Treatment Plant
  - \$12.9 million for upgrades at the Fourth Creek Facility
- \$23.6 million for various electric distribution system improvements.
- \$12.8 million for gas main replacement and construction of new mains for the gas system.
- \$11.5 million for pipe replacement for the water system.
- \$10.1 million for water plant and system improvements.
- \$8.9 million for pole replacements for the electric system.

### **Debt Administration**

As of June 30, 2013, KUB had \$839.3 million in outstanding debt (including the current portion of revenue bonds) compared to \$742.2 million last year, an increase of \$97.1 million. KUB's weighted average cost of debt as of June 30, 2013 was 4.11 percent.

During fiscal year 2013, \$21.6 million in bonds were repaid, reducing outstanding debt levels.

During the fiscal year, \$110 million in long-term bonds were issued to finance capital improvements for the electric, gas, and wastewater systems.

# Knoxville Utilities Board

## Management's Discussion and Analysis

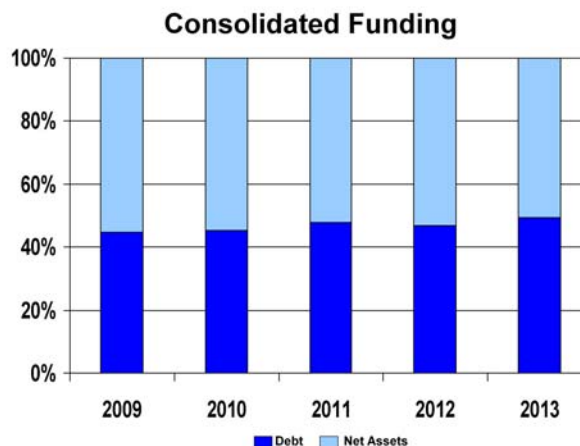
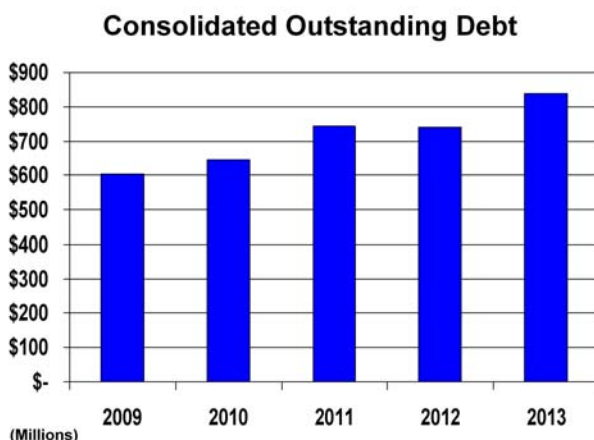
### June 30, 2013 and 2012

KUB issued \$143.9 million in refunding bonds for the purpose of refunding outstanding bonds for all four divisions at lower interest rates. The bonds refunded were issued in 2005 and 2006. KUB will realize a total debt service savings of \$24.6 million over the life of the bonds (\$16.9 million on a net present value basis).

KUB's outstanding debt is rated by Standard & Poor's and Moody's Investors Service. As of June 30, 2013, Standard & Poor's rated the revenue bonds of the Electric, Water, and Wastewater Divisions AA+ and the revenue bonds of the Gas Division AA. Moody's Investors Service rated the bonds of all four divisions Aa2.

The following is a schedule of KUB's outstanding debt as of June 30, 2013.

<b>Outstanding Debt</b>			
<b>As of June 30</b>			
<i>(in thousands of dollars)</i>		<b>2013</b>	<b>2012</b>
Revenue bonds		\$ 839,305	\$ 742,210
Total outstanding debt		<u>\$ 839,305</u>	<u>\$ 742,210</u>



Since fiscal year 2009, KUB's outstanding debt has increased from \$604.6 million to its current level of \$839.3 million. The majority of the growth is attributed to new debt in the Wastewater Division to fund capital projects to meet the capital requirements of the Consent Decree.

### Impacts on Future Financial Position

KUB anticipates net customer growth of 1,980 customers during fiscal year 2014.

KUB sold \$50 million in revenue bonds in September 2013 for the purpose of funding capital improvements for the natural gas and water systems.

A previously adopted one percent electric rate increase, to help fund Century II electric system improvements, will be effective October 1, 2013. This increase will add \$1 to each residential electric customer's monthly bill.

## **Knoxville Utilities Board**

### **Management's Discussion and Analysis**

#### **June 30, 2013 and 2012**

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A previously adopted five percent water rate increase, designed to help fund Century II water system improvements, will be effective January 1, 2014. This increase will add \$1 to each residential water customer's monthly bill.

In June 2013, the Board of Commissioners adopted a five percent gas rate increase, effective on October 2013 customer bills. This increase will add \$3 to each residential gas customer's average monthly bill.

The TVA Board approved a 1.5 percent October 2013 base rate increase which will be passed through to KUB's electric retail rates via its Purchased Power Adjustment.

KUB debt portfolio includes \$137.6 million of Build America Bond (BABs) in which the U.S. Treasury provides a rebate to KUB for a portion of the interest. The interest rebates were subject to federal sequestration during the fiscal year and were reduced by 8.7 percent. Any future actions by Congress may also affect the anticipated rebates for future fiscal years.

GASB Statement No. 67, *Financial Reporting for Pension Plans*, is effective for periods beginning after June 15, 2013 and GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, is effective for periods beginning after June 15, 2014. KUB has not elected early implementation of these standards and has not completed the process of evaluating the impact of these statements on its financial statements.

No other facts, decisions, or conditions are currently known which would have a significant impact on KUB's financial position or results of operations during fiscal year 2014.

### **Financial Contact**

KUB's financial statements are designed to present users (citizens, customers, investors, and creditors) with a general overview of KUB's financial position and results of operations for the fiscal years ending June 30, 2013 and 2012. If you have questions about the statements or need additional financial information, contact KUB's Chief Financial Officer at 445 South Gay Street, Knoxville, Tennessee 37902.

**Knoxville Utilities Board**  
**Consolidated Statements of Net Position**  
**June 30, 2013 and 2012**

	<b>2013</b>	<b>2012</b>
<b>Assets and Deferred Outflows of Resources</b>		
Current assets:		
Cash and cash equivalents	\$ 125,723,586	\$ 69,858,112
Short-term investments	27,500,000	30,500,000
Short-term contingency fund investments	31,322,858	30,795,149
Other current assets	1,464,300	2,775,000
Accrued interest receivable	52,927	115,080
Accounts receivable, less allowance of uncollectible accounts of \$948,358 in 2013 and \$955,065 in 2012	77,154,986	68,491,633
Inventories	8,038,772	7,642,232
Prepaid expenses	2,256,827	745,139
Gas storage	9,333,190	13,789,493
Total current assets	<u>282,847,446</u>	<u>224,711,838</u>
Restricted assets:		
Bond funds	23,580,016	21,354,636
Other funds	53,820	23,769
Unused bond proceeds	206	13,803,726
Total restricted assets	<u>23,634,042</u>	<u>35,182,131</u>
Plant in service	1,987,349,747	1,866,937,094
Less accumulated depreciation	<u>(681,775,954)</u>	<u>(647,505,932)</u>
	1,305,573,793	1,219,431,162
Retirement in progress	1,731,738	1,305,720
Construction in progress	158,365,607	146,742,096
Net plant in service	<u>1,465,671,138</u>	<u>1,367,478,978</u>
Other assets:		
Long-term contingency fund investments	46,980,060	41,602,818
TVA conservation program receivable	10,189,286	9,552,209
Under recovered purchased power cost	-	17,654,719
Under recovered purchased gas cost	841,779	2,825,163
Other	6,439,241	3,455,053
Total other assets	<u>64,450,366</u>	<u>75,089,962</u>
Total assets	<u>1,836,602,992</u>	<u>1,702,462,909</u>
Deferred outflows of resources:		
Unamortized bond refunding costs	13,002,043	3,586,800
Unamortized costs	-	59,898
Total deferred outflows of resources	<u>13,002,043</u>	<u>3,646,698</u>
Total assets and deferred outflows of resources	<u>\$ 1,849,605,035</u>	<u>\$ 1,706,109,607</u>

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

**Knoxville Utilities Board**  
**Consolidated Statements of Net Position**  
**June 30, 2013 and 2012**

	<b>2013</b>	<b>2012</b>
<b>Liabilities, Deferred Inflows, and Capitalization</b>		
Current liabilities:		
Current portion of revenue bonds	\$ 23,965,000	\$ 21,635,000
Sales tax collections payable	1,181,170	1,145,588
Accounts payable	59,560,896	51,127,955
Accrued expenses	26,917,368	26,741,204
Customer deposits plus accrued interest	15,451,660	14,720,397
Accrued interest on revenue bonds	11,261,245	10,150,676
Total current liabilities	<u>138,337,339</u>	<u>125,520,820</u>
Other liabilities:		
TVA conservation program	10,005,739	9,335,409
Accrued compensated absences	8,267,550	8,237,657
Customer advances for construction	1,217,528	1,283,627
Over recovered purchased power cost	4,927,581	-
Other	506,818	211,564
Total other liabilities	<u>24,925,216</u>	<u>19,068,257</u>
Long-term debt:		
Revenue bonds	<u>815,340,000</u>	<u>720,575,000</u>
Total long-term debt	<u>815,340,000</u>	<u>720,575,000</u>
Total liabilities	<u>978,602,555</u>	<u>865,164,077</u>
Deferred inflows of resources:		
Unamortized costs	<u>7,357,600</u>	<u>5,639,155</u>
Total deferred inflows of resources	<u>7,357,600</u>	<u>5,639,155</u>
Total liabilities and deferred inflows of resources	<u>985,960,155</u>	<u>870,803,232</u>
Net position		
Net investment in capital assets	630,793,054	621,992,896
Restricted for:		
Debt service	12,318,771	11,203,959
Other	53,820	23,768
Unrestricted	<u>220,479,235</u>	<u>202,085,752</u>
Total net position	<u>863,644,880</u>	<u>835,306,375</u>
Total liabilities, deferred inflows, and net position	<u>\$ 1,849,605,035</u>	<u>\$ 1,706,109,607</u>

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

**Knoxville Utilities Board**  
**Consolidated Statements of Revenues, Expenses and Changes in Net Position**  
**June 30, 2013 and 2012**

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	2013	2012
Operating revenues		
Electric	\$ 528,220,515	\$ 500,812,890
Gas	103,280,814	85,526,548
Water	37,618,140	37,091,445
Wastewater	74,129,548	70,099,897
Total operating revenues	<u>743,249,017</u>	<u>693,530,780</u>
Operating expenses		
Purchased power	427,099,886	405,767,449
Purchased gas	62,222,336	50,270,966
Treatment	13,280,091	12,624,245
Distribution and collection	57,051,845	53,940,051
Customer service	11,990,979	11,099,777
Administrative and general	30,402,021	31,065,524
Provision for depreciation and amortization	52,363,765	47,613,323
Taxes and tax equivalents	26,031,585	24,552,314
Total operating expenses	<u>680,442,508</u>	<u>636,933,649</u>
Operating income	<u>62,806,509</u>	<u>56,597,131</u>
Non-operating revenues (expenses)		
Contributions in aid of construction	6,411,589	5,729,916
Interest and dividend income	1,031,771	1,503,523
Interest expense	(35,265,771)	(34,077,313)
Write-down of plant for costs recovered through contributions	(6,411,589)	(5,729,916)
Other	(612,200)	(767,199)
Total non-operating revenues (expenses)	<u>(34,846,200)</u>	<u>(33,340,989)</u>
Change in net position before capital contributions	27,960,309	23,256,142
Capital contributions	378,196	3,081,451
Change in net position	28,338,505	26,337,593
Net position, beginning of year	835,306,375	808,968,782
Net position, end of year	<u>\$ 863,644,880</u>	<u>\$ 835,306,375</u>

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



# Knoxville Utilities Board

## Consolidated Statements of Cash Flows

### June 30, 2013 and 2012

	2013	2012
Cash flows from operating activities:		
Cash receipts from customers	\$ 732,089,984	\$ 695,320,206
Cash receipts from other operations	13,193,284	16,434,833
Cash payments to suppliers of goods or services	(532,005,075)	(539,558,030)
Cash payments to employees for services	(47,326,006)	(48,822,557)
Payment in lieu of taxes	(22,555,022)	(21,252,243)
Cash receipts from collections of TVA conservation loan program participants	2,825,755	2,286,470
Cash payments for TVA Conservation loan program	(2,757,835)	(2,094,050)
Net cash provided by operating activities	<u>143,465,085</u>	<u>102,314,629</u>
Cash flows from capital and related financing activities:		
Net proceeds from bond issuance	111,031,459	24,978,728
Principal paid on revenue bonds and notes payable	(21,635,000)	(19,750,000)
(Increase) decrease in unused bond proceeds	13,803,520	34,004,216
Interest paid on revenue bonds and notes payable	(34,155,202)	(35,108,938)
Acquisition and construction of plant	(158,749,321)	(149,920,294)
Changes in bond funds, restricted	(2,225,380)	126,482
Customer advances for construction	(66,099)	(168,243)
Proceeds received on disposal of plant	58,144	73,054
Cash received from developers and individuals for capital purposes	6,411,588	5,729,917
Net cash used in capital and related financing activities	<u>(85,526,291)</u>	<u>(140,035,078)</u>
Cash flows from investing activities:		
Purchase of investment securities	(3,621,062)	(19,063,289)
Maturities of investment securities	716,112	840,078
Interest received	1,093,924	1,503,523
Other property and investments	(262,294)	(249,019)
Net cash used in investing activities	<u>(2,073,320)</u>	<u>(16,968,707)</u>
Net increase (decrease) in cash and cash equivalents	55,865,474	(54,689,156)
Cash and cash equivalents, beginning of year	<u>69,858,112</u>	<u>124,547,268</u>
Cash and cash equivalents, end of year	<u>\$ 125,723,586</u>	<u>\$ 69,858,112</u>
<b>Reconciliation of operating income to net cash provided by operating activities</b>		
Operating income	\$ 62,806,509	\$ 56,597,131
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization expenses	54,177,358	49,492,211
Changes in operating assets and liabilities:		
Accounts receivable	(8,663,354)	7,833,203
Inventories	(396,540)	(2,419,939)
Prepaid expenses	2,944,614	(2,947,910)
TVA conservation program receivable	(637,077)	(1,003,161)
Other assets	(1,703,536)	846,269
Sales tax collections payable	35,582	38,046
Accounts payable and accrued expenses	8,638,999	(2,773,549)
TVA conservation program payable	670,330	1,136,351
Unrecovered purchased power cost	22,582,300	(1,728,336)
Underrecovered gas costs	1,983,384	(3,892,237)
Customer deposits plus accrued interest	731,264	1,066,966
Other liabilities	295,252	69,584
Net cash provided by operating activities	<u>\$ 143,465,085</u>	<u>\$ 102,314,629</u>
Noncash capital activities:		
Acquisition of plant assets through developer contributions	\$ 378,196	\$ 3,081,451

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

# Knoxville Utilities Board

## Notes to Consolidated Financial Statements

### June 30, 2013 and 2012

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#### 1. Description of Business:

Knoxville Utilities Board (KUB), comprised of the Electric Division, Gas Division, Water Division, and Wastewater Division (Divisions), is reported as a component unit enterprise fund in the financial statements of the City of Knoxville. KUB's responsibility is to oversee the purchase, production, distribution, and processing of electricity, water, natural gas, and wastewater services. A seven-member Board of Commissioners governs KUB. The Board has all powers to construct, acquire, expand, or operate the Divisions. It has full control and complete jurisdiction over the management and operation of the Divisions including setting rates. KUB's accounts are maintained in conformity with the Uniform System of Accounts of the Federal Energy Regulatory Commission (FERC), the Uniform System of Accounts of the National Association of Regulatory Utility Commissioners (NARUC), and the Governmental Accounting Standards Board (GASB), as applicable.

#### 2. Significant Accounting Policies:

##### **Basis of Accounting**

KUB follows the provisions of GASB Statement No. 34 (Statement No. 34), *Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*. Statement No. 34 established standards for external financial reporting for all state and local governmental entities.

The consolidated financial statements are prepared on the accrual basis of accounting, whereby revenues are recognized when earned and expenses are recognized when incurred. The accounting and financial reporting treatment applied is determined by measurement focus. The transactions are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operations are included on the statement of net position. Net position (i.e., total assets and deferred outflows of resources net of total liabilities and deferred inflows of resources) are segregated into net investment in capital assets; restricted for capital activity and debt service; and unrestricted components.

##### **Recently Adopted New Accounting Pronouncements**

In December 2010, the GASB issued Statement No. 62 (Statement No. 62), *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, effective for KUB's fiscal year beginning July 1, 2012. The objective of this Statement is to incorporate into the GASB's authoritative literature certain Financial Accounting Standards Board (FASB) and American Institute of Certified Public Accountants' (AICPA) accounting and financial reporting guidance issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements.

Statement No. 62 supersedes Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, thereby eliminating the election to apply FASB statements, related interpretations, Accounting Principles Board opinions and accounting research bulletins issued post-November 30, 1989 that do not conflict with Governmental Accounting Standards. However, FASB pronouncements issued post-November 30, 1989 that do not conflict with or contradict Governmental Accounting Standards can continue to apply as other accounting literature.

In June 2011, the GASB issued Statement No. 63 (Statement No. 63), *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position*, effective for KUB's fiscal year beginning July 1, 2012. Statement No. 63 amends the net asset reporting requirements in Statement No. 34 and other pronouncements. Under these new standards, financial statements include deferred outflows of resources and deferred inflows of resources, in addition to assets and liabilities, and will report *net position* instead of net assets. Statement No. 63 requires the classification of net position into three components – net investment in capital assets; net position-restricted; and net position-unrestricted.

# Knoxville Utilities Board

## Notes to Consolidated Financial Statements

### June 30, 2013 and 2012

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These classifications are defined as follows:

- Net investment in capital assets – This component of net position consists of capital assets, including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. Deferred outflows of resources and deferred inflows of resources that are attributable to the acquisition, construction, or improvement of those assets or related debt also should be included in this component of net position. If there are significant unspent related debt proceeds at year end, the portion of the debt attributable to the unspent proceeds are not included in the calculation of net investment in capital assets. Rather, that portion of the debt is included in the same net position component as the unspent proceeds.
- Net position-restricted – This component of net position consists of restricted assets reduced by liabilities and deferred inflows of resources related to those assets. Generally, a liability relates to restricted assets if the asset results from a resource flow that also results in the recognition of a liability or if the liability will be liquidated with the restricted assets reported.
- Net position-unrestricted – This component of net position consists of assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of net investment in capital assets or the restricted component of net position.

Implementation of Statement No. 63 had no effect on KUB's net position or changes in net position for the fiscal years ended June 30, 2013 and June 30, 2012.

In March 2012, the GASB issued Statement No. 65 (Statement No. 65), *Items Previously Reported as Assets and Liabilities*, effective for KUB's fiscal year beginning July 1, 2013; however, KUB early adopted Statement No. 65 effective for the fiscal year beginning July 1, 2012. Statement No. 65 establishes accounting and financial reporting standards that reclassify as deferred outflows of resources or deferred inflows of resources certain items that were previously reported as assets and liabilities. Implementation of Statement No. 65 had no effect on KUB's net position or changes in net position for the fiscal years ended June 30, 2013 and June 30, 2012.

#### Principles of Consolidation

The consolidated financial statements include the accounts of the Electric, Gas, Water and Wastewater Divisions. All significant intercompany balances and transactions have been eliminated in consolidation.

KUB issues separate financial reports, which include financial statements and required supplementary information, for the Electric, Gas, Water, and Wastewater Divisions. These reports may be obtained by writing Knoxville Utilities Board, P.O. Box 59017, Knoxville, TN 37950-9017.

#### Plant

Plant and other property are stated on the basis of original cost. The costs of current repairs and minor replacements are charged to operating expense. The costs of renewals and improvements are capitalized. The original cost of utility plant assets retired or otherwise disposed of and the cost of removal less salvage value is charged to accumulated depreciation. When other property is retired, the related asset and accumulated depreciation are removed from the accounts, and the gain or loss is included in the results of operations.

The provision for depreciation of plants in service is based on the estimated useful lives of the assets, which range from three to sixty-seven years, and is computed using the straight-line method. Pursuant to FERC/NARUC, the caption "Provision for depreciation" in the consolidated statements of revenues, expenses and changes in net position does not include depreciation for transportation equipment of \$1,813,593 in fiscal year 2013 and \$1,878,888 in fiscal year 2012. Interest costs are expensed as incurred.

# **Knoxville Utilities Board**

## **Notes to Consolidated Financial Statements**

### **June 30, 2013 and 2012**

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#### **Operating Revenue**

Operating revenue consists primarily of charges for services provided by the principal operations of KUB. Operating revenue is recorded when the service is rendered, on a cycle basis, and includes an estimate of unbilled revenue. Revenues are reported net of bad debt expense of \$1,962,060 in fiscal year 2013 and \$1,599,128 in fiscal year 2012.

#### **Non-operating Revenue**

Non-operating revenue consists of revenues that are related to financing and investing types of activities and result from non-exchange transactions or ancillary activities.

#### **Expense**

When an expense is incurred for purposes for which there are both restricted and unrestricted assets available, it is KUB's policy to apply those expenses to restricted assets to the extent such are available and then to unrestricted assets.

#### **Contributions in Aid of Construction and Capital Contributions**

Contributions in aid of construction are cash collections from customers or others for a particular purpose, generally the construction of new facilities to serve new customers in excess of the investment KUB is willing to make for a particular incremental revenue source. KUB reduces the plant account balances to which contributions relate by the actual amount of the contribution and recognizes the contributions as non-operating revenue in accordance with Statement No. 62.

Capital contributions represent contributions of utility plant infrastructure constructed by developers and others in industrial parks and other developments, and transferred to KUB upon completion of construction and the initiation of utility service. In accordance with GASB Statement No. 33, *"Accounting and Financial Reporting for Nonexchange Transactions"*, such contributions are recognized as revenues and capital assets upon receipt.

#### **Inventories**

Inventories, consisting of plant materials and operating supplies, are valued at the lower of average cost or replacement value.

#### **Pension Plan**

KUB's employees are participants in the Knoxville Utilities Board Pension Plan as authorized by the Charter of the City of Knoxville §1107(J) (Note 10). KUB's policy is to fund pension cost accrued. As required by GASB Statement No. 27, KUB measures and discloses the annual pension cost on the accrual basis of accounting. At the time the funding method is introduced, there is a liability, which represents the contributions that would have been accumulated if this method of funding had always been used. The excess, if any, of this liability over the actuarial value of the assets held in the fund is the unfunded actuarial accrued liability, which is typically funded over a chosen period in accordance with an amortization schedule.

#### **Investments**

Investments are carried at fair value as determined by quoted market prices at the reporting date.

#### **Self-Insurance**

KUB has established self-insurance programs covering portions of workers' compensation, employee health, environmental liability, general liability, property and casualty liability, and automobile liability claims. A liability is accrued for claims as they are incurred. When applicable, claims in excess of the self-insured risk are covered by KUB's insurance carriers. Additionally, KUB provides certain lifetime health benefits to eligible retired employees under a self-insurance plan administered by a third party.

# Knoxville Utilities Board

## Notes to Consolidated Financial Statements

### June 30, 2013 and 2012

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#### **Purchased Gas Adjustment**

In November 1990, the Division implemented a deferred Purchased Gas (Cost) Adjustment (PGA) mechanism, which allows the Division to flow changes in purchased gas costs through to its customers. These changes in gas costs are reflected as adjustments to the base gas rates established by KUB's Board of Commissioners. The rate-setting authority vested in the KUB Board by the City Charter meets the "self-regulated" provisions of GASB Statement No. 62 (Statement No. 62), *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*.

The PGA is intended to assure that KUB recovers the total cost of natural gas purchased, transported and/or reserved for delivery to its sales and transportation customers on an equitable basis. The PGA is also intended to assure that no excess or deficient cost recovery from KUB's customers occurs.

Under the PGA mechanism, the Division tracks the actual (under)/over recovered amount in the (Under)/Over recovered Purchased Gas Costs accounts. These accounts are rolled into the PGA rate adjustment on June 30 of each year thereby assuring that any (under)/over recovered amounts are passed on to the Division's customers. The amount of (under)/over recovered cost was (\$841,779) at June 30, 2013 and (\$2,825,163) at June 30, 2012.

#### **Purchased Power Adjustment**

In October 2002, the Board adopted a Purchased Power Adjustment (PPA) to address changes in wholesale power costs. The PPA was established in response to an amendment to KUB's power supply contract under which, among other things, TVA relinquished its regulatory authority over KUB retail electric rates. The PPA allows KUB to promptly adjust retail electric rates in response to wholesale rate changes or adjustments, thus ensuring that KUB will recover the costs incurred for purchased power. These changes in electric costs are reflected as adjustments to the base electric rates established by KUB's Board of Commissioners. The rate-setting authority vested in the KUB Board by the City Charter meets the "self-regulated" provisions of Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, and KUB meets the remaining criteria of Statement No. 62.

TVA implemented a fuel cost adjustment in October 2006 applied on a quarterly basis to wholesale power rates. TVA's quarterly fuel cost adjustment became a monthly fuel cost adjustment effective October 2009. KUB flows changes to wholesale power rates, from TVA's fuel cost adjustment mechanism, directly through to its retail electric rates via the PPA.

In April 2011, TVA modified its wholesale rate structure to demand and energy billing for its distributors. In response, KUB revised its PPA to include a deferred accounting component to ensure appropriate matching of revenue and expense and cost recovery. KUB will adjust its retail rates on an annual basis to flow any over or under recovery of wholesale power costs through to its customers via the PPA.

#### **Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles 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 the reported amounts of revenues and expenses during the reporting period. These estimates are based on historical experience and various other assumptions that KUB believes are reasonable under the circumstances. However, future events are subject to change and the best estimates and judgments routinely require adjustment. Estimates are used for, but not limited to, inventory valuation, provision for doubtful accounts, depreciable lives of plant assets, unbilled revenue volumes, pension trust valuations, OPEB trust valuations, insurance liability reserves, and potential losses from contingencies and litigation. Actual results could differ from those estimates.

# **Knoxville Utilities Board**

## **Notes to Consolidated Financial Statements**

### **June 30, 2013 and 2012**

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#### **Restricted and Designated Assets**

Certain assets are restricted by bond resolutions for the construction of utility plant and debt repayment. Certain additional assets are designated by management for contingency purposes and economic development.

#### **Cash Equivalents**

For purposes of the statements of cash flows, KUB considers all unrestricted and undesignated highly liquid investments with an original maturity of three months or less when purchased to be cash equivalents.

#### **Environmental Cleanup Matters**

KUB's policy is to accrue environmental cleanup costs when those costs are believed to be probable and can be reasonably estimated. For certain matters, KUB expects to share costs with other parties. KUB does not include anticipated recoveries from insurance carriers in the estimated liability.

#### **Deferred Outflows and Inflows of Resources**

Deferred outflows of resources are items previously reported as assets related to the acquisition of assets or related debt which are amortized over the life of the asset or debt. Deferred inflows of resources are items previously reported as liabilities related to the acquisition of assets or related debt which are amortized over the life of the asset or debt. In accordance with Statement No. 62, KUB records debt issuance costs, including discounts and premiums as a deferred outflow or inflow. Likewise, KUB records costs associated with the gain or loss on refunding of debt as either a deferred outflow or inflow based on the parameters of Statement No. 65.

#### **Compensated Absences**

KUB accrues a liability for earned but unpaid paid-time off (PTO) days.

#### **Subsequent Events**

KUB has evaluated events and transactions through October 22, 2013, the date these financial statements were issued, for items that should potentially be recognized or disclosed.

#### **Reclassifications**

Certain reclassifications have been made to the fiscal year 2012 balances to conform to fiscal year 2013 presentation.

#### **Recently Issued Accounting Pronouncements**

In June 2012, the GASB issued two related Statements that affect accounting and financial reporting of pensions by state and local governments. GASB Statement No. 67 (Statement No. 67), *Financial Reporting for Pension Plans*, is intended to improve financial reporting for state and local government pension plans. GASB Statement No. 68 (Statement No. 68), *Accounting and Financial Reporting for Pensions*, establishes new accounting and financial reporting requirements for governments that provide their employees with pensions. Statements No. 67 and 68 supersede existing guidance on financial reporting for defined pension plans found in Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, and Statement No. 50, *Pension Disclosures*.

Statement No. 67 is effective for periods beginning after June 15, 2013 and Statement No. 68 is effective for periods beginning after June 15, 2014. KUB has not elected early implementation of these standards and has not completed the process of evaluating the impact of these statements on its financial statements.

# Knoxville Utilities Board

## Notes to Consolidated Financial Statements

### June 30, 2013 and 2012

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### 3. Deposits and Investments

State law authorizes KUB to invest in obligations of the United States Treasury, its agencies and instrumentalities; certificates of deposit; repurchase agreements; money market funds; and the State Treasurer's Investment Pool. All deposits in excess of federal depository insurance limits and investments in other than the State Treasurer's Investment Pool are collateralized with government securities held in KUB's name by third-party custodian bank(s) acting as KUB's agent(s), or through the state of Tennessee's collateral pool. Financial institutions that participate in the collateral pool are subject to special assessment; therefore, the deposits and investments of investors such as KUB are considered insured. Interest income is recorded on an accrual basis.

Information related to the carrying value and bank balances of deposits, and the carrying value and fair value of investments, at June 30, 2013 is as follows:

	<b>Carrying Value</b>	<b>Bank Balance</b>
Deposits		
Deposits in financial institutions	\$ 125,776,035	\$ 130,310,618
Investments		
Certificates of Deposits	76,320,162	76,320,162
State Treasurer's Investment Pool	10,039,012	10,039,012
Agency Bonds	42,799,225	42,799,225
	<u>\$ 254,934,434</u>	<u>\$ 259,469,017</u>

Classification of deposits and investments:

<b>Depository Account</b>	<b>Bank Balance</b>
Insured	\$ 1,822,987
Collateralized:	
Collateral held by pledging bank's trust department in KUB's name	42,799,225
Collateral held by pledging bank's trust department not in KUB's name*	214,846,805
Total deposits and investments	<u>\$ 259,469,017</u>

\* - Funds are collateralized with the Tennessee State Investment Pool in the name of the pledging bank in accordance with Tennessee Code Annotated, Title 9, Chapter 4, parts 1 and 4.

**Knoxville Utilities Board**  
**Notes to Consolidated Financial Statements**  
**June 30, 2013 and 2012**

Classification of deposits and investments per statement of net position:

	<b>2013</b>	<b>2012</b>
Current assets		
Cash and cash equivalents	\$ 125,723,586	\$ 69,858,112
Short-term investments	27,500,000	30,500,000
Short-term contingency fund investments	31,322,858	30,775,170
Other assets		
Long-term contingency fund investments	46,753,948	41,403,246
Restricted assets		
Unused bond proceeds	206	13,789,178
Bond fund	23,580,016	21,354,636
Other funds	53,820	23,769
	<u>\$ 254,934,434</u>	<u>\$ 207,704,111</u>

The above amounts do not include accrued interest of \$226,112 in fiscal year 2013 and \$234,101 in fiscal year 2012.

KUB follows the provisions of Statement No. 40 of the Governmental Accounting Standards Board *Deposit and Investment Risk Disclosures an amendment of GASB Statement No. 3*. This Statement establishes and modifies disclosure requirements for state and local governments related to deposit and investment risks.

	<b>Deposit and Investment Maturities (in Years)</b>		
	<b>Fair Value</b>	<b>Less Than 1</b>	<b>1-5</b>
Supersweep NOW and Other Deposits	\$ 130,310,618	\$ 130,310,618	\$ -
State Treasurer's Investment Pool	10,039,012	10,039,012	-
Agency Bonds	42,799,225	18,197,859	24,601,366
Certificates of Deposits	76,320,162	54,180,162	22,140,000
	<u>\$ 259,469,017</u>	<u>\$ 212,727,651</u>	<u>\$ 46,741,366</u>

**Interest Rate Risk.** KUB's primary investment objectives, in order, are to place investments in a manner to ensure the preservation of capital, remain sufficiently liquid to meet all operating requirements, and maximize yield of return. KUB minimizes its exposure to interest rate risk by adhering to Tennessee state law requirements for the investment of public funds. This includes types of investments, as described above, and investment maturity. The maximum maturity is four years from the date of investment. KUB also limits its exposure by holding investments to maturity unless cash flow requirements dictate otherwise.

**Credit Risk.** KUB's investment policy, as required by state law, is to apply the prudent-person rule: Investments are made with judgment and care, under circumstances then prevailing, which persons of prudence, discretion, and intelligence exercise in the management of their own affairs, not for speculation, but for investment, considering the probable income to be derived, as well as the probable safety of their capital. KUB's Agency Bond investments are rated Aaa by Moody's Investors Service.



**Knoxville Utilities Board**  
**Notes to Consolidated Financial Statements**  
**June 30, 2013 and 2012**

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**4. Accounts Receivable**

Accounts receivable consists of the following:

	<b>2013</b>	<b>2012</b>
Wholesale and retail customers		
Billed services	\$ 47,675,837	\$ 37,731,872
Unbilled services	26,686,419	27,180,833
Other	3,741,088	4,533,993
Allowance for uncollectible accounts	(948,358)	(955,065)
	<u>\$ 77,154,986</u>	<u>\$ 68,491,633</u>

**5. Accounts Payable and Accruals**

Accounts payable and accruals consist of the following:

	<b>2013</b>	<b>2012</b>
Trade accounts	\$ 59,560,896	\$ 51,127,955
Salaries and wages	1,093,893	871,022
Advances on pole rental	1,142,702	1,119,017
Self-insurance liabilities	1,733,984	1,827,920
Other current liabilities	22,946,789	22,923,245
	<u>\$ 86,478,264</u>	<u>\$ 77,869,159</u>

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# Knoxville Utilities Board

## Notes to Consolidated Financial Statements

### June 30, 2013 and 2012

#### 6. Long-Term Obligations

Long-term debt consists of the following:

	Balance June 30, 2012	Additions	Payments	Balance June 30, 2013	Amounts Due Within One Year
<b>Electric</b>					
V-2004 - 2.0 - 4.75%	\$ 1,015,000	\$ -	\$ 1,015,000	\$ -	\$ -
W-2005 - 3.0 - 4.5%	36,520,000	-	1,660,000	34,860,000	1,720,000
X-2006 - 4.0 - 5.0%	16,850,000	-	11,650,000	5,200,000	1,650,000
Y-2009 - 2.5 - 5.0%	38,700,000	-	1,350,000	37,350,000	1,450,000
Z-2010 - 1.45 - 6.35%	28,970,000	-	1,245,000	27,725,000	1,255,000
AA-2012 - 3.0 - 5.0%	36,815,000	-	100,000	36,715,000	920,000
BB-2012 - 3.0 - 4.0%	-	35,000,000	-	35,000,000	500,000
CC-2013 - 3.0 - 4.0%	-	9,660,000	-	9,660,000	75,000
Total debt	<u>\$ 158,870,000</u>	<u>\$ 44,660,000</u>	<u>\$ 17,020,000</u>	<u>\$ 186,510,000</u>	<u>\$ 7,570,000</u>
<b>Gas</b>					
L-2005 - 3.0 - 4.75%	\$ 12,645,000	\$ -	\$ 620,000	\$ 12,025,000	\$ 645,000
M-2006 - 4.0 - 5.0%	15,625,000	-	15,625,000	-	-
N-2007 - 4.0 - 5.0%	12,000,000	-	-	12,000,000	-
O-2010 - 2.0 - 3.0%	10,170,000	-	120,000	10,050,000	3,225,000
P-2010 - 3.3 - 6.2%	12,000,000	-	-	12,000,000	-
Q-2012 - 2.0 - 4.0%	24,920,000	-	225,000	24,695,000	665,000
R-2012 - 2.0 - 4.0%	-	10,000,000	-	10,000,000	200,000
S-2013 - 2.0 - 4.0%	-	11,580,000	-	11,580,000	50,000
Total debt	<u>\$ 87,360,000</u>	<u>\$ 21,580,000</u>	<u>\$ 16,590,000</u>	<u>\$ 92,350,000</u>	<u>\$ 4,785,000</u>
<b>Water</b>					
R-2005 - 3.5 - 5.0%	\$ 10,000,000	\$ -	\$ 9,510,000	\$ 490,000	\$ 235,000
S-2005 - 3.5 - 5.0%	7,965,000	-	390,000	7,575,000	415,000
T-2007 - 4.0 - 5.5%	25,000,000	-	-	25,000,000	650,000
U-2009 - 3.0 - 4.5%	25,000,000	-	-	25,000,000	750,000
V-2010 - 2.0 - 2.5%	2,220,000	-	2,220,000	-	-
W-2011 - 2.0 - 4.0%	25,000,000	-	550,000	24,450,000	550,000
X-2012 - 3.0 - 5.0%	10,050,000	-	-	10,050,000	440,000
Y-2013 - 3.0 - 4.0%	-	9,285,000	-	9,285,000	25,000
Total debt	<u>\$ 105,235,000</u>	<u>\$ 9,285,000</u>	<u>\$ 12,670,000</u>	<u>\$ 101,850,000</u>	<u>\$ 3,065,000</u>
<b>Wastewater</b>					
2005 A - 4.0 - 5.0%	\$ 140,000,000	\$ -	\$ 103,450,000	\$ 36,550,000	-
2005 B - 3.0 - 5.0%	19,440,000	-	760,000	18,680,000	1,285,000
2007 - 4.0 - 5.0%	75,000,000	-	-	75,000,000	-
2008 - 4.0 - 6.0%	38,500,000	-	3,400,000	35,100,000	4,125,000
2010 - 6.3 - 6.5%	30,000,000	-	-	30,000,000	-
2010B - 2.0 - 3.0%	1,735,000	-	1,735,000	-	-
2010C - 1.18 - 6.1%	69,000,000	-	1,075,000	67,925,000	1,075,000
2012A - 2.0 - 4.0%	17,070,000	-	70,000	17,000,000	785,000
2012B - 1.25 - 5.0%	-	65,000,000	-	65,000,000	850,000
2013A - 2.0 - 4.0%	-	113,340,000	-	113,340,000	425,000
Total debt	<u>\$ 390,745,000</u>	<u>\$ 178,340,000</u>	<u>\$ 110,490,000</u>	<u>\$ 458,595,000</u>	<u>\$ 8,545,000</u>

# Knoxville Utilities Board

## Notes to Consolidated Financial Statements

### June 30, 2013 and 2012

Other liabilities consist of the following:

	Balance June 30, 2012	Increase	Decrease	Balance June 30, 2013	Amounts Due Within One Year
TVA conservation program	\$ 9,335,409	\$ 3,487,807	\$ (2,817,477)	\$ 10,005,739	\$ 1,500,000
Accrued compensated absences	8,237,657	14,546,694	(14,516,801)	8,267,550	2,100,000
Customer advances for construction	1,283,627	420,496	(486,595)	1,217,528	121,000
Other	211,564	869,647	(574,393)	506,818	90,000
	<u>\$ 19,068,257</u>	<u>\$ 19,324,644</u>	<u>\$ (18,395,266)</u>	<u>\$ 19,997,635</u>	<u>\$ 3,811,000</u>

Debt service over remaining term of the debt is as follows:

Fiscal Year	Principal	Interest	Total
2014	\$ 23,965,000	\$ 34,486,925	\$ 58,451,925
2015	25,090,000	33,542,273	58,632,273
2016	26,120,000	32,582,306	58,702,306
2017	26,775,000	31,588,351	58,363,351
2018	27,905,000	30,518,757	58,423,757
2019-2023	157,895,000	134,203,974	292,098,974
2024-2028	168,170,000	99,542,085	267,712,085
2029-2033	137,445,000	68,085,490	205,530,490
2034-2038	106,815,000	45,090,331	151,905,331
2039-2043	105,625,000	21,694,150	127,319,150
2044-2047	33,500,000	2,925,000	36,425,000
Total	<u>\$ 839,305,000</u>	<u>\$ 534,259,642</u>	<u>\$ 1,373,564,642</u>

The Divisions have pledged sufficient revenue, after deduction of all current operating expenses (exclusive of tax equivalents), to meet bond principal and interest payments of revenue bonds when due. Such bond requirements are being met through monthly deposits to the bond funds as required by the bond covenants. As of June 30, 2013 these requirements had been satisfied.

During fiscal year 2006, KUB's Electric Division issued Series W 2005 bonds in part to retire certain existing debt and fund electric system capital improvements. Concurrent with the issuance of these bonds, KUB transferred funds to an irrevocable trust to pay a portion of the Series U 2001 bonds, as such amounts mature. KUB's Electric Division also issued Series X 2006 bonds in part to retire certain existing debt and to fund electric system capital improvements. Concurrent with the issuance of these bonds, KUB transferred funds to an irrevocable trust to pay the remaining maturities of principal and interest on the Series S 1998 revenue bonds. During fiscal year 2009, KUB's Electric Division issued Series Y 2009 bonds to fund electric system capital improvements. During fiscal year 2011, KUB's Electric Division issued series Z 2010 bonds to fund electric system capital improvements. The bonds were issued as federally taxable Build America Bonds with a 35 percent interest payment rebate to be received from the United States Government for each interest payment. Effective March 1, 2013 these bonds became subject to an 8.7% reduction in rebate payment amounts due to the United States Government sequestration. The sequestration is effective until September 30, 2013 or intervening Congressional action, at which time the sequestration rate is subject to change. During fiscal year 2012, KUB's Electric Division issued Series AA 2012 bonds to retire a portion of outstanding Series V 2004 bonds. During fiscal year

# **Knoxville Utilities Board**

## **Notes to Consolidated Financial Statements**

### **June 30, 2013 and 2012**

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2013, KUB's Electric Division issued Series BB 2012 bonds to fund electric system capital improvements. KUB's Electric Division also issued Series CC 2013 bonds to retire a portion of outstanding Series X 2006 bonds as follows. KUB sold \$9.7 million in electric system revenue refunding bonds in March 2013 for the purpose of refinancing \$10.1 million in outstanding bonds at lower interest rates. The net proceeds of the bonds of \$10 million (\$9.7 million plus premium of \$0.5 million less issuance costs of \$0.2 million) combined with an additional KUB contribution of \$1.1 million was placed in an irrevocable trust with an escrow agent to pay debt service on the bonds to be refunded prior to the call date and to retire the outstanding bonds when called. As a result, the bonds are considered to be defeased and the liability for those bonds has been removed from the financial statements. This refunding decreases total debt service payments over the life of the bonds by \$1.2 million resulting in an economic gain (difference between the present values of the debt service payments on the old and new debt) of \$0.7 million. In the current and prior years, certain revenue bonds were defeased by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. Accordingly, the liability for the defeased bonds, \$72.3 million at June 30, 2013, and the trust account assets are not included in the financial statements.

During fiscal year 2006, KUB's Gas Division issued Series L 2005 bonds in part to retire certain existing debt. Concurrent with the issuance of these bonds, KUB transferred funds to an irrevocable trust to pay a portion of the Series J 2001 bonds, as such amounts mature. KUB's Gas Division also issued Series M 2006 bonds in part to retire certain existing debt and to fund gas system capital improvements. Concurrent with the issuance of these bonds, KUB transferred funds to an irrevocable trust to pay the remaining maturities of principal and interest on the Series H 1998 bonds. During fiscal year 2008, KUB's Gas Division issued Series N 2007 to fund gas system capital improvements. During fiscal year 2010, KUB's Gas Division issued Series O 2010 bonds to retire Series I 2001 bonds. During fiscal year 2011, KUB's Gas Division issued Series P 2010 bonds to fund gas system capital improvements. The bonds were issued as federally taxable Build America Bonds with a 35 percent interest payment rebate to be received from the United States Government for each interest payment. Effective March 1, 2013 these bonds became subject to an 8.7% reduction in rebate payment amounts due to the United States Government sequestration. The sequestration is effective until September 30, 2013 or intervening Congressional action, at which time the sequestration rate is subject to change. During fiscal year 2012, KUB's Gas Division issued Series Q 2012 bonds to retire Series K 2004 bonds. During fiscal year 2013, KUB's Gas Division issued Series R 2012 bonds to fund gas system capital improvements. KUB's Gas Division also issued Series S 2013 bonds to retire Series M 2006 outstanding bonds as follows. KUB sold \$11.6 million in gas system revenue refunding bonds in March 2013 for the purpose of refinancing outstanding bonds at lower interest rates. The net proceeds of the bonds of \$12 million (\$11.6 million plus premium of \$0.6 million less issuance costs of \$0.2 million) combined with an additional KUB contribution of \$1.1 million was placed in an irrevocable escrow account to be used to pay debt service on the bonds to be refunded prior to the call date in 2015 and to retire the outstanding bonds when called. As a result, the bonds are considered to be defeased and the liability for those bonds has been removed from the financial statements. This refunding decreases total debt service payments over the next 18 years by \$1.6 million resulting in an economic gain (difference between the present values of the debt service payments on the old and new debt) of \$1 million. In the current and prior years, certain revenue bonds were defeased by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. Accordingly, the liability for the defeased bonds, \$47.4 million at June 30, 2013, and the trust account assets are not included in the financial statements.

During fiscal year 2006, KUB's Water Division issued Series R 2005 bonds for the purpose of funding water system capital improvements. KUB's Water Division also issued Series S 2005 bonds to retire certain existing debt and fund water system capital improvements. Concurrent with the issuance of these bonds, KUB transferred funds to an irrevocable trust to pay a portion of the Series P 2001 bonds, as such amounts mature. During fiscal year 2008, KUB's Water Division issued Series T 2007 bonds to fund water system capital improvements. During fiscal year 2010, KUB's Water Division issued Series U 2009 bonds to fund water system capital improvements.

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KUB's Water Division also issued Series V 2010 bonds to retire Series O 2001 bonds. During fiscal year 2012, KUB's Water Division issued Series W 2011 bonds to fund water system capital improvements. KUB's Water Division also issued Series X 2012 bonds to retire Series Q 2004 bonds. During fiscal year 2013, KUB's Water Division issued Series Y 2013 bonds to retire a portion of outstanding Series R 2005 bonds as follows. KUB sold \$9.3 million in water system revenue refunding bonds in March 2013 for the purpose of refinancing outstanding bonds at lower interest rates. The net proceeds of the bonds of \$9.5 million (\$9.3 million plus premium of \$0.3 million less issuance costs of \$0.1 million) combined with an additional KUB contribution of \$0.8 million was placed in an irrevocable escrow account to be used to pay debt service on the bonds to be refunded prior to the call date in 2015 and to retire the outstanding bonds when called. As a result, the bonds are considered to be defeased and the liability for those bonds has been removed from the financial statements. This refunding decreases total debt service payments over the next 17 years by \$1.3 million resulting in an economic gain (difference between the present values of the debt service payments on the old and new debt) of \$0.8 million. In the current and prior years, certain revenue bonds were defeased by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. Accordingly, the liability for the defeased bonds, \$16.9 million at June 30, 2013, and the trust account assets are not included in the financial statements.

During fiscal year 2006, KUB's Wastewater Division issued Series 2005A bonds for the purpose of funding wastewater system capital improvements and to pay off a previously issued \$30 million revenue anticipation note (line of credit), which was used to fund capital improvements to the wastewater system. KUB's Wastewater Division also issued Series 2005B bonds in part to retire certain existing debt and fund wastewater system capital improvements. Concurrent with the issuance of these bonds, KUB transferred funds to an irrevocable trust to pay a portion of the Series 1998 bonds and Series 2001A bonds, as such amounts mature. During fiscal year 2008, KUB's Wastewater Division issued Series 2007 bonds in part to pay off the outstanding balance on a previously issued revenue anticipation note (line of credit), and to fund wastewater system capital improvements. During fiscal year 2009, KUB's Wastewater Division issued Series 2008 bonds to fund wastewater system capital improvements. During fiscal year 2010, KUB's Wastewater Division issued Series 2010 bonds to fund capital improvements. These bonds were issued as federally taxable Build America Bonds with a 35 percent interest payment rebate to be received from the United States Government for each interest payment. Effective March 1, 2013 these bonds became subject to an 8.7% reduction in rebate payment amounts due to the United States Government sequestration. The sequestration is effective until September 30, 2013 or intervening Congressional action, at which time the sequestration rate is subject to change. KUB's Wastewater Division also issued Series 2010B bonds to retire Series 2001 bonds. During fiscal year 2011, KUB's Wastewater Division issued Series 2010C bonds to fund capital improvements. These bonds were issued as federally taxable Build America Bonds with a 35 percent interest payment rebate to be received from the United States Government for each interest payment. Effective March 1, 2013 these bonds became subject to an 8.7% reduction in rebate payment amounts due to the United States Government sequestration. The sequestration is effective until September 30, 2013 or intervening Congressional action, at which time the sequestration rate is subject to change. During fiscal year 2012, KUB's Wastewater Division issued Series 2012A bonds to retire Series 2004A bonds. During fiscal year 2013, KUB's Wastewater Division issued Series 2012B bonds to fund wastewater system capital improvements. KUB's Wastewater Division also issued Series 2013A bonds to retire a portion of outstanding Series 2005A bonds as follows. KUB sold \$113.3 million in revenue refunding bonds in March 2013 for the purpose of refinancing outstanding bonds at lower interest rates. The net proceeds of the bonds of \$112.9 million (\$113.3 million plus premium of \$0.3 million less issuance costs of \$0.7 million) combined with an additional KUB contribution of \$2.5 million was placed in an irrevocable escrow account to be used to pay debt service on the bonds to be refunded prior to the call date in 2015 and to retire the outstanding bonds when called. As a result, the bonds are considered to be defeased and the liability for those bonds has been removed from the financial statements. This refunding decreases total debt service payments over the next 24 years by \$20.5 million resulting in an economic gain (difference between the present values of the debt service payments on the old and new debt) of \$14.4 million. In the

# Knoxville Utilities Board

## Notes to Consolidated Financial Statements

### June 30, 2013 and 2012

current and prior years, certain revenue bonds were defeased by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. Accordingly, the liability for the defeased bonds, \$122.1 million at June 30, 2013, and the trust account assets are not included in the financial statements.

## 7. Lease Commitments

KUB has non-cancelable operating lease commitments for office equipment and vehicles, summarized for the following fiscal years:

2014	\$	70,639
2015		56,954
2016		20,544
2017		2,142
Total operating minimum lease payments	\$	<u>150,279</u>

## 8. Capital Assets

Capital asset activity for the year ended June 30, 2013, was as follows:

	Beginning 6/30/2012	Increase	Decrease	Ending 06/30/2013
<b>Production Plant (Intakes)</b>	\$ 742,503	\$ -	\$ -	\$ 742,503
<b>Pumping and Treatment Plant</b>	227,104,785	18,400,939	(5,104,994)	240,400,730
<b>Distribution and Collection Plant</b>				
Mains and metering	709,505,764	66,081,616	(8,104,010)	767,483,370
Services and meters	140,357,031	5,560,463	(773,564)	145,143,930
Electric station equipment	105,130,022	10,028,048	(603,068)	114,555,002
Poles, towers and fixtures	108,135,676	10,105,632	(3,860,834)	114,380,474
Overhead conductors	109,067,998	4,160,364	(495,572)	112,732,790
Line transformers	83,128,398	5,315,026	(1,687,507)	86,755,917
Other accounts	253,087,890	16,440,291	(1,705,143)	267,823,038
<b>Total Distribution &amp; Collection Plant</b>	\$ 1,508,412,779	\$ 117,691,440	\$ (17,229,698)	\$ 1,608,874,521
<b>General Plant</b>	130,677,027	10,054,272	(3,399,306)	137,331,993
<b>Total Plant Assets</b>	\$ 1,866,937,094	\$ 146,146,651	\$ (25,733,998)	\$ 1,987,349,747
Less Accumulated Depreciation	(647,505,932)	(55,062,934)	20,792,912	(681,775,954)
<b>Net Plant Assets</b>	\$ 1,219,431,162	\$ 91,083,717	\$ (4,941,086)	\$ 1,305,573,793
Work In Progress	148,047,816	148,210,109	(136,160,580)	160,097,345
<b>Total Net Plant</b>	\$ <u>1,367,478,978</u>	\$ <u>239,293,826</u>	\$ <u>(141,101,666)</u>	\$ <u>1,465,671,138</u>

## 9. Risk Management

KUB is exposed to various risks of loss related to active and retiree medical claims; injuries to workers; theft of, damage to, and destruction of assets; environmental damages; and natural disasters. Claims expenditures and liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. These losses include an estimate of claims that have been incurred but not reported.

# Knoxville Utilities Board

## Notes to Consolidated Financial Statements

### June 30, 2013 and 2012

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These liabilities are included in accrued expenses in the Statement of Net Position. The liability is KUB's best estimate based on available information. At June 30, 2013, the amount of these liabilities was \$1,733,984 resulting from the following changes:

	2013	2012
Balance, beginning of year	\$ 1,827,920	\$ 2,175,294
Current year claims and changes in estimates	12,256,762	14,130,565
Claims payments	(12,350,698)	(14,477,939)
Balance, end of year	<u>\$ 1,733,984</u>	<u>\$ 1,827,920</u>

## 10. Pension Plan

### Description of Plan

The Plan is a single-employer contributory, defined benefit pension plan established by Resolution No. 980 dated February 18, 1999, effective July 1, 1999, as authorized by the Charter of the City of Knoxville § 1107(J). The Plan is designed to provide retirement, disability and death benefits. The Plan is a governmental plan as defined by the Employee Retirement Income Security Act of 1974 and is not subject to any of the provisions of the Act. The Plan is funded by contributions from KUB, if funding is required, and from Plan A and Plan B employee participants.

At December 31, 2012, the Plan had approximately 647 retirees and beneficiaries currently receiving benefits and 54 terminated employees entitled to benefits but not yet receiving them. Of the approximately 824 current employees in the Plan, 747 were fully vested at December 31, 2012. The Plan issues a financial report, which includes financial statements and required supplementary information. The report may be obtained by writing the Knoxville Utilities Board Retirement System, P.O. Box 59017, Knoxville, TN 37950-9017.

Effective January 1, 2011, KUB froze the Plan such that persons employed or re-employed by KUB on or after January 1, 2011, shall not be eligible to participate, but that eligible employees hired prior to January 1, 2011, who have not separated from service, shall continue as Participants and accrue benefits under the Plan.

The Plan provides three different benefit arrangements for KUB participants, retirees, and beneficiaries, as follows:

#### *Career Equity Program (CEP)*

CEP is for eligible employees hired on or after January 1, 1999, and for eligible former City System Plan A members who elected CEP coverage as of July 1, 1999. CEP is a closed plan.

All eligible employees became participants on the date of his/her KUB employment. Participants are covered by Social Security. Participation in CEP does not require or permit employee contributions.

#### *Plan A*

Plan A benefits are for former City System Plan A active employees, vested terminated employees, retirees, and beneficiaries. Plan A is a closed plan.

All employees participating in the City System Plan A as of June 30, 1999 were eligible to participate in KUB's Plan A or the CEP program. Participants of Plan A are covered by Social Security. Plan A is a closed plan and is not available to KUB employees hired after July 1, 1999. Participation in Plan A requires employee contributions of 3 percent of the first \$4,800 of annual

# **Knoxville Utilities Board**

## **Notes to Consolidated Financial Statements**

### **June 30, 2013 and 2012**

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earnings and 5 percent of annual earnings in excess of \$4,800. Plan A provides for early retirement benefits with 25 years of service and normal retirement benefits at age 62 or older.

#### *Plan B*

Plan B benefits are for former City System Plan B active employees, vested terminated employees, retirees, and beneficiaries. Plan B is a closed plan.

All employees participating in the City System Plan B as of June 30, 1999 are eligible to participate in KUB's Plan B. Plan B is now a closed plan and no participants can be added. Participants of Plan B are not covered by Social Security. Participation in Plan B requires employee contributions of 4 percent of annual earnings. Plan B provides for retirement benefits after 25 years of service and the attainment of age 50.

#### **Funding Policy**

For the Plan year ended December 31, 2012, a contribution of \$5,502,677 is required to be made in the Plan sponsor's fiscal year ending June 30, 2014. The annual required contribution was determined as part of the January 1, 2012 valuation using the Individual Entry Age Normal funding method. The objective under this method is to fund each participant's benefits under the Plan as payments which are level as a percentage of salary, starting on the original participation date (employment date) and continuing until the assumed retirement, termination, disability or death. For the Plan year ended December 31, 2012, the Plan's actuarial funded ratio was 94.1 percent.

At the time the funding method is introduced, there is a liability, which represents the contributions that would have been accumulated if this method of funding had always been used. The excess, if any, of this liability over the actuarial value of the assets held in the fund, is the unfunded actuarial accrued liability, which is typically funded over a chosen period in accordance with an amortization schedule.

Significant actuarial assumptions used in the valuation include (a) rate of return of investments of 8 percent, (b) the RP2000 Mortality Table, (c) annual projected salary increases based on participants' ages ranging from age 25 to age 65 with salary increases from 2.58 percent to 7.92 percent, and (d) cost of living adjustment of 2.8 percent annually. The actuarial value of assets was determined using techniques that smooth the effect of short-term volatility in the market value of equities over a five-year period.

As of the actuarial report for the Plan year ended December 31, 2012, contributions of \$5,502,677 and \$3,593,282 for 2012 and 2011, respectively, are required to be made during the Plan sponsor's fiscal years ending June 30, 2014 and 2013, respectively.

Subsequent to June 30, 2013, the actuarial valuation for the Plan year ending December 31, 2013 was completed. The actuarial valuation resulted in a recommended contribution of \$6,314,399 for the fiscal year ending June 30, 2015, based on the Plan's current funding policy. For the Plan year ending December 31, 2013, the Plan's actuarial funded ratio was 89.3 percent. See Required Supplementary Information for Pension Schedule of Funding Progress.

## **11. Defined Contribution Plan**

KUB has a defined contribution 401(k) employee retirement savings plan covering eligible KUB employees. Employees hired prior to January 1, 2011 may participate and receive a matching contribution of 50 percent of their own contribution up to a maximum match of 3 percent. Employees hired on or after January 1, 2011 have an enhanced 401(k) Plan due to the closure of the Defined Benefit Pension Plan. They may participate and receive a matching contribution of 50 percent of their own contribution up to a maximum match of 3 percent. They also receive a



# **Knoxville Utilities Board**

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### **June 30, 2013 and 2012**

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nonelective KUB contribution of from 3 percent to 6 percent, depending on years of service, whether they contribute or not.

Since July 1, 2000, 401(k) matching contributions for employees eligible to participate in the KUB Pension Plan have been funded by the Pension Plan. These funds are held by the Pension trustee until eligible for distribution. IRS rules permit the funding of 401(k) matching contributions from excess pension assets for employees covered under the Pension Plan. Given the current funding level of the Pension Plan, effective July 1, 2011, KUB began to reimburse the Pension Plan for the current matching contributions. The match and nonelective contributions for employees hired on or after January 1, 2011 are paid directly by KUB.

## **12. Other Post-Employment Benefits (OPEB)**

The Governmental Accounting Standards Board (GASB) established new standards for the measurement, recognition, and reporting of other post-employment benefits (OPEB). OPEB includes post-employment benefits other than pension, which, for KUB, is presently limited to post-employment health care. GASB Statement No. 45 (Statement No. 45) requires the recognition of the accrued OPEB liability for the respective year, plus the disclosure of the total unfunded liability. Statement No. 45 was effective for KUB for the fiscal year beginning July 1, 2007.

KUB currently provides post-employment health care benefits to 618 former employees and 635 covered dependents. The cost of coverage is shared with retirees and beneficiaries. KUB recognizes its share of the cost of post-employment health care benefits as an expense as claims are paid.

In anticipation of Statement No. 45, KUB amended its Group Health Plan in 1999, eliminating post-employment health care benefits for all employees hired on or after July 1, 1999. As of June 30, 2013, 419 active employees were eligible for individual and dependent coverage at separation. To qualify, the employee must meet the Rule of 80 (age plus years of service) with a minimum of 20 years of service, and be enrolled in medical coverage on their last day.

In May 2006, the state of Tennessee adopted Tennessee Code Annotated, Title 8, Chapter 50, Part 12 authorizing governmental entities to establish Trusts for the purpose of pre-funding their respective OPEB liabilities.

Although Statement No. 45 does not require pre-funding of the liability, KUB has determined that it is in the long-term economic interest of KUB and its ratepayers to establish a Trust to pre-fund KUB's OPEB liability.

In October 2007, the KUB Board authorized the establishment of an OPEB Trust. The applicable documentation was submitted to the State Funding Board and, in December 2007, the State Funding Board approved the Trust. The Trust was also approved by the Internal Revenue Service in June 2008.

The Trust issues a financial report, which includes financial statements and required supplementary information. The report may be obtained by writing the Knoxville Utilities Board Retirement System, P.O. Box 59017, Knoxville, TN 37950-9017.

The general administration and responsibility for the proper operation of the Trust is governed by a board of trustees, appointed by KUB's President & CEO. The investment of all deposits to the Trust is governed by an Investment Policy, which was adopted by the KUB Board and approved by the State Funding Board.

# Knoxville Utilities Board

## Notes to Consolidated Financial Statements

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Total contributions to the OPEB Trust for the fiscal year ended June 30, 2013 were \$4.4 million. The contribution to the Trust exceeded the annual required contribution (ARC), as determined by the Postretirement Benefit Plan's actuarial valuation for the year ended December 31, 2011, which was \$3.3 million. As of June 30, 2013, the employer's net OPEB obligation was \$0.6 million.

The ARC for the fiscal year ending June 30, 2014, as determined by the Plan's actuarial valuation for the year ended December 31, 2012 is \$3.3 million.

The actuarial valuation for the Plan for the year ending December 31, 2013 has been completed. The valuation determined that the Plan's actuarial accrued liability was \$63.3 million. The actuarial value of the Plan's assets was \$38.6 million. As a result, the Plan's unfunded actuarial accrued liability was \$24.8 million. The Plan's actuarial funded ratio was 61 percent. The valuation also determined that the employer's ARC is \$3.5 million for the fiscal year ending June 30, 2015. See Required Supplementary Information for OPEB Schedule of Funding Progress.

### 13. Related Party Transactions

KUB, in the normal course of operations, is involved in transactions with the City of Knoxville. Such transactions for the years ended June 30, 2013 and 2012 are summarized as follows:

	2013	2012
City of Knoxville		
Amounts billed by KUB for utilities and related services	\$ 12,126,434	\$ 11,457,145
Payments by KUB in lieu of property tax	14,172,900	13,453,228
Payments by KUB for services provided	776,724	1,118,297

With respect to these transactions, accounts receivable from and accounts payable to the City of Knoxville included in the balance sheet at year end were:

	2013	2012
Accounts receivable	\$ 935,773	\$ 726,455

### 14. Natural Gas Supply Contract Commitments

For fiscal year 2013, the Gas Division hedged 53 percent of its total gas purchases via gas supply contracts. As of June 30, 2013, the Gas Division had hedged the price on approximately 15 percent of its anticipated gas purchases for fiscal year 2014.

# Knoxville Utilities Board

## Notes to Consolidated Financial Statements

### June 30, 2013 and 2012

KUB contracts separately for the purchase, transportation and storage of natural gas. Purchase commitments for the next five years are as follows:

Firm obligations related to purchased gas – demand

	2014	2015	2016	2017	2018
Transportation					
Tennessee Gas Pipeline	\$ 7,325,892	\$ 7,325,892	\$ 2,441,964	\$ -	\$ -
East Tennessee Natural Gas	10,066,388	10,066,388	3,355,463	-	-
Storage					
Tennessee Gas Pipeline	2,076,288	2,076,288	692,096	-	-
East Tennessee Natural Gas	757,460	757,460	252,487	-	-
Saltville Natural Gas	1,917,780	1,776,765	1,353,720	1,353,720	1,015,290
Demand Total	<u>\$ 22,143,808</u>	<u>\$ 22,002,793</u>	<u>\$ 8,095,730</u>	<u>\$ 1,353,720</u>	<u>\$ 1,015,290</u>

Firm obligations related to purchased gas – commodity

	2014	2015	2016	2017	2018
Baseload					
Conoco	\$ 4,198,815	\$ -	\$ -	\$ -	\$ -
Equitable	2,684,849	-	-	-	-
Shell Energy	2,064,660	-	-	-	-
CNX	2,625,513	-	-	-	-
Commodity Total	<u>\$ 11,573,837</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

The total commodity values presented here are based upon firm supply obligations with each individual natural gas supplier. The firm obligations value for Conoco and Shell Energy are based upon firm supply obligations at locked prices with those suppliers. The firm obligations value for the CNX contract is based upon firm supply obligations and the applicable four month NYMEX strip prices on July 31, 2013.

## 15. Other Commitments and Contingencies

In the normal course of business, there are various lawsuits pending against KUB. Management has reviewed these lawsuits with counsel, who is vigorously defending KUB's position and is of the opinion that the ultimate disposition of these matters will not have a material adverse effect on KUB's financial position, results of operations or cash flows.

In February 2005, a Consent Decree was entered into federal court regarding the operation of KUB's wastewater system. Under the terms of the Consent Decree, the remediation of identified sanitary sewer overflows ("SSOs") on KUB's wastewater system must be completed by June 30, 2016. KUB anticipates the Division will spend approximately \$530 million in capital investments in order to comply with the terms of the Consent Decree related to the collection system. The Consent Decree also required KUB to perform an evaluation of the wet-weather performance and capacity of its wastewater treatment plants.

In July 2007, KUB submitted a Composite Correction Plan (CCP) for its wastewater treatment plants to EPA for review. The development and filing of the CCP was a requirement of the federal order of February 2005. The CCP includes recommended improvements to KUB's Kuwahee and Fourth Creek treatment plants to address wet weather capacity issues noted in prior assessments. The EPA approved the CCP in January 2009 including a recommended schedule of plant improvements

# **Knoxville Utilities Board**

## **Notes to Consolidated Financial Statements**

### **June 30, 2013 and 2012**

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that extends beyond the expiration date of the original Consent Decree. An amendment to the Consent Decree incorporating and establishing this schedule was agreed to by all parties and was entered on June 23, 2009. The purpose of the Amendment is to allow KUB to complete a portion of work outlined in the CCP after the Consent Decree deadline of June 30, 2016. The CCP provides for a biologically enhanced high-rate clarification (the "BEHRC") secondary treatment system to be installed at the Fourth Creek treatment plant by June 30, 2018, and at the Kuwahee treatment plant by June 30, 2021. The total cost of such improvements is estimated to be approximately \$120 million.

KUB's total estimated capital investment to comply with the terms of the Consent Decree is \$650 million.

During fiscal year 2006, KUB launched the Private Lateral Program (PLP), as required by the Consent Decree, under which KUB tests private collection system laterals on its wastewater system over a ten-year period. Defective laterals and improper connections can introduce rainwater overloading the wastewater system and add pollution to area waterways. If a private lateral fails the respective inspection test, then the customer is required to have the lateral repaired/replaced within a specified time period. The \$2 million SEP provides funding for lateral repairs/replacements for eligible low-income customers. A \$1.7 million liability was accrued in May 2006 for the SEP. In fiscal year 2012, KUB completed funding of the SEP.

KUB's funding plan for the Consent Decree includes long-term bonds and a series of rate increases phased in over the term of the order. Bond proceeds fund all wastewater capital projects, the majority of which are related to the Consent Decree. As of June 30, 2013, the Wastewater Division had issued \$425 million in bonds to fund system capital improvements since the inception of the Consent Decree. The KUB Board of Commissioners approved two 50 percent rate increases, which went into effect in April 2005 and January 2007, respectively. The Board also approved an 8 percent rate increase, which was effective in September 2008, and two 12 percent rate increases, which were effective in April 2011 and October 2012, respectively. KUB anticipates additional bond issues and rate increases over the next decade to help fund wastewater capital improvements.

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**16. Segment Information**

The following financial information represents identifiable activities for which the revenue bonds and other revenue backed debt are outstanding for the respective divisions:

**Condensed Statement of Net Position**

	<b>2013</b>			
	<b>Electric</b>	<b>Gas</b>	<b>Water</b>	<b>Wastewater</b>
Assets and Deferred Outflows of Resources				
Current assets	\$ 142,703,353	\$ 43,538,246	\$ 26,482,828	\$ 70,123,019
Restricted assets	11,351,830	2,758,469	2,381,993	7,141,750
Net capital assets	406,025,800	215,489,834	226,021,885	618,133,619
Other assets	29,116,601	10,800,255	6,997,675	17,535,835
Total assets	<u>\$ 589,197,584</u>	<u>\$ 272,586,804</u>	<u>\$ 261,884,381</u>	<u>\$ 712,934,223</u>
Deferred outflows of resources	1,605,482	583,939	\$ 280,012	\$ 10,532,610
Total assets and deferred outflows of resources	<u>\$ 590,803,066</u>	<u>\$ 273,170,743</u>	<u>\$ 262,164,393</u>	<u>\$ 723,466,833</u>
Liabilities and Deferred Inflows of Resources				
Current liabilities	\$ 86,674,896	\$ 17,955,454	\$ 10,472,588	\$ 23,234,401
Other liabilities	19,710,985	1,802,040	1,679,909	1,732,282
Long-term debt	178,940,000	87,565,000	98,785,000	450,050,000
Total liabilities	<u>\$ 285,325,881</u>	<u>\$ 107,322,494</u>	<u>\$ 110,937,497</u>	<u>\$ 475,016,683</u>
Deferred inflows of resources	4,480,711	2,158,467	\$ 593,592	\$ 124,830
Total liabilities and deferred inflows of resources	<u>\$ 289,806,592</u>	<u>\$ 109,480,961</u>	<u>\$ 111,531,089</u>	<u>\$ 475,141,513</u>
Net position				
Invested in capital assets, net of related debt	\$ 216,052,130	\$ 121,257,219	\$ 123,858,306	\$ 169,625,399
Restricted	7,595,395	1,602,296	1,027,248	2,147,652
Unrestricted	77,348,949	40,830,267	25,747,750	76,552,269
Total net position	<u>\$ 300,996,474</u>	<u>\$ 163,689,782</u>	<u>\$ 150,633,304</u>	<u>\$ 248,325,320</u>

**Knoxville Utilities Board**  
**Notes to Consolidated Financial Statements**  
**June 30, 2013 and 2012**

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**Condensed Statement of Revenues, Expenses  
and Changes in Net Position**

	2013			
	Electric	Gas	Water	Wastewater
Operating revenues	\$ 534,888,206	\$ 103,597,256	\$ 38,063,528	\$ 74,579,313
Operating expenses	494,487,099	85,404,376	24,387,640	31,678,914
Provision for depreciation & amortization	22,376,706	9,112,867	6,419,430	14,454,762
Total operating expenses	<u>516,863,805</u>	<u>94,517,243</u>	<u>30,807,070</u>	<u>46,133,676</u>
Operating income	18,024,401	9,080,013	7,256,458	28,445,637
Non-operating expense	(6,995,597)	(3,711,069)	(4,320,408)	(19,819,126)
Change in net position before capital contributions	11,028,804	5,368,944	2,936,050	8,626,511
Capital contributions	177,364	-	56,852	143,980
Change in net position	<u>11,206,168</u>	<u>5,368,944</u>	<u>2,992,902</u>	<u>8,770,491</u>
Net position				
Beginning of year	<u>289,790,306</u>	<u>158,320,838</u>	<u>147,640,402</u>	<u>239,554,829</u>
End of year	<u>\$ 300,996,474</u>	<u>\$ 163,689,782</u>	<u>\$ 150,633,304</u>	<u>\$ 248,325,320</u>

**Condensed Statement of Cash Flows**

	2013			
	Electric	Gas	Water	Wastewater
Net cash provided by operating activities	\$ 59,182,454	\$ 22,427,097	\$ 15,563,903	\$ 46,291,631
Net cash used in capital and related financing activities	(32,318,024)	(13,988,771)	(18,577,387)	(20,642,109)
Net cash provided by (used in) investing activities	<u>6,465,993</u>	<u>1,943,320</u>	<u>(2,747,286)</u>	<u>(7,735,347)</u>
Net increase (decrease) in cash and cash equivalents	33,330,423	10,381,646	(5,760,770)	17,914,175
Cash and cash equivalents, beginning of year	<u>27,255,636</u>	<u>9,721,275</u>	<u>17,884,010</u>	<u>14,997,191</u>
Cash and cash equivalents, end of year	<u>\$ 60,586,059</u>	<u>\$ 20,102,921</u>	<u>\$ 12,123,240</u>	<u>\$ 32,911,366</u>

**Knoxville Utilities Board**  
**Required Supplementary Information - Schedule of Funding Progress**  
**June 30, 2013**  
**(Unaudited)**

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**Pension Plan**

Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (b)	Unfunded Actuarial Accrued Liability (UAAL) (b-a)	Funded Ratio (a)/(b)	Annual Covered Payroll (c)	UAAL as a Percentage of Covered Payroll [(b)-(a)]/(c)
January 1, 2010	\$ 203,704,898	\$ 190,679,453	\$ (13,025,445)	106.8%	\$ 48,228,428	(27.01%)
January 1, 2011	195,692,781	187,257,434	(8,435,347)	104.5%	47,405,874	(17.79%)
January 1, 2012	183,980,665	195,536,152	11,555,487	94.1%	48,836,721	23.66%
January 1, 2013	175,936,548	197,049,614	21,113,066	89.3%	47,553,598	44.40%

**Other Post-Employment Benefits (OPEB)**

Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded Actuarial Accrued Liability (UAAL) (b-a)	Funded Ratio (a)/(b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll [(b)-(a)]/(c)
January 1, 2008	\$ -	\$ 108,329,141	\$ 108,329,141	0%	\$ 31,234,509	346.8%
January 1, 2009	14,593,487	100,726,738	86,133,251	14%	31,846,091	270.5%
January 1, 2010	21,275,643	58,475,364	37,199,721	36%	30,069,028	123.7%
January 1, 2011	40,749,815	64,289,254	23,539,439	63%	28,878,791	81.5%
January 1, 2012	37,907,357	61,603,466	23,696,109	62%	28,269,123	83.8%
January 1, 2013	38,571,803	63,341,531	24,769,728	61%	27,566,340	89.9%

See accompanying Report of Independent Auditors on Supplemental Information.

**Knoxville Utilities Board**  
**Supplemental Information –**  
**Schedule of Expenditures of Federal Awards by Grant**  
**June 30, 2013**

**Schedule 1**

KUB was awarded a grant from the Department of Energy in October 2009, under DOE's Smart Grid Investment Grant Program. The grant, which totals \$3.58 million, will be used to help fund a smart grid pilot project in the University of Tennessee and surrounding areas. KUB was also awarded two grants from Tennessee Emergency Management Agency (as a flow through from FEMA) for reimbursement for costs related to storms in 2011. The schedule below shows the activities for the current fiscal year.

<u>Program Name</u>	<u>Federal/State Agency</u>	<u>CFDA Number</u>	<u>Contract Number</u>	<u>Beginning Receivable</u>	<u>Cash Receipts</u>	<u>Expenditures</u>	<u>Adjustments</u>	<u>Ending Receivable</u>
ARRA-Electricity Delivery and Energy Reliability, Research, Development and Analysis	Department of Energy	81.122	DE-OE0000405	\$ -	\$ 413,414	\$ 413,414	\$ -	\$ -
Total Program 81.122				\$ -	\$ 413,414	\$ 413,414	\$ -	\$ -
U.S. Department of Homeland Security	Tennessee Emergency Management	97.036	34101-0000009205	\$ 806,771	\$ 191,276	\$ -	\$ (2,282)	\$ 613,213
U.S. Department of Homeland Security	Tennessee Emergency Management	97.036	34101-0000009832	\$ 983,465	\$ -	\$ -	\$ -	\$ 983,465
Total Program 97.036				\$ 1,790,236	\$ 191,276	\$ -	\$ (2,282)	\$ 1,596,678
<b>Total Federal Awards</b>				<u>\$ 1,790,236</u>	<u>\$ 604,690</u>	<u>\$ 413,414</u>	<u>\$ (2,282)</u>	<u>\$ 1,596,678</u>

**NOTE 1 - BASIS OF PRESENTATION**

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of Knoxville Utilities Board and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

See accompanying Report of Independent Auditors on Supplemental Information.



**Knoxville Utilities Board  
Supplemental Information –  
Schedule of Findings and Questioned Costs  
June 30, 2013**

**Schedule 2**

**Summary of Audit Results**

Financial Statements

Type of auditors report issued: Unqualified

Internal control over financial reporting:

Material weakness(es) identified? ☐ Yes ☒ No

Significant deficiencies identified that are not considered to be material weakness(es)? ☐ Yes ☒ None reported

Noncompliance material to financial statements noted? ☐ Yes ☒ No

Federal Awards

Internal control over major programs:

Material weakness(es) identified? ☐ Yes ☒ No

Significant deficiencies identified that are not considered to be material weakness(es)? ☐ Yes ☒ None reported

Type of auditor's report issued on compliance for major programs: Unqualified

Any audit findings disclosed that are required to be reported in Accordance with Section 510(a) of Circular A-133? ☐ Yes ☒ None reported

Major programs:	<u>CFDA Number</u>	<u>Name of Federal Program</u>
	81.122	ARRA-Electricity Delivery and Energy Reliability, Research, Development and Analysis
	97.036	U.S. Department of Homeland Security
Dollar threshold used to distinguish between type A And type B programs	\$300,000	
Auditee qualified as low-risk auditee?	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No

**Findings – Financial Statements Audit**

None

**Findings and Questioned Costs – Major Federal Award Programs Audit**

None

See accompanying Report of Independent Auditors on Supplemental Information.

**Knoxville Utilities Board**  
**Supplemental Information - Schedule of Insurance in Force**  
**June 30, 2013**  
**(Unaudited)**

**Schedule 3**

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**Crime**

Covers losses resulting from employee dishonesty, robbery, burglary, and computer fraud. Limits of coverage - \$5,000,000; \$250,000 retention.

**Directors' and Officers' Liability Insurance**

Covers KUB personnel appropriately authorized to make decisions on behalf of KUB (including but not limited to Commissioners, President and CEO, Senior Vice Presidents, Vice Presidents, and Directors) for wrongful acts. Limits of coverage - \$20,000,000; \$1,000,000 corporate deductible, \$0 individual deductible.

**Employment Practices Liability**

Coverage for costs related to actual or alleged employment practices violations for amounts exceeding specified amount (\$500,000). Limits of coverage - \$10,000,000.

**Fiduciary**

Covers losses resulting from wrongful acts related to KUB's Pension, 401(k), and OPEB Trust funds. Limits of coverage - \$10,000,000; \$150,000 deductible.

**Pollution Legal Liability**

New conditions coverage for losses exceeding specified amount per occurrence (\$1,000,000). Limits of coverage - \$20,000,000.

**Property Insurance**

This coverage provides protection of KUB's property for fire, extended coverage, vandalism and malicious mischief, and coverage on boilers and machinery. Also included are flood and earthquake damage and mechanical failure. Limits of coverage - \$250,000,000 per occurrence (subject to certain sublimits); \$2,500,000 deductible per occurrence.

**Travel Accident**

Covers losses related to employees' business travel. Limits of coverage - \$1,500,000 aggregate.

**Excess Insurance for General Liability**

As a government entity, KUB's liability is limited under the Tennessee Governmental Tort Liability Act (TCA §29-20-403). KUB is self-insured for up to the first \$700,000 of any accident and has insurance of \$1,000,000 above this retention.

**Excess Insurance for Workers' Compensation**

Covers all losses exceeding specified amount per occurrence (\$1,000,000). Limits of coverage - Statutory; stop loss coverage applies for aggregate losses over \$5,000,000.

**Employee Health Plan Stop Loss Coverage**

KUB's employee health plan is self-funded. KUB has purchased stop loss insurance, which covers KUB's exposure to annual expenses in excess of \$400,000 per individual participant.

See accompanying Report of Independent Auditors on Supplemental Information.

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

To the Board of Commissioners  
Knoxville Utilities Board  
Knoxville, Tennessee

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Knoxville Utilities Board ("KUB"), (an independent agency reported as a component unit for financial purposes only) of Knoxville, Tennessee, as of and for the year ended June 30, 2013 and the related notes to the financial statements, which collectively comprise KUB's basic financial statements, and have issued our report thereon dated October 22, 2013.

**Internal Control Over Financial Reporting**

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

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

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

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether KUB's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

### **Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing and not to provide an opinion on the effectiveness of KUB's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering KUB's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

*Rodefin Moss & Co, PLLC*

Knoxville, Tennessee  
October 22, 2013



**Independent Auditors' Report on Compliance for Each Major Program and  
on Internal Control Over Compliance Required by OMB Circular A-133**

To the Board of Commissioners  
Knoxville Utilities Board  
Knoxville, Tennessee

**Report on Compliance for Each Major Federal Program**

We have audited the Knoxville Utilities Board's ("KUB") (an independent agency reported as a component unit for financial purposes only by the City of Knoxville, Tennessee) compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of KUB's major federal programs for the year ended June 30, 2013. KUB's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs.

**Management's Responsibility**

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

**Auditors' Responsibility**

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

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of KUB's compliance.

**Opinion on Each Major Federal Program**

In our opinion, KUB complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2013.

**Report on Internal Control Over Compliance**

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

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent or

detect, and correct noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

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

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

*Rodehorst Moss & Co, PLLC*

Knoxville, Tennessee  
October 22, 2013

