Knoxville Utilities Board

Consolidated Financial Statements and Supplemental Information

June 30, 2013 and 2012

Knoxville Utilities Board
Index
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.

Rodefer Moss & Co, PLLC

Knoxville, Tennessee
October 22, 2013

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.

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 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 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.

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

(in thousands of dollars)	**FY 2013 Budget**	**FY 2013 Actual FYTD**	**Dollar Variance***	**Percent Variance**
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	$ 122,080	153,223	$ 31,143	25.5%

**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.

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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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.

Statements of Net Position
As of June 30

(in thousands of dollars)	**2013**	**2012**
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	1,849,605	1,706,110
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	985,960	870,803
Net position		
Net investment in capital assets	630,793	621,993
Restricted	12,372	11,228
Unrestricted	220,480	202,086
Total net position	$ 863,645	$ 835,307

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.

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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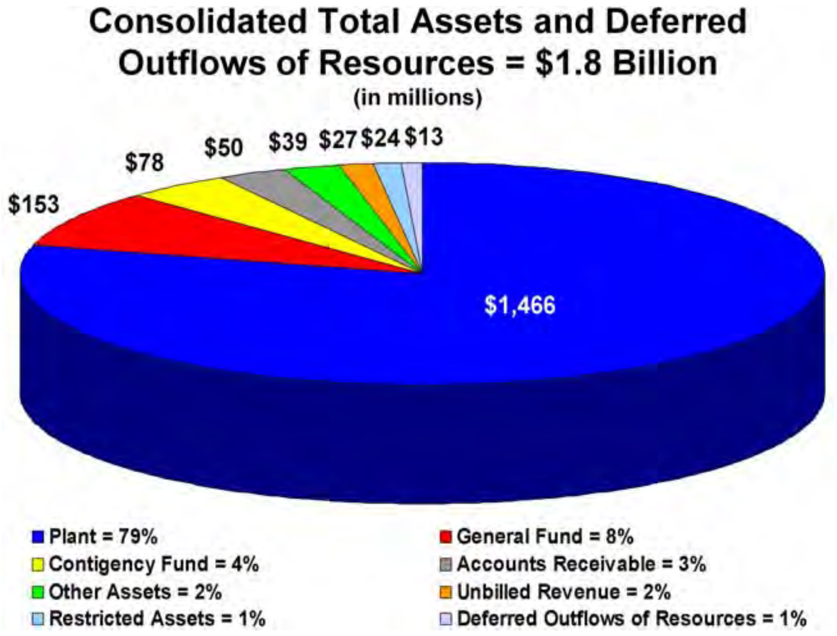

Current and Other Liabilities

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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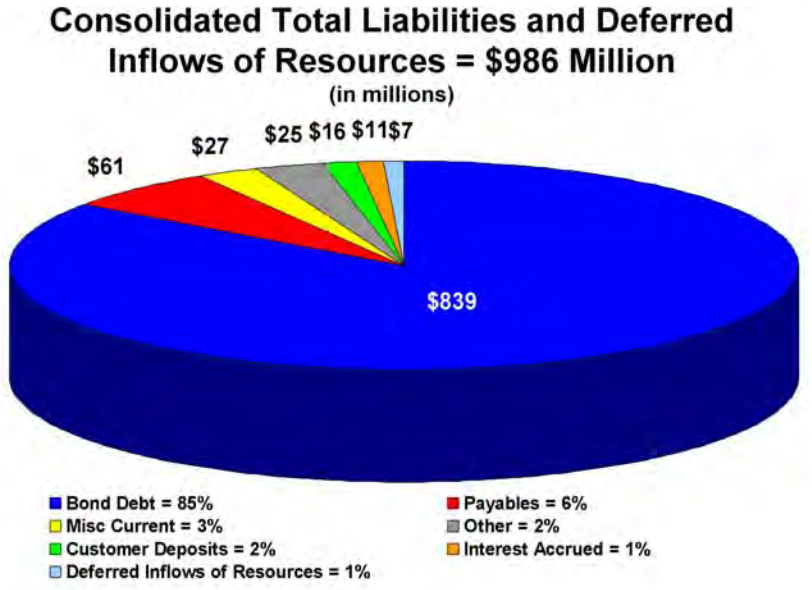

Net Position

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.

Statements of Revenues, Expenses and Changes in Net Position
For the Years Ended June 30

(in thousands of dollars)	2013	2012
Operating revenues	$ 743,249	$ 693,531
Less: Purchased energy expense	489,322	456,038
Margin from sales	253,927	237,493
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	191,121	180,895
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	27,960	23,258
Capital contributions	378	3,081
Change in net position	$ 28,338	$ 26,339

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.

- 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

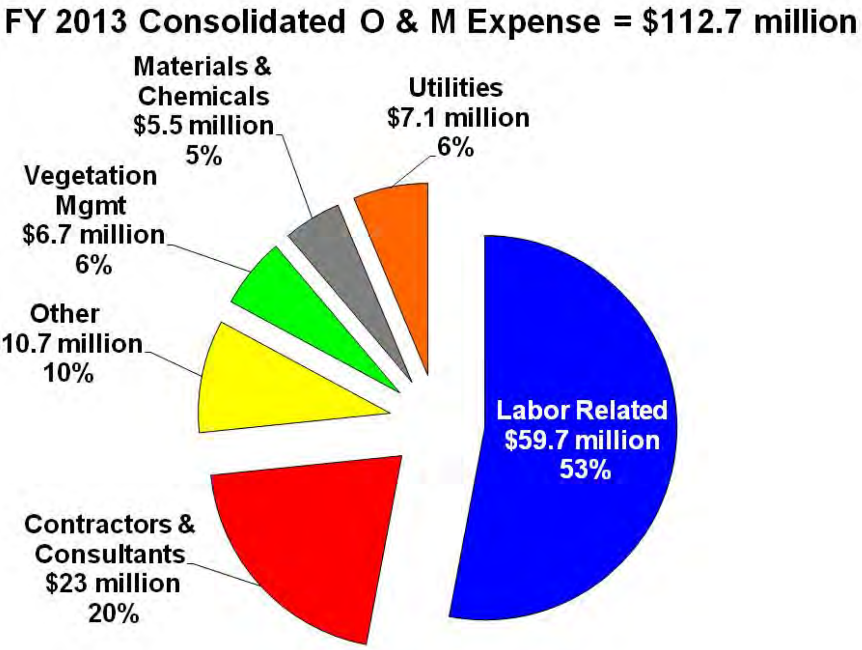
Operating expenses (excluding wholesale purchased energy expense) increased $10.2 million or 5.7 percent compared to last fiscal year. Operating expenses are categorized as the following:

- 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.

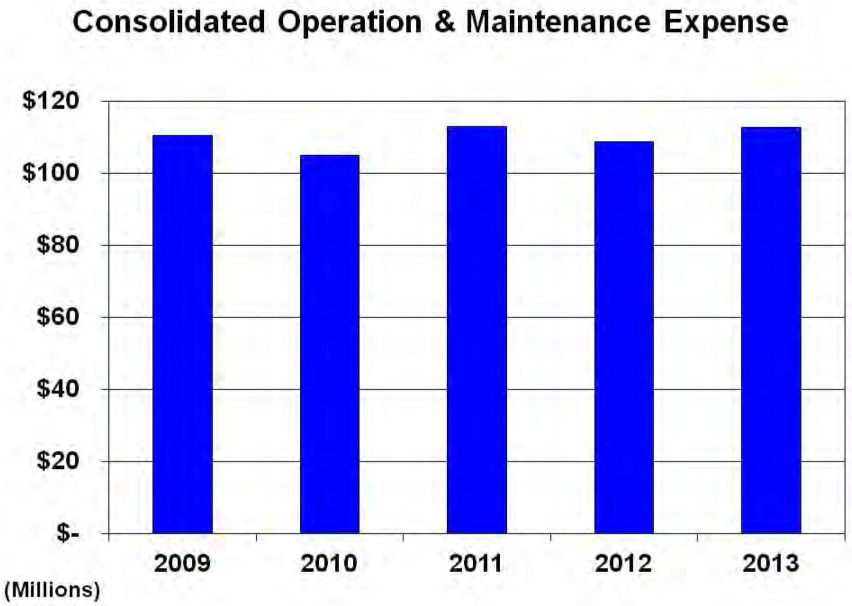
- Distribution and collection expenses increased $3.1 million or 5.8 percent, the result of higher outside contractor and consultant expenses related to electric substation maintenance, transformer testing and an assessment of the gas distribution system.

- 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.



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.



- 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 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.

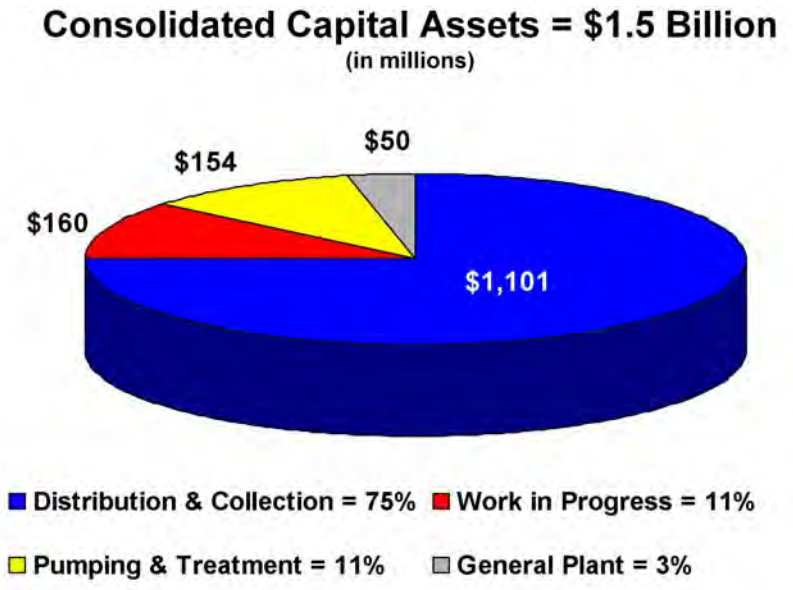
Capital Assets and Debt Administration

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.

Capital Assets
As of June 30
(Net of Depreciation)

(in thousands of dollars)	**2013**	**2012**
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	$ 1,465,672	$ 1,367,479



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.

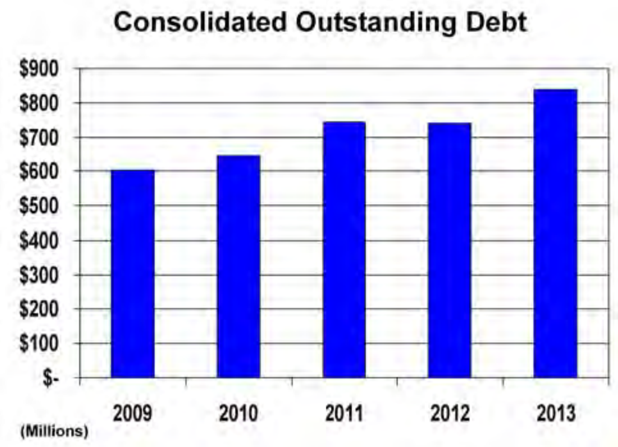
KUB issued $143.9 million in refunding bonds for the purpose of refunding outstanding bonds for all four divisions at lower interest rates. The bonds refunded were issued in 2005 and 2006. KUB will realize a total debt service savings of $24.6 million over the life of the bonds ($16.9 million on a net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

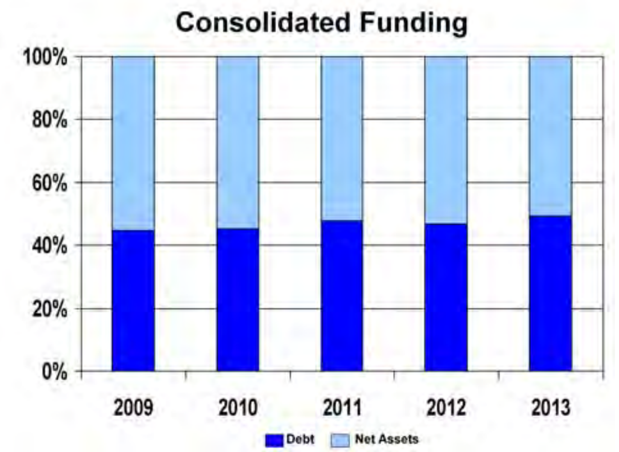
KUB's outstanding debt is rated by Standard & Poor's and Moody's Investors Service. As of June 30, 2013, Standard & Poor's rated the revenue bonds of the Electric, Water, and Wastewater Divisions AA+ and the revenue bonds of the Gas Division AA. Moody's Investors Service rated the bonds of all four divisions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

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

Outstanding Debt
As of June 30

(in thousands of dollars)	**2013**	**2012**
Revenue bonds	$ 839,305	$ 742,210
Total outstanding debt	$ 839,305	$ 742,210





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.

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

	2013	2012
Assets and Deferred Outflows of Resources		
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	282,847,446	224,711,838
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	23,634,042	35,182,131
Plant in service	1,987,349,747	1,866,937,094
Less accumulated depreciation	(681,775,954)	(647,505,932)
	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	1,465,671,138	1,367,478,978
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	64,450,366	75,089,962
Total assets	1,836,602,992	1,702,462,909
Deferred outflows of resources:		
Unamortized bond refunding costs	13,002,043	3,586,800
Unamortized costs	-	59,898
Total deferred outflows of resources	13,002,043	3,646,698
Total assets and deferred outflows of resources	$ 1,849,605,035	$ 1,706,109,607

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

	2013	2012
Liabilities, Deferred Inflows, and Capitalization		
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	138,337,339	125,520,820
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	24,925,216	19,068,257
Long-term debt:		
Revenue bonds	815,340,000	720,575,000
Total long-term debt	815,340,000	720,575,000
Total liabilities	978,602,555	865,164,077
Deferred inflows of resources:		
Unamortized costs	7,357,600	5,639,155
Total deferred inflows of resources	7,357,600	5,639,155
Total liabilities and deferred inflows of resources	985,960,155	870,803,232
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	220,479,235	202,085,752
Total net position	863,644,880	835,306,375
Total liabilities, deferred inflows, and net position	$ 1,849,605,035	$ 1,706,109,607

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

	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	743,249,017	693,530,780
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	680,442,508	636,933,649
Operating income	62,806,509	56,597,131
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)	(34,846,200)	(33,340,989)
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	$ 863,644,880	$ 835,306,375

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	143,465,085	102,314,629
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	(85,526,291)	(140,035,078)
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	(2,073,320)	(16,968,707)
Net increase (decrease) in cash and cash equivalents	55,865,474	(54,689,156)
Cash and cash equivalents, beginning of year	69,858,112	124,547,268
Cash and cash equivalents, end of year	$ 125,723,586	$ 69,858,112
Reconciliation of operating income to net cash provided by operating activities		
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	$ 143,465,085	$ 102,314,629
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.

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.

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.

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.

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.

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.

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:

	Carrying Value	Bank Balance
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
	$ 254,934,434	$ 259,469,017

Classification of deposits and investments:

Depository Account	**Bank Balance**
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	$ 259,469,017

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

Classification of deposits and investments per statement of net position:

		2013		**2012**
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
	$	254,934,434	$	207,704,111

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.

		Deposit and Investment Maturities (in Years)				
		Fair Value		**Less Than 1**		**1-5**
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
	$	259,469,017	$	212,727,651	$	46,741,366

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.

4. Accounts Receivable

Accounts receivable consists of the following:

	2013	2012
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)
	$ 77,154,986	$ 68,491,633

5. Accounts Payable and Accruals

Accounts payable and accruals consist of the following:

	2013	2012
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
	$ 86,478,264	$ 77,869,159

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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
Electric					
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	$ 158,870,000	$ 44,660,000	$ 17,020,000	$ 186,510,000	$ 7,570,000
Gas					
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	$ 87,360,000	$ 21,580,000	$ 16,590,000	$ 92,350,000	$ 4,785,000
Water					
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	$ 105,235,000	$ 9,285,000	$ 12,670,000	$ 101,850,000	$ 3,065,000
Wastewater					
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	$ 390,745,000	$ 178,340,000	$ 110,490,000	$ 458,595,000	$ 8,545,000

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
	$ 19,068,257	$ 19,324,644	$ (18,395,266)	$ 19,997,635	$ 3,811,000

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	$ 839,305,000	$ 534,259,642	$ 1,373,564,642

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

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.

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 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	$ 150,279

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**
Production Plant (Intakes)	$ 742,503	$ -	$ -	$ 742,503
Pumping and Treatment Plant	227,104,785	18,400,939	(5,104,994)	240,400,730
Distribution and Collection Plant				
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
Total Distribution & Collection Plant	$ 1,508,412,779	$ 117,691,440	$ (17,229,698)	$ 1,608,874,521
General Plant	130,677,027	10,054,272	(3,399,306)	137,331,993
Total Plant Assets	$ 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)
Net Plant Assets	$ 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
Total Net Plant	$ 1,367,478,978	$ 239,293,826	$ (141,101,666)	$ 1,465,671,138

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.

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	$ 1,733,984	$ 1,827,920

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 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 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.

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.

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	$ 22,143,808	$ 22,002,793	$ 8,095,730	$ 1,353,720	$ 1,015,290

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	$ 11,573,837	$ -	$ -	$ -	$ -

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 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

	2013			
	Electric	**Gas**	**Water**	**Wastewater**
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	$ 589,197,584	$ 272,586,804	$ 261,884,381	$ 712,934,223
Deferred outflows of resources	1,605,482	583,939	$ 280,012	$ 10,532,610
Total assets and deferred outflows of resources	$ 590,803,066	$ 273,170,743	$ 262,164,393	$ 723,466,833
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	$ 285,325,881	$ 107,322,494	$ 110,937,497	$ 475,016,683
Deferred inflows of resources	4,480,711	2,158,467	$ 593,592	$ 124,830
Total liabilities and deferred inflows of resources	$ 289,806,592	$ 109,480,961	$ 111,531,089	$ 475,141,513
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	$ 300,996,474	$ 163,689,782	$ 150,633,304	$ 248,325,320

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	516,863,805	94,517,243	30,807,070	46,133,676
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	11,206,168	5,368,944	2,992,902	8,770,491
Net position				
Beginning of year	289,790,306	158,320,838	147,640,402	239,554,829
End of year	$ 300,996,474	$ 163,689,782	$ 150,633,304	$ 248,325,320

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	6,465,993	1,943,320	(2,747,286)	(7,735,347)
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	27,255,636	9,721,275	17,884,010	14,997,191
Cash and cash equivalents, end of year	$ 60,586,059	$ 20,102,921	$ 12,123,240	$ 32,911,366

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

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%

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.

Program Name	Federal/State Agency	CFDA Number	Contract Number	Beginning Receivable	Cash Receipts	Expenditures	Adjustments	Ending Receivable
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
		Total Federal Awards		$ 1,790,236	$ 604,690	$ 413,414	$ (2,282)	$ 1,596,678

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.

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:

CFDA Number	Name of Federal Program
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? ___Yes ✓___ No

Findings – Financial Statements Audit

None

Findings and Questioned Costs – Major Federal Award Programs Audit

None

Knoxville Utilities Board
Supplemental Information - Schedule of Insurance in Force
June 30, 2013
(Unaudited) Schedule 3

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.

• Certified Public Accountants
• Business Advisors

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Knoxville, TN 37932

RM
RODEFER MOSS & CO, PLLC

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.

Rodefer Moss & Co, PLLC

Knoxville, Tennessee
October 22, 2013

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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.

Rodefer Moss & Co, PLLC

Knoxville, Tennessee
October 22, 2013

Knoxville Utilities Board
Electric Division

Financial Statements and Supplemental Information

June 30, 2013 and 2012

Knoxville Utilities Board Electric Division
Index
June 30, 2013 and 2012

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Independent Auditors' Report

To the Board of Commissioners
Knoxville Utilities Board - Electric Division
Knoxville, Tennessee

Report on the Financial Statements

We have audited the accompanying financial statements of the Knoxville Utilities Board, Electric Division (the "Division"), 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 financial statements, which collectively comprise the Division's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 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 financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Division's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the Division'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 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 financial statements referred to above present fairly, in all material respects, the respective financial position of the Division 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 3-18 and 38 be presented to supplement the basic financial statements. Such information, although not a part of the basic 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 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 financial statements, and other knowledge we obtained during our audit of the basic 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 financial statements that collectively comprise the Knoxville Utilities Board's basic financial statements. The supplemental schedules on pages 40-69 are presented for the purpose of additional analysis and are not a required part of the basic financial statements. The schedule of expenditures of federal awards on page 39 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 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 financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic 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 financial statements or to the basic 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 financial statements as a whole.

The supplemental schedules have not been subjected to the auditing procedures applied in the audit of the basic 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 the Division'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 the Division's internal control over financial reporting and compliance.

Rodefer Moss & Co, PLLC

Knoxville, Tennessee
October 22, 2013

Knoxville Utilities Board (KUB), comprised of the Electric Division, Water Division, Gas 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. The Electric Division (Division) provides services to certain customers in Knox County and in seven surrounding counties in East Tennessee. The Division's accounts are maintained in conformity with the Uniform System of Accounts of the Federal Energy Regulatory Commission and the Governmental Accounting Standards Board, as applicable. The financial statements present only the Electric Division and do not purport to, and do not, present fairly the consolidated financial position of Knoxville Utilities Board at June 30, 2013 and 2012, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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

The Division's 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 the Division's financial statements.

Electric Division Highlights

System Highlights

KUB serves 198,350 electric customers over a 688 square mile service area and maintains 5,300 miles of service lines and 59 electric substations to provide 5.6 million mega watt-hours to its customers annually. KUB added 650 customers to its electric system in fiscal year 2013, which is down from the addition of 1,200 customers last year.

In 2007 KUB launched Century II, a new infrastructure management program, which includes the assessment of each utility system's infrastructure and the appropriateness of current life cycle replacement programs. For the fiscal year ending June 30, 2013, KUB exceeded its target replacement goals for its key electric system assets, while staying within its total capital budget. 3,164 poles were replaced, exceeding the target level of 2,600, and 14.8 miles of underground electric cable were replaced, exceeding the target level of 14 miles.

The Division generated $4.8 million of additional margin during the fiscal year as a result of the 2011 and 2012 rate increases, previously adopted by the KUB Board of Commissioners to help fund the electric system's Century II infrastructure program.

In December 2012, the Division issued $35 million in electric system revenue bonds to fund capital improvements.

KUB sold $9.7 million in electric system revenue refunding bonds in March 2013. This refunding will provide debt service savings of $1.2 million over the life of the bonds.

The typical residential customer's monthly electric bill was $102.28 of June 30, 2013, representing an increase of $5.24 or 5.4 percent compared to June 30, 2012. The increase in the monthly bill was the combined result of KUB's one percent rate increase, the flow-through of TVA wholesale rate adjustments, and the flow-through of previously under recovered wholesale power costs.

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.

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. 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.

Century II Infrastructure Program

In 2007 KUB launched Century II, a new infrastructure management program, which includes 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 the difficult economy. Although major increases to infrastructure replacement funding were delayed, significant investments were made to maintain reliability and system integrity. In April 2011, given the critical infrastructure needs of the electric and water distribution systems, management recommended the Board endorse a plan to resume 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, which included a combination of rate increases and debt issues to fully fund the programs for the next ten years.

The electric distribution system is an older system with several major components nearing the end of or exceeding their respective service lives, including certain substation transformers, wood poles, and underground cable. In addition, KUB needs to upgrade certain existing circuits and build new circuits to provide greater operational flexibility and reduce storm restoration times.

Ten years of Century II funding for the electric system will cover replacing all critical substation transformers, 26,000 wood poles, and all XLP (cross-linked polyethylene) underground cable. At the proposed rate of pole replacement, no poles older than the mid-1960s will remain after ten years. Replacing all XLP cable is critical, as this type of cable has experienced a significantly higher failure rate in recent years.

In September 2011, the KUB Board adopted a resolution, which endorsed the Century II electric program and the associated ten-year funding plan. The resolution also adopted the initial three electric rate increases, the first two of which were effective October 1, 2011 and October 1, 2012, respectively. The remaining increase will be effective October 1, 2013. Each of the 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 bill for each of the rate increases.

With Board approval, KUB immediately began implementing the accelerated pace of infrastructure replacement for the electric system.

Financial Highlights

The Division's net position increased $11.2 million or 3.9 percent, compared to a $9.1 million increase last fiscal year.

Operating revenue increased $28.8 million or 5.7 percent over the prior fiscal year. The growth in operating revenue was the result of additional revenue from KUB electric rate increases, increased sales volumes, and the flow-through of TVA rate adjustments. KUB flows changes to wholesale power rates directly through to its retail electric rates via its Purchased Power Adjustment. Margin on electric sales (operating revenue less purchased power expense) increased $6.3 million or 6.5 percent.

The Division expended 81 percent of electric system sales revenue to TVA for wholesale power purchases for the fiscal year ended June 30, 2013.

Operating expenses (excluding purchased power expense) increased $3.8 million or 4.7 percent. Operating and maintenance ("O&M") expenditures increased $1.1 million or 2.4 percent. Depreciation expense increased $1.7 million or 8.3 percent. Taxes and tax equivalents were $0.9 million higher than the prior fiscal year.

Lower interest rates on investments resulted in a $0.1 million decrease in interest income. Interest expense increased $0.3 million or 4.2 percent, reflecting a partial year of interest expense on revenue bonds sold in December 2012.

Capital contributions fell $0.1 million, due to fewer street lighting assets being provided to KUB this fiscal year.

Total plant assets (net) increased $29.7 million or 7.9 percent over the end of the last fiscal year reflecting distribution system improvements and pole replacements as part of KUB's Century II electric program.

Long-term debt represented 38.3 percent of the Division's capital structure as of June 30, 2013, compared to 35.4 percent last year. Capital structure equals long-term debt (including the current portion of any revenue bonds and notes, as applicable, due to be retired the next fiscal year) plus net position.

The Division's bond covenants require a debt service coverage ratio of at least 1.2 times the maximum principal and interest payments over the life of the Division's outstanding bonds. Current year debt coverage for the fiscal year was 3.95. Maximum debt service coverage was 3.45.

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Division Cash Budget Appropriations

KUB's Board of Commissioners adopted an Electric Division budget of $558.1 million for fiscal year 2013. At year end, actual cash expenditures were $13.8 million or 2.5 percent below budget. Purchased power expense was $10.4 million below budget, reflecting lower than expected wholesale power rates. Capital expenditures were $3.3 million lower than expected, the result of timing on planned information technology and facilities projects. Bond proceeds of $35.6 million were transferred to the Division's general fund to pay for capital projects during fiscal year 2013. The amount of bond proceeds transferred was $9 million less than expected, as the amount of bonds sold in fiscal year 2013 was $10 million lower than originally anticipated. The Electric Division general fund year-end balance was $14.9 million higher than budgeted. The numbers below are presented on a cash basis.

Electric Division Cash Report
As of June 30, 2013

(in thousands of dollars)	**FY 2013 Budget**	**FY 2013 Actual FYTD**	**Dollar Variance***	**Percent Variance**
Beginning Balance General Fund	$ 43,256	$ 43,256		
Operating Receipts	525,637	533,432	7,795	1.5%
Disbursements				
Purchased Energy Expense	421,346	410,927	10,419	2.5%
Operation & Maintenance Expense	49,379	48,535	844	1.7%
Capital Expenditures	59,078	55,820	3,258	5.5%
Debt Service & Taxes	28,243	28,956	(713)	-2.5%
Total Disbursements	558,046	544,238	13,808	2.5%
Bond Proceeds	44,550	35,565	(8,985)	-20.2%
Net Flow-throughs and Transfers	(705)	1,571	2,276	-
Ending General Fund Balance	$ 54,692	$ 69,586	$ 14,894	27.2%

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

Knoxville Utilities Board Electric Division - Financial Statements

The Division's financial performance is reported under three basic 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

The Division 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, electric 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 the Division has done with its accumulated earnings, not just the balance.

Net investment in capital assets, is the net 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 the Division'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

The Division 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

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

The statement indicates the Division's beginning cash balance and ending cash balance and how it was either increased or decreased during the reporting period.

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

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Condensed Financial Statements

Statement of Net Position

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

Statements of Net Position
As of June 30

(in thousands of dollars)	2013	2012
Current and other assets	$ 183,172	$ 165,590
Capital assets, net	406,026	376,338
Deferred outflows of resources	1,605	1,852
Total assets and deferred outflows of resources	590,803	543,780
Current and other liabilities	106,386	98,274
Long-term debt outstanding	178,940	151,950
Deferred inflows of resources	4,481	3,766
Total liabilities and deferred inflows of resources	289,807	253,990
Net position		
Net investment in capital assets	216,052	214,981
Restricted	7,595	6,924
Unrestricted	77,349	67,885
Total net position	$ 300,996	$ 289,790

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.

Current Year Impacts and Analysis

Current and Other Assets

Current and other assets increased $17.6 million or 10.6 percent. The increase in assets is attributed to cash proceeds from a $35 million December 2012 bond issue and increased revenue from one percent October 2011 and 2012 rate increases. Accounts receivable was $3.9 million higher than June 30 of the previous year contributing to the overall increase in assets. Other assets decreased by $17.7 million as KUB flowed-through previously under recovered wholesale power costs to its electric customers through the Purchased Power Adjustment.

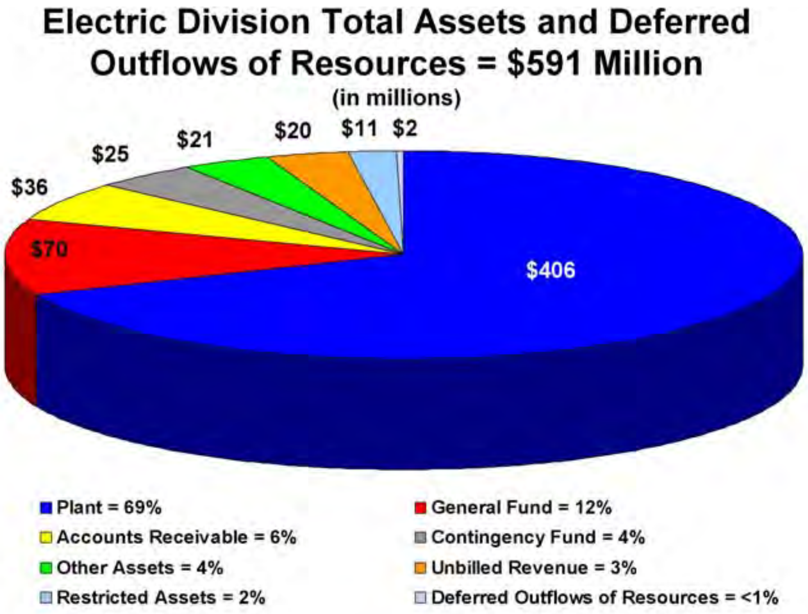
The Division contributed $1 million to operating contingency reserves in order to maintain the required balance in the fund, which is 45 days of operating expenses.

Capital Assets

Capital assets, net of depreciation, increased $29.7 million or 7.9 percent. Major capital expenditures included $23.6 million for distribution system improvements, $8.9 million for pole replacements, $4.6 million for system growth-related expenditures, and $2.2 million for fleet and heavy equipment.

Deferred Outflows of Resources

Deferred outflows of resources decreased $0.2 million compared to the prior year, reflecting issuance costs received in the refunding of long term debt in March 2013.



Current and Other Liabilities

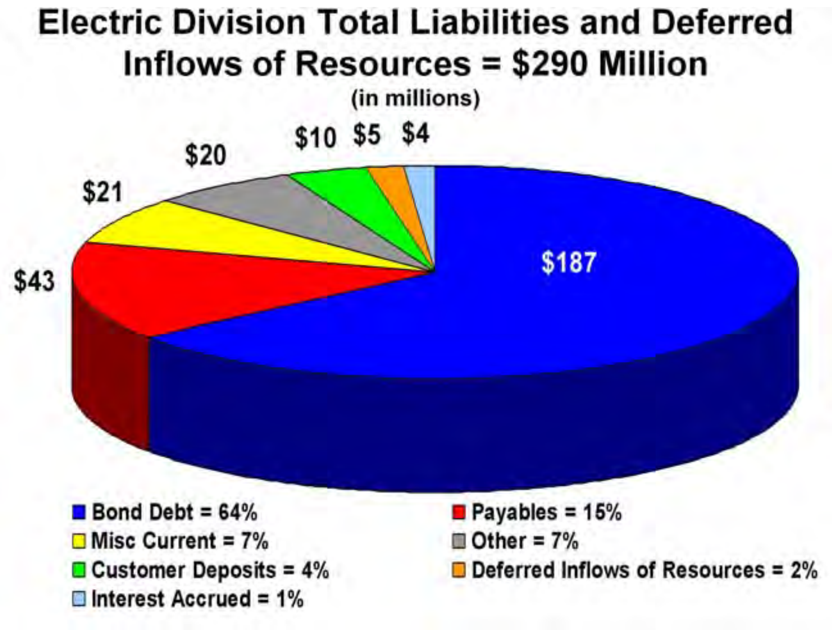
Current and other liabilities increased $8.1 million or 8.3 percent, due in part to a $4.9 million over recovery of purchased power expenses in fiscal year 2013. The $4.9 million over recovery will be flowed back to KUB's electric customers next fiscal year through adjustments to electric rates via the Purchased Power Adjustment. Accounts payable rose $0.8 million due to higher contractor costs for June 2013 compared to June 2012. TVA conservation loans increased $0.7 million. The Division's share of liability for post-employment medical benefits was $0.6 million lower while the liability for pension benefits was $0.9 million higher than the prior year.

Long-Term Debt

Long-term debt increased $27 million or 17.8 percent, the net result of a $35 million December 2012 bond issue, the scheduled repayment of debt, and a $0.4 million reduction in principal as a result of the March 2013 debt refunding.

Deferred Inflows of Resources

The net unamortized cost of debt increased $0.7 million reflecting premiums received in the refunding of long term debt in March 2013.



Net Position

Net investment in capital assets increased by $1.1 million or 0.5 percent. The increase was the net result of $29.7 million of net electric plant additions and the addition of new electric system debt and debt issuance costs totaling $28.6 million. Unrestricted net position increased $9.5 million due to the $17.6 million increase in current and other assets. Restricted net position increased $0.7 million due to the net increase of the electric bond fund and the associated interest payable.

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Statement of Revenues, Expenses and Changes in Net Position

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

Statements of Revenues, Expenses and Changes in Net Position
For the Years Ended June 30

(in thousands of dollars)	2013	2012
Operating revenues	$ 534,888	$ 506,054
Less: Purchased power expense	432,024	409,443
Margin from sales	102,864	96,611
Operating expenses		
Distribution	30,914	29,123
Customer service	5,588	5,305
Administrative and general	13,021	13,954
Depreciation and amortization	22,377	20,656
Taxes and tax equivalents	12,940	12,003
Total operating expenses	84,840	81,041
Operating income	18,024	15,570
Interest income	371	502
Interest expense	(7,281)	(6,990)
Other income/(expense)	(85)	(251)
Change in net position before capital contributions	11,029	8,831
Capital contributions	177	302
Change in net position	$ 11,206	$ 9,133

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 the volume of electric power sales for the fiscal year. Any change (increase/decrease) in retail electric rates would also be a cause of change in operating revenue.

- Purchased power expense is determined by volume of power purchases from TVA for the fiscal year. Also, any change (increase/decrease) in TVA wholesale power rates would result in a change in purchased power expense.

- Operating expenses (distribution, customer service, administrative and general) are normally impacted by changes in areas including, but not limited to, labor costs (staffing, wage rates), active employee and retiree medical costs, and overhead line maintenance (tree trimming, pole inspection, etc.).

- Depreciation expense is impacted by plant additions and retirements during the fiscal year.

- Taxes and tax equivalents are impacted by plant additions/retirements, changes in property tax rates, and gross margin levels.

- Interest income is impacted by the level of interest rates and investments.

- Interest expense on debt is impacted by the level of outstanding debt and the interest rates on the outstanding debt.

- Other income/(expenses) is impacted by miscellaneous non-operating revenues and expenses.

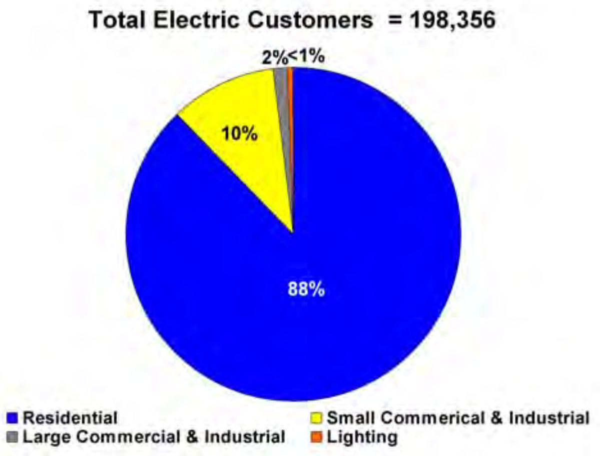
- Capital contributions are impacted by a donation of facilities/infrastructure to KUB by developers and governmental agencies. The contributions are recognized as revenue and recorded as plant in service based on the fair market value of the asset(s).

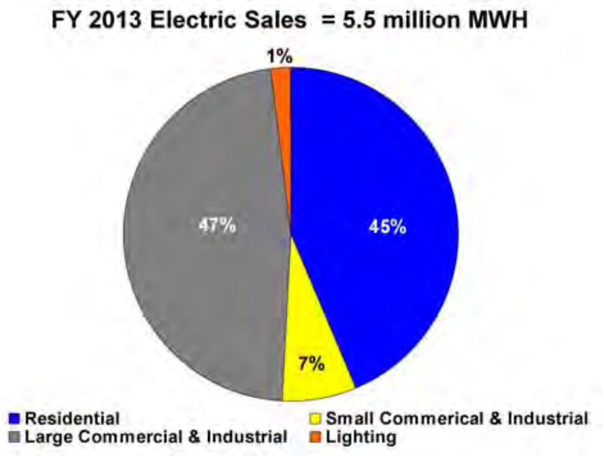
Current Year Impacts and Analysis

The Division's net position increased $11.2 million, which was $2.1 million more than last year's $9.1 million increase. The higher earnings were due to the net effect of a $6.3 million increase in margin on sales, a $3.8 million rise in operating expenses, a $0.3 million increase in interest expense, and a $0.1 million decline in capital contributions.

Margin on electric sales grew $6.3 million, which was the combined result of an increase in sales volumes and additional revenue from the one percent October 2011 and 2012 rate increases.

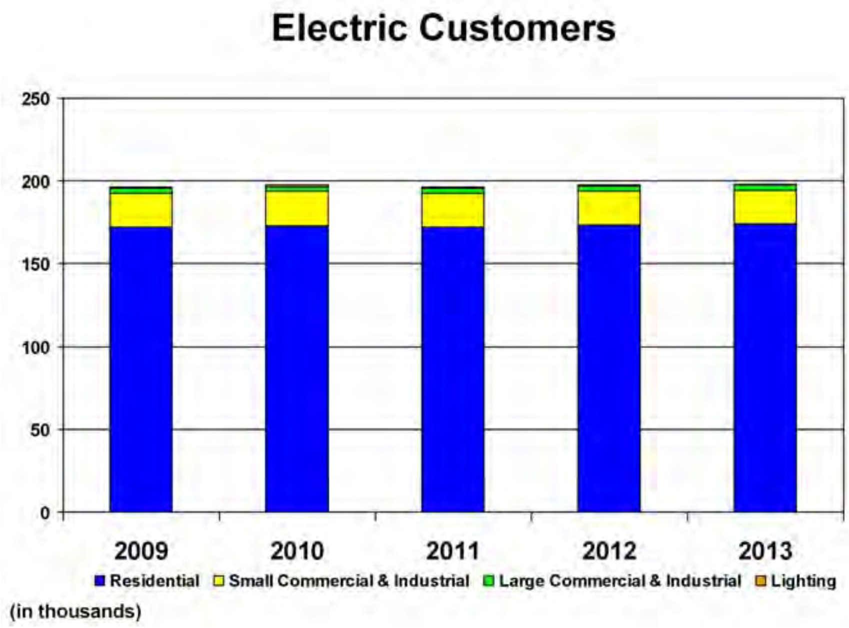
Operating revenue increased $28.8 million or 5.7 percent. Purchased power expense increased $22.6 million over last year, the net result of higher purchases, slightly lower TVA wholesale power rates, and the recovery of prior year under recovered purchase power costs. Power sales of 5.5 million MWh were 1.1 percent higher than the prior year.


Total Electric Customers = 198,356

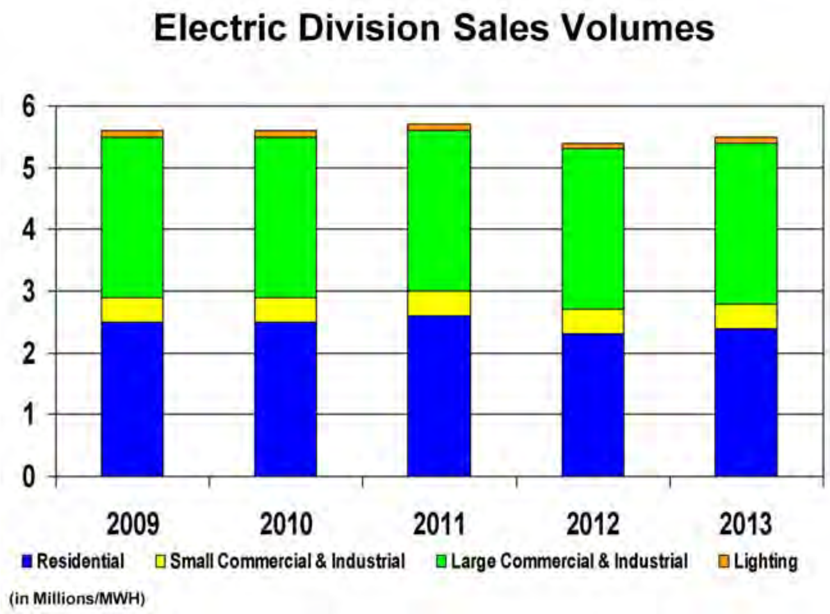

FY 2013 Electric Sales = 5.5 million MWH

Residential customers represented 88 percent of total electric system customers and accounted for 45 percent of electric sales volumes for the year. Large commercial and industrial customers accounted for the largest portion of total sales volumes for the year and were consistent with the prior year due to a steady customer base. KUB's ten largest electric customers accounted for 15.6 percent of KUB's billed volumes. Those ten customers are comprised of five industrial and five commercial customers including two governmental customers. Sales to Gerdau Ameristeel, KUB's largest industrial customer, were 291.3 MWh or 5.3 percent of total electric system sales.

Electric sales were slightly lower during the first six months of fiscal year 2013 compared to the previous fiscal year. However, sales over the course of the winter heating season were significantly higher than the prior year, reflecting colder temperatures. Sales in the last two months of the fiscal year were lower than the previous year due to milder summer temperatures.



KUB has added 1,900 electric system customers over the past five years, representing annual growth of 0.24 percent.

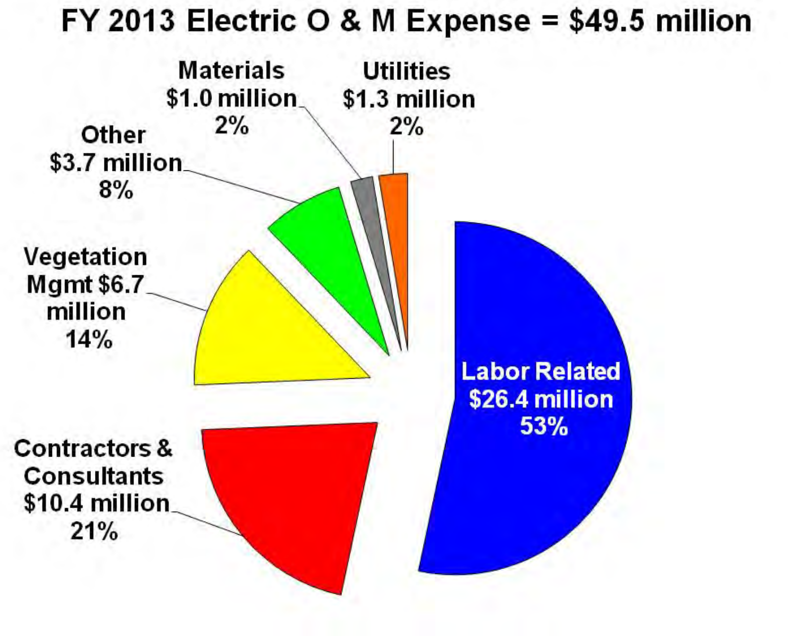


Electric sales volumes have declined 2.6 percent since fiscal year 2009. Large commercial and industrial sales have decreased 3.5 percent over the same period of time.

Operating Expenses

Operating expenses (excluding purchased power expense) increased $3.8 million or 4.7 percent compared to last fiscal year. Operating expenses are categorized as the following:

- Distribution expenses increased $1.8 million or 6.1 percent, due in large part to an increase in outside contractor expenses.
- Customer service expenses were up $0.3 million compared with the prior year, primarily due to the Division’s share of increased meter reading expenses.
- Administrative and general expenses decreased $0.9 million or 6.7 percent, primarily due to a $0.7 million decrease in the Division’s portion of shared costs.



Operation and Maintenance (O&M) expense has increased at a rate of 0.8 percent annually over the past five years. During this period, KUB management worked to identify cost saving measures and implemented staffing reductions through attrition in an effort to keep O&M expense relatively stable.

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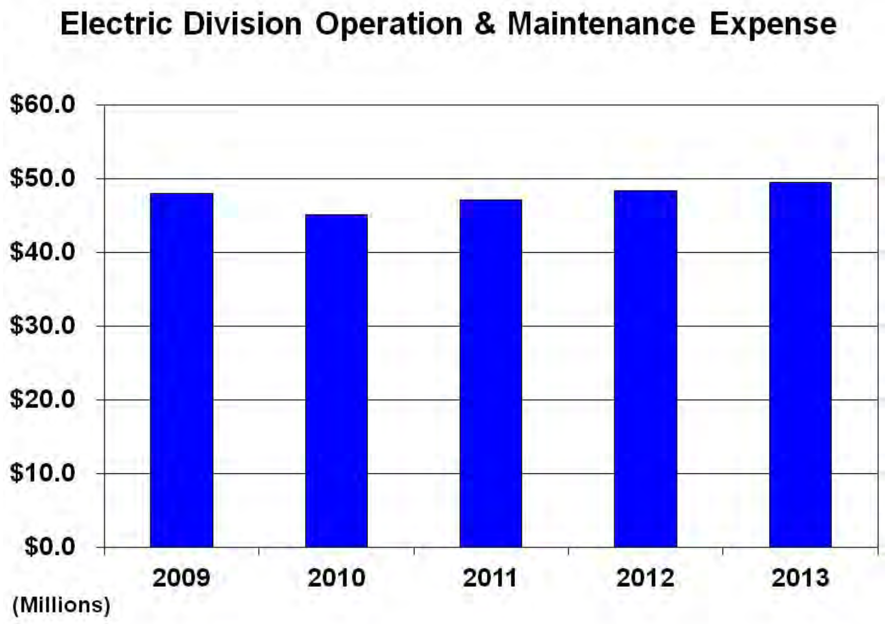

- Depreciation expense for fiscal year 2013 increased $1.7 million or 8.3 percent. This increase was the result of a full year depreciation on $27 million of assets added in the fiscal year 2012 and a partial year of depreciation on $46.4 million of assets placed in service in fiscal year 2013. The Division also retired $10.4 million in assets over the course of the fiscal year.

- Taxes and tax equivalents were $0.9 million higher than the prior fiscal year due to an increase in tax equivalent payments to the City of Knoxville, Knox County, and other taxing jurisdictions as a result of capital asset and margin growth.

Other Income and Expense

Interest income decreased $0.1 million. This decrease was primarily due to lower long-term interest rates on operating contingency fund investments.

Interest expense increased $0.3 million or 4.2 percent, the net result of interest cost on $35 million of bonds issued during the fiscal year and savings on the refunding of $10.1 million of outstanding bonds in March 2013.

Other income (net) increased $0.2 million.

The Division recorded $0.2 million in capital contributions from donated street lighting assets during the fiscal year.

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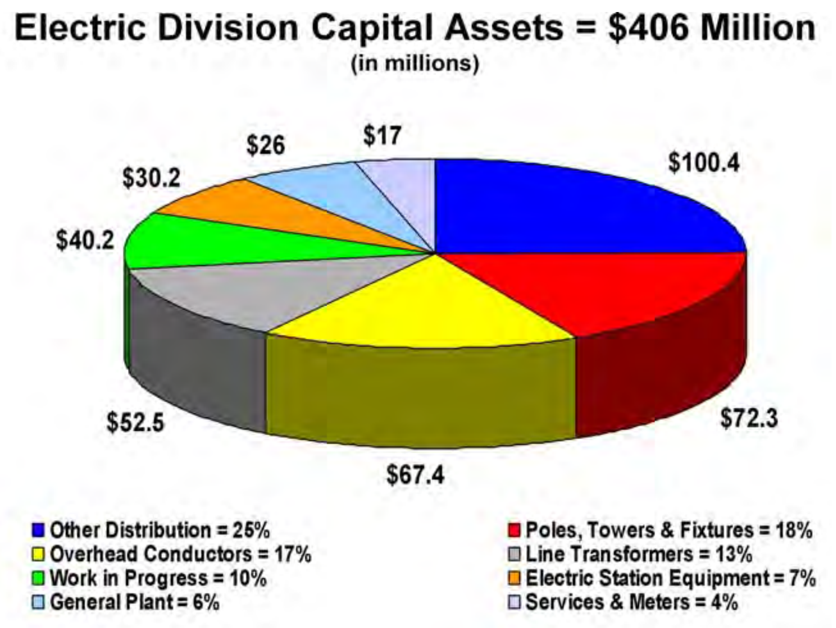
Capital Assets and Debt Administration

Capital Assets

As of June 30, 2013, the Division had $406 million invested in a variety of capital assets, as reflected in the schedule below, which represents a net increase (including additions, retirements, and depreciation) of $29.7 million or 7.9 percent over the end of the last fiscal year.

Capital Assets
As of June 30
(Net of Depreciation)

(in thousands of dollars)	**2013**	**2012**
Distribution plant:		
Services and meters	$ 16,968	$ 16,949
Electric station equipment	30,227	25,181
Poles, towers and fixtures	72,274	63,621
Overhead conductors	67,448	69,161
Line transformers	52,503	48,486
Others	100,458	94,414
Total distribution plant	339,878	317,812
General plant	25,959	25,131
Total plant	365,837	342,943
Work in progress	40,189	33,395
Total net plant	$ 406,026	$ 376,338



Major capital asset expenditures during the year were as follows:

- $23.6 million for various electric distribution system improvements.
- $8.9 million for pole replacements.
- $4.6 million for installation of new electric services and the upgrade or replacement of existing services.
- $2.2 million for fleet and heavy equipment.

Debt Administration

As of June 30, 2013, the Division had $186.5 million in outstanding debt (including the current portion of revenue bonds), compared to $158.9 million last year, an increase of $27.6 million or 17.4 percent. The Division's weighted average cost of debt at June 30, 2012 was 4.06 percent.

This increase in debt was attributable to the net result of scheduled repayment of bond debt during the fiscal year, the issuance of $35 million in electric bonds to fund Century II capital improvements, and the refunding of outstanding bonds.

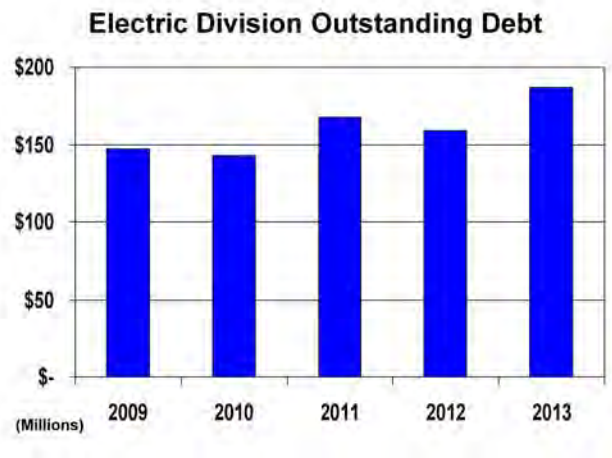
In March 2013, KUB sold $9.7 million in revenue refunding bonds for the purpose of refunding electric bonds issued in 2006 at lower interest rates. The Division will realize a total debt service savings of $1.2 million over the life of the bonds ($0.7 million on a net present value basis).

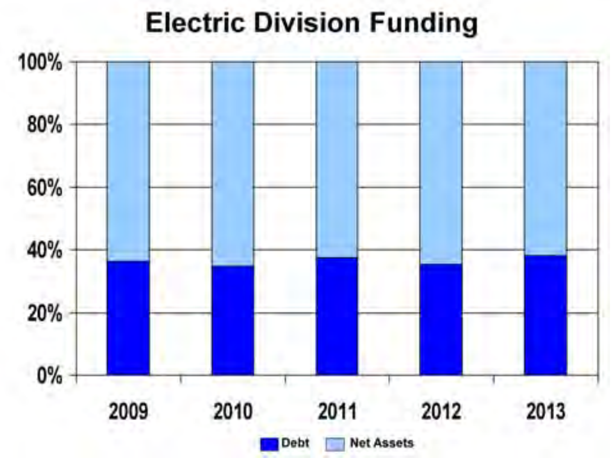
The Division's outstanding debt is rated by Standard & Poor's and Moody's Investors Service. As of June 30, 2013, the Division's revenue bonds were rated AA+ by Standard & Poor's and Aa2 by Moody's Investors Service.

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

Outstanding Debt
As of June 30

(in thousands of dollars)	**2013**	**2012**
Revenue bonds	$ 186,510	$ 158,870
Total outstanding debt	$ 186,510	$ 158,870


Electric Division Outstanding Debt


Electric Division Funding

The Division's outstanding debt has increased over the past five years from $146.8 million to its current level of $186.5 million. Debt as a percentage of debt to capitalization ratio has risen from 34.7 percent in 2010 to 38.3 percent as of June 30, 2013.

The Division will pay $92.2 million in principal payments over the next ten years, representing 49 percent of the outstanding bonds. KUB's Debt Management Policy requires that a minimum of 30 percent of electric debt principal be repaid over the next ten years.

Impacts on Future Financial Position

KUB anticipates adding 950 additional electric system customers in fiscal year 2014.

A previously adopted one percent rate increase will be effective October 1, 2013, which will add $1 to every residential customer's monthly electric bill.

The Division does not anticipate the issuance of new electric system debt in fiscal year 2014.

KUB debt portfolio includes $27.7 million of Electric Division 2010 Build America Bonds (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.

The TVA Board approved a 1.5 percent October 2013 wholesale base rate increase which will be flowed through to KUB's electric retail rates via its Purchased Power Adjustment. The flow-through of this wholesale rate increase will raise the typical residential electronic customer's monthly bill $1.45.

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 the Division's financial position or results of operations during fiscal year 2014.

Financial Contact

The Division's financial statements are designed to present users (citizens, customers, investors, and creditors) with a general overview of the Division'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 Electric Division
Statements of Net Position
June 30, 2013 and 2012

	2013	2012
Assets and Deferred Outflows of Resources		
Current assets:		
Cash and cash equivalents	$ 60,586,059	$ 27,255,636
Short-term investments	9,000,000	16,000,000
Short-term contingency fund investments	9,105,900	11,583,104
Other current assets	9,878	123,399
Accrued interest receivable	23,071	63,882
Accounts receivable, less allowance of uncollectible accounts of $706,454 in 2013 and $706,300 in 2012	56,265,887	52,375,520
Inventories	6,605,123	6,282,591
Prepaid expenses	1,107,435	615,053
Total current assets	142,703,353	114,299,185
Restricted assets:		
Electric bond fund	11,326,535	9,883,801
Other funds	25,295	4,598
Total restricted assets	11,351,830	9,888,399
Electric plant in service	708,307,167	672,256,230
Less accumulated depreciation	(342,470,640)	(329,313,025)
	365,836,527	342,943,205
Retirement in progress	1,264,225	575,826
Construction in progress	38,925,048	32,818,806
Net plant in service	406,025,800	376,337,837
Other assets:		
Long-term contingency fund investments	16,037,087	12,644,008
TVA conservation program receivable	10,189,286	9,552,209
Under recovered purchased power cost	-	17,654,719
Other	2,890,228	1,552,281
Total other assets	29,116,601	41,403,217
Total assets	589,197,584	541,928,638
Deferred outflows of resources		
Unamortized bond refunding costs	1,605,482	1,851,645
Total deferred outflows of resources	1,605,482	1,851,645
Total assets and deferred outflows of resources	$ 590,803,066	$ 543,780,283

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

Knoxville Utilities Board Electric Division
Statements of Net Position
June 30, 2013 and 2012

	2013	2012
Liabilities, Deferred Inflows, and Capitalization		
Current liabilities:		
Current portion of revenue bonds	$ 7,570,000	$ 6,920,000
Sales tax collections payable	882,823	849,237
Accounts payable	42,610,817	41,783,516
Accrued expenses	21,440,709	22,028,051
Customer deposits plus accrued interest	10,414,112	10,042,817
Accrued interest on revenue bonds	3,756,435	2,963,701
Total current liabilities	86,674,896	84,587,322
Other liabilities:		
TVA conservation program	10,005,739	9,335,409
Accrued compensated absences	3,879,950	3,766,444
Customer advances for construction	588,441	572,870
Over recovered purchased power cost	4,927,581	-
Other	309,274	12,010
Total other liabilities	19,710,985	13,686,733
Long-term debt:		
Electric revenue bonds	178,940,000	151,950,000
Total long-term debt	178,940,000	151,950,000
Total liabilities	285,325,881	250,224,055
Deferred inflows of resources:		
Unamortized costs	4,480,711	3,765,922
Total deferred inflows of resources	4,480,711	3,765,922
Total liabilities and deferred inflows of resources	289,806,592	253,989,977
Net position		
Net investment in capital assets	216,052,130	214,980,691
Restricted for:		
Debt service	7,570,100	6,920,100
Other	25,295	4,597
Unrestricted	77,348,949	67,884,918
Total net position	300,996,474	289,790,306
Total liabilities, deferred inflows, and net position	$ 590,803,066	$ 543,780,283

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

Knoxville Utilities Board Electric Division
Statements of Revenues, Expenses and Changes in Net Position
Years Ended June 30, 2013 and 2012

	2013	2012
Operating revenues	$ 534,888,206	$ 506,053,787
Operating expenses		
Purchased power	432,023,455	409,442,667
Distribution	30,914,192	29,123,344
Customer service	5,587,902	5,305,047
Administrative and general	13,021,407	13,954,120
Provision for depreciation and amortization	22,376,706	20,655,981
Taxes and tax equivalents	12,940,143	12,002,885
Total operating expenses	516,863,805	490,484,044
Operating income	18,024,401	15,569,743
Non-operating revenues (expenses)		
Contributions in aid of construction	3,953,118	4,121,515
Interest and dividend income	370,800	501,903
Interest expense	(7,281,191)	(6,990,310)
Write-down of plant for costs recovered through contributions	(3,953,118)	(4,121,515)
Other	(85,206)	(249,734)
Total non-operating revenues (expenses)	(6,995,597)	(6,738,141)
Change in net position before capital contributions	11,028,804	8,831,602
Capital contributions	177,364	301,720
Change in net position	11,206,168	9,133,322
Net position, beginning of year	289,790,306	280,656,984
Net position, end of year	$ 300,996,474	$ 289,790,306

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

Knoxville Utilities Board Electric Division
Statements of Cash Flows
Years Ended June 30, 2013 and 2012

	2013	**2012**
Cash flows from operating activities:		
Cash receipts from customers	$ 524,253,890	$ 500,580,961
Cash receipts from other operations	8,560,444	11,622,384
Cash payments to suppliers of goods or services	(440,706,161)	(441,113,876)
Cash payments to employees for services	(21,692,297)	(21,788,995)
Payment in lieu of taxes	(11,301,342)	(10,506,823)
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	59,182,454	38,986,071
Cash flows from capital and related financing activities:		
Net proceeds from bond issuance	35,565,144	-
Principal paid on revenue bonds and notes payable	(6,920,000)	(6,415,000)
(Increase) decrease in unused bond proceeds	-	9,872,075
Interest paid on revenue bonds and notes payable	(6,488,457)	(7,804,677)
Acquisition and construction of electric plant	(57,024,217)	(52,689,771)
Changes in electric bond fund, restricted	(1,442,734)	309,391
Customer advances for construction	15,571	(298,713)
Proceeds received on disposal of plant	23,551	26,889
Cash received from developers and individuals for capital purposes	3,953,118	4,121,515
Net cash used in capital and related financing activities	(32,318,024)	(52,878,291)
Cash flows from investing activities:		
Changes in deposit and investment accounts:		
Purchase of investment securities	5,870,736	(10,152,809)
Maturities of investment securities	213,389	234,112
Interest received	411,611	501,903
Other property and investments	(29,743)	(79,564)
Net cash provided by (used in) investing activities	6,465,993	(9,496,358)
Net increase (decrease) in cash and cash equivalents	33,330,423	(23,388,578)
Cash and cash equivalents, beginning of year	27,255,636	50,644,214
Cash and cash equivalents, end of year	$ 60,586,059	$ 27,255,636
Reconciliation of operating income to net cash provided by operating activities		
Operating income	$ 18,024,401	$ 15,569,743
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization expenses	23,437,295	21,741,781
Changes in operating assets and liabilities:		
Accounts receivable	(3,890,367)	4,754,583
Inventories	(322,532)	(2,630,387)
Prepaid expenses	(492,382)	(13,193)
TVA conservation program receivable	(637,077)	(1,003,161)
Other assets	(1,245,124)	49,633
Sales tax collections payable	33,586	29,127
Accounts payable and accrued expenses	353,465	308,963
Unrecovered purchased power cost	22,582,300	(1,728,336)
TVA conservation program payable	670,330	1,136,351
Customer deposits plus accrued interest	371,295	780,624
Other liabilities	297,263	(9,657)
Net cash provided by operating activities	$ 59,182,454	$ 38,986,071
Noncash capital activities:		
Acquisition of plant assets through developer contributions	$ 177,364	$ 301,720

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

1. Description of Business

Knoxville Utilities Board (KUB), comprised of the Electric Division, Water Division, Gas 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, 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. The Electric Division (Division) provides services to certain customers in Knox County and in seven surrounding counties in East Tennessee. The Division's accounts are maintained in conformity with the Uniform System of Accounts of the Federal Energy Regulatory Commission (FERC) and the Governmental Accounting Standards Board (GASB), as applicable. The financial statements present only the Electric Division and do not purport to, and do not, present fairly the consolidated financial position of Knoxville Utilities Board at June 30, 2013 and 2012, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

2. Summary of 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 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 to the Division is determined by measurement focus. The transactions of the Division 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.

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.

Electric Plant

Electric plant and other property are stated on the basis of original cost. The cost of current repairs and minor replacements is charged to operating expense. The cost of renewals and improvements is 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 electric plant in service is based on the estimated useful lives of the assets, which range from three to forty years, and is computed using the straight-line method. Pursuant to FERC, the caption "Provision for depreciation" in the statements of revenues, expenses and changes in net position does not include depreciation for transportation equipment of

$1,060,589 in fiscal year 2013 and $1,085,800 in fiscal year 2012. Interest costs are expensed as incurred.

Operating Revenue

Operating revenue consists primarily of charges for services provided by the principal operations of the KUB Electric Division. 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 $1,555,482 in fiscal year 2013 and $1,274,458 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 net assets available, it is KUB's policy to apply those expenses to restricted net assets to the extent such are available and then to unrestricted net 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

The Division'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). The Division'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.

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.

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 fiscal year 2012 balances to conform to fiscal year 2013 presentation.

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.

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.

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 a 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:

	Carrying Value	Bank Balance
Deposits		
Deposits in financial institutions	$ 60,610,811	$ 62,792,712
Investments		
Certificates of deposits	25,252,372	25,252,372
State Treasurer's Investment Pool	6,490,321	6,490,321
Agency Bonds	13,655,303	13,655,303
	$ 106,008,807	$ 108,190,708

Classification of deposits and investments:

Depository Account	**Bank Balance**
Insured	$ 856,804
Collateralized:	
Collateral held by pledging bank's trust department in KUB's name	13,655,303
Collateral held by pledging bank's trust department not in KUB's name*	93,678,601
Total deposits and investments	$ 108,190,708

* - Deposits 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. KUB deposits with First Tennessee Bank are collateralized at 115 percent of their total value.

Classification of deposits and investment of net position:

	2013	**2012**
Current assets		
Cash and cash equivalents	$ 60,586,059	$ 27,255,636
Short-term investments	9,000,000	16,000,000
Short-term contingency fund investments	9,105,900	11,583,104
Other assets		
Long-term contingency fund investments	15,965,018	12,571,419
Restricted assets		
Electric bond fund	11,326,535	9,883,801
Other funds	25,295	4,598
	$ 106,008,807	$ 77,298,558

The above amounts do not include accrued interest of $72,069 in fiscal year 2013 and $72,589 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.

	Deposit and Investment Maturities (in Years)		
	Fair Value	**Less Than 1**	**1-5**
Supersweep NOW and Other Deposits	$ 62,792,712	$ 62,792,712	$ -
State Treasurer's Investment Pool	6,490,321	6,490,321	-
Agency Bonds	13,655,303	5,305,310	8,349,993
Certificates of deposits	25,252,372	17,638,396	7,613,976
	$ 108,190,708	$ 92,226,739	$ 15,963,969

Interest Rate Risk. KUB's primary investment objectives 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 limiting investments to those types described above and limiting maturity horizons. 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.

4. Accounts Receivable

Accounts receivable consists of the following:

	2013	**2012**
Wholesale and retail customers		
Billed services	$ 33,748,677	$ 28,946,942
Unbilled services	20,691,034	21,563,662
Other	2,532,630	2,571,216
Allowance for uncollectible accounts	(706,454)	(706,300)
	$ 56,265,887	$ 52,375,520

5. Accounts Payable and Accruals

Accounts payable and accruals were composed of the following:

	2013	**2012**
Trade accounts	$ 42,610,817	$ 41,783,516
Salaries and wages	598,379	458,932
Advances on pole rental	1,142,702	1,119,017
Self-insurance liabilities	816,900	880,493
Other current liabilities	18,882,728	19,569,609
	$ 64,051,526	$ 63,811,567

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**
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	$ 158,870,000	$ 44,660,000	$ 17,020,000	$ 186,510,000	$ 7,570,000

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	3,766,444	7,055,540	$ (6,942,034)	3,879,950	1,000,000
Customer advances for construction	572,870	306,207	(290,636)	588,441	85,000
Other	12,010	318,885	(21,621)	309,274	5,000
	$ 13,686,733	$ 11,168,439	$ (10,071,768)	$ 14,783,404	$ 2,590,000

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

Fiscal Year	**Principal**	**Total Interest**	**Grand Total**
2014	$ 7,570,000	$ 7,405,114	$ 14,975,114
2015	7,935,000	7,145,450	15,080,450
2016	8,270,000	6,832,230	15,102,230
2017	8,585,000	6,503,212	15,088,212
2018	8,940,000	6,157,884	15,097,884
2019-2023	50,885,000	24,450,365	75,335,365
2024-2028	54,115,000	13,076,727	67,191,727
2029-2033	23,385,000	4,105,931	27,490,931
2034-2038	7,525,000	1,978,125	9,503,125
2039-2043	9,300,000	722,250	10,022,250
Total	$ 186,510,000	$ 78,377,288	$ 264,887,288

The Division has pledged sufficient revenue, after deduction of all current operating expenses (exclusive of tax equivalents), to meet the revenue bonds principal and interest payments when due. Such bond requirements are being met through monthly deposits to the Electric Bond Fund 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 to 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 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 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 general obligation 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.

7. Lease Commitments

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

2014	$ 33,200
2015	26,768
2016	9,656
2017	1,007
Total operating minimum lease payments	$ 70,631

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**
Distribution Plant				
Services and Meters	$ 39,532,732	$ 1,013,854	$ (51,780)	$ 40,494,806
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	159,403,184	10,615,934	(1,582,285)	168,436,833
Total Distribution Plant	$ 604,398,010	$ 41,238,858	$ (8,281,046)	$ 637,355,822
General Plant	67,858,220	5,197,018	(2,103,893)	70,951,345
Total Plant Assets	$ 672,256,230	$ 46,435,876	$ (10,384,939)	$ 708,307,167
Less Accumulated Depreciation	(329,313,025)	(23,386,328)	10,228,713	(342,470,640)
Net Plant Assets	$ 342,943,205	$ 23,049,548	$ (156,226)	$ 365,836,527
Work In Progress	33,394,632	49,877,113	(43,082,472)	40,189,273
Total Net Plant	$ 376,337,837	$ 72,926,661	$ (43,238,698)	$ 406,025,800

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.

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 $816,900 resulting from the following changes:

	2013	**2012**
Balance, beginning of year	$ 880,493	$ 1,065,904
Current year claims and changes in estimates	5,742,173	6,248,439
Claims payments	(5,805,766)	(6,433,850)
Balance, end of year	$ 816,900	$ 880,493

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 Division 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 Division Plan A active employees, vested terminated employees, retirees, and beneficiaries. Plan A is a closed plan.

All employees participating in the City Division 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 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 Division Plan B active employees, vested terminated employees, retirees, and beneficiaries. Plan B is a closed plan.

All employees participating in the City Division 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 Electric Division's portion of this contribution is $2,586,258. 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. Of these amounts, $2,586,258 and $1,688,843 are attributable to the Electric Division.

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. The Electric Division's portion of this recommended contribution is $2,967,767. 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 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.

Total contributions to the OPEB Trust for the fiscal year ended June 30, 2013 were $4.4 million (Division's share $2.1 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 (Division's share $1.6 million). As of June 30, 2013, the employer's net OPEB obligation was $0.6 million (Division's share $0.3 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 (Division's share $1.6 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 (Division's share $29.8 million). The actuarial value of the Plan's assets was $38.6 million (Division's share $18.1 million). As a result, the Plan's unfunded actuarial accrued liability was $24.8 million (Division's share $11.7 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 (Division's share $1.6 million). See Required Supplementary Information for OPEB Schedule of Funding Progress.

13. Related Party Transactions

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

	2013	**2012**
City of Knoxville		
Amounts billed by the Division for utilities and related services	$ 7,345,378	$ 6,950,602
Payments by the Division in lieu of property tax	5,627,417	5,250,083
Payments by the Division for services provided	89,907	81,734
Other divisions of KUB		
Amounts billed to other divisions for utilities and related services provided	5,705,766	4,450,495
Interdivisional rental expense	-	-
Interdivisional rental income	688,858	790,402
Amounts billed to the Division by other divisions for utilities services provided	199,291	176,456

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

	2013	**2012**
Accounts receivable	$ 566,006	$ 424,732

14. 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.

Knoxville Utilities Board Electric Division
Required Supplementary Information – Schedule of Funding Progress
June 30, 2013
(Unaudited)

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%

Knoxville Utilities Board Electric Division
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.

Program Name	Federal/State Agency	CFDA Number	Contract Number	Beginning Receivable	Cash Receipts	Expenditures	Adjustments	Ending Receivable
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	$ 488,959	$ -	$ -	$ 44,801	$ 533,760
U.S. Department of Homeland Security	Tennessee Emergency Management	97.036	34101-0000009832	$ 980,465	$ -	$ -	$ -	$ 980,465
		Total Program 97.036		$ 1,469,424	$ -	$ -	$ 44,801	$ 1,514,225
		Total Federal Awards		$ 1,469,424	$ 413,414	$ 413,414	$ 44,801	$ 1,514,225

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.

Knoxville Utilities Board Electric Division
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:

CFDA Number	Name of Federal Program
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? ___Yes ✓___ No

Findings – Financial Statements Audit

None

Findings and Questioned Costs – Major Federal Award Programs Audit

None

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

Schedule 3

Insurance coverage is for KUB as a consolidated entity.

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.

Knoxville Utilities Board Electric Division
Supplemental Information - Schedule of Debt Maturities by Fiscal Year
June 30, 2013

Schedule 4

Continued on Next Page

FY	W-2005		X-2006		Y-2009		Z-2010			AA-2012	
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Rebate*	Principal	Interest
13-14	$ 1,720,000	$ 1,460,806	$ 1,650,000	$ 210,500	$ 1,450,000	$ 1,503,375	$ 1,255,000	$ 1,327,604	$ 444,253	$ 920,000	$ 1,537,713
14-15	1,790,000	1,381,831	1,725,000	134,375	1,525,000	1,466,187	1,265,000	1,299,244	454,736	955,000	1,490,838
15-16	1,870,000	1,299,481	1,825,000	45,625	1,600,000	1,427,125	1,285,000	1,265,436	442,903	990,000	1,442,213
16-17	1,940,000	1,218,606			1,675,000	1,382,000	1,305,000	1,225,919	429,072	2,540,000	1,353,963
17-18	2,015,000	1,139,506			1,750,000	1,330,625	1,330,000	1,180,440	413,154	2,670,000	1,223,713
18-19	2,095,000	1,057,306			1,850,000	1,267,375	1,355,000	1,128,729	395,055	2,805,000	1,086,838
19-20	2,185,000	970,341			1,950,000	1,191,375	1,390,000	1,070,710	374,749	2,955,000	942,838
20-21	2,275,000	878,354			2,025,000	1,101,750	1,425,000	1,007,355	352,575	3,100,000	791,463
21-22	2,370,000	781,069			2,150,000	997,375	1,470,000	939,300	328,756	3,270,000	632,213
22-23	2,470,000	678,219			2,250,000	887,375	1,515,000	866,145	303,151	3,415,000	482,163
23-24	2,580,000	569,294			2,350,000	784,125	1,560,000	787,710	275,698	3,540,000	360,763
24-25	2,695,000	453,903			2,475,000	687,625	1,615,000	703,545	246,241	3,640,000	253,063
25-26	2,820,000	333,263			2,600,000	582,875	1,670,000	613,180	214,614	1,105,000	180,506
26-27	2,950,000	205,201			2,700,000	470,250	1,725,000	516,395	180,739	1,140,000	144,025
27-28	3,085,000	69,413			2,850,000	348,750	1,785,000	413,266	144,643	1,180,000	106,325
28-29					3,000,000	217,125	1,850,000	303,738	106,308	1,225,000	65,713
29-30					3,150,000	74,813	1,925,000	187,156	65,505	1,265,000	22,138
30-31							2,000,000	63,500	22,225		
31-32											
32-33											
33-34											
34-35											
35-36											
36-37											
37-38											
38-39											
39-40											
40-41											
41-42											
42-43											
Total	$ 34,860,000	$ 12,496,593	$ 5,200,000	$ 390,500	$ 37,350,000	$ 15,720,125	$ 27,725,000	$ 14,899,372	$ 5,194,377	$ 36,715,000	$ 12,116,488

*Series Z-2010 bonds were issued as federally taxable Build America Bonds. KUB is scheduled to receive a 35 percent interest rebate payment 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. The rebate payments are currently scheduled to total $6,177,546 over the life of the bonds. The net cost of issuing the bonds is $11,510,487.

Knoxville Utilities Board Electric Division

Supplemental Information - Schedule of Debt Maturities by Fiscal Year

June 30, 2013

Schedule 4

Continued from Previous Page

	BB-2012		CC-2013		Total		Grand Total (P + I)	Grand Total (Less Rebate)
FY	Principal	Interest	Principal	Interest	Principal	Interest		
13-14	$ 500,000	$ 1,112,536	$ 75,000	$ 252,580	$ 7,570,000	$ 7,405,114	$ 14,975,114	$ 14,530,861
14-15	625,000	1,056,625	50,000	316,350	7,935,000	7,145,450	15,080,450	14,625,714
15-16	650,000	1,037,500	50,000	314,850	8,270,000	6,832,230	15,102,230	14,659,327
16-17	675,000	1,017,625	450,000	305,099	8,585,000	6,503,212	15,088,212	14,659,140
17-18	700,000	997,000	475,000	286,600	8,940,000	6,157,884	15,097,884	14,684,730
18-19	725,000	972,000	475,000	267,600	9,305,000	5,779,848	15,084,848	14,689,793
19-20	750,000	942,500	500,000	248,100	9,730,000	5,365,864	15,095,864	14,721,115
20-21	800,000	911,500	515,000	227,800	10,140,000	4,918,222	15,058,222	14,705,647
21-22	825,000	879,000	540,000	206,700	10,625,000	4,435,657	15,060,657	14,731,901
22-23	875,000	849,375	560,000	187,497	11,085,000	3,950,774	15,035,774	14,732,623
23-24	900,000	822,750	575,000	170,475	11,505,000	3,495,117	15,000,117	14,724,419
24-25	950,000	795,000	590,000	153,000	11,965,000	3,046,136	15,011,136	14,764,895
25-26	975,000	766,125	640,000	134,550	9,810,000	2,610,499	12,420,499	12,205,885
26-27	1,025,000	736,125	650,000	115,200	10,190,000	2,187,196	12,377,196	12,196,457
27-28	1,075,000	704,625	670,000	95,400	10,645,000	1,737,779	12,382,779	12,238,136
28-29	1,125,000	671,625	675,000	75,225	7,875,000	1,333,426	9,208,426	9,102,118
29-30	1,175,000	637,125	710,000	54,450	8,225,000	975,682	9,200,682	9,135,177
30-31	1,225,000	601,125	725,000	32,925	3,950,000	697,550	4,647,550	4,625,325
31-32	1,275,000	563,625	735,000	11,023	2,010,000	574,648	2,584,648	2,584,648
32-33	1,325,000	524,625			1,325,000	524,625	1,849,625	1,849,625
33-34	1,375,000	484,125			1,375,000	484,125	1,859,125	1,859,125
34-35	1,450,000	441,750			1,450,000	441,750	1,891,750	1,891,750
35-36	1,500,000	397,500			1,500,000	397,500	1,897,500	1,897,500
36-37	1,575,000	351,375			1,575,000	351,375	1,926,375	1,926,375
37-38	1,625,000	303,375			1,625,000	303,375	1,928,375	1,928,375
38-39	1,700,000	253,500			1,700,000	253,500	1,953,500	1,953,500
39-40	1,775,000	201,375			1,775,000	201,375	1,976,375	1,976,375
40-41	1,850,000	147,000			1,850,000	147,000	1,997,000	1,997,000
41-42	1,950,000	90,000			1,950,000	90,000	2,040,000	2,040,000
42-43	2,025,000	30,375			2,025,000	30,375	2,055,375	2,055,375
Total	$ 35,000,000	$ 19,298,786	$ 9,660,000	$ 3,455,424	$ 186,510,000	$ 78,377,288	$ 264,887,288	$ 259,692,911

Knoxville Utilities Board Electric Division

Supplemental Information - Schedule of Current Rates in Force

June 30, 2013

(Unaudited)

Schedule 5

Rate Class		Base Charge			Number of Customers
Residential		Customer Charge:	$13.60 per month, less Hydro Allocation Credit: $1.60 per month.		173,846
		Energy Charge:	Summer Period	9.116 cents per kWh per month.	
			Winter Period	9.075 cents per kWh per month.	
			Transition Period	9.075 cents per kWh per month.	
Commercial/ Industrial	**A. 1.**	If (a) the higher of (i) the customer's currently effective contract demand, if any, or (ii) its highest billing demand during the latest 12-month period is not more than 50 kWh, and (b) customer's monthly energy takings for any month during such period do not exceed 15,000 kWh:			20,727
		Customer Charge:	$17.00 per delivery point per month.		
		Energy Charge:	Summer Period	10.447 cents per kWh.	
			Winter Period	10.406 cents per kWh.	
			Transition Period	10.406 cents per kWh.	
	2.	If (a) the higher of (i) the customer's currently effective contract demand or (ii) its highest billing demand during the latest 12-month period is greater than 50 kW but not more than 1,000 kW, or (b) if the customer's billing demand is less than 50 kW and its energy takings for any month during such period exceed 15,000 kWh:			2,803
		Customer Charge:	$50.00 per delivery point per month.		
		Demand Charge:	First 50 kW of billing demand per month, no demand charge.		
			Excess over 50 kW of billing demand per month, at		
			Summer Period	$12.80 per kW.	
			Winter Period	$12.01 per kW.	
			Transition Period	$12.01 per kW.	
		Energy Charge:	Summer Period	First 15,000 kWh per month at 11.042 cents per kWh Additional kWh per month at 6.356 cents per kWh.	
			Winter Period	First 15,000 kWh per month at 11.001 cents per kWh Additional kWh per month at 6.356 cents per kWh.	
			Transition Period	First 15,000 kWh per month at 11.001 cents per kWh Additional kWh per month at 6.356 cents per kWh.	

Knoxville Utilities Board Electric Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2013
(Unaudited)

Schedule 5

Rate Class			**Number of Customers**
3.	If (a) the higher of the customer's currently effective contract demand or (b) its highest billing demand during the latest 12-month period is greater than 1,000 kW:		55

Customer Charge:	$140.00 per delivery point per month.	
Demand Charge:	Summer Period	First 1,000 kW of billing demand per month, at $12.50 per kW. Excess over 1,000 kW of billing demand per month, at $14.16 per kW, plus an additional $14.16 per kW per month for each kW, if any, of the amount by which the customer's billing demand exceeds the higher of 2,500 kW or its contract demand.
	Winter Period	First 1,000 kW of billing demand per month, at $11.74 per kW. Excess over 1,000 kW of billing demand per month, at $13.40 per kW, plus an additional $13.40 per kW per month for each kW, if any, of the amount by which the customer's billing demand exceeds the higher of 2,500 kW or its contract demand.
	Transition Period	First 1,000 kW of billing demand per month, at $11.74 per kW. Excess over 1,000 kW of billing demand per month, at $13.40 per kW, plus an additional $13.40 per kW per month for each kW, if any, of the amount by which the customer's billing demand exceeds the higher of 2,500 kW or its contract demand.
Energy Charge:	Summer Period	6.593 cents per kWh.
	Winter Period	6.593 cents per kWh.
	Transition Period	6.593 cents per kWh.

Rate Class		Base Charge			Number of Customers
Commercial/ Industrial	**B.**	This rate shall apply to the firm electric power requirements where a customer's currently effective contract demand is greater than 5,000 kW but not more than 15,000 kW:			1
		Customer Charge:	$1,500 per delivery point per month.		
		Administrative Charge:	$700 per delivery point per month.		
		Demand Charge:	Summer Period	$17.09 per kW per month of the customer's onpeak billing demand, plus $4.56 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus $17.09 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.	
			Winter Period	$9.94 per kW per month of the customer's onpeak billing demand, plus $4.56 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus $9.94 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.	
			Transition Period	$4.56 per kW per month of the customer's offpeak billing demand, plus $9.94 per kW per month for each kW of the amount, if any, by which the customer's offpeak billing demand exceeds its offpeak contract demand.	

Energy Charge:	Summer Period	9.896 cents per kWh per month for all metered onpeak kWh, plus 6.405 cents per kWh per month for the first 425 hours of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 4.525 cents per kWh per month for the next 195 hours use of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 2.930 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours multiplied by the ratio of offpeak energy to total energy.
	Winter Period	6.808 cents per kWh per month for all metered onpeak kWh, plus 6.405 cents per kWh per month for the first 425 hours of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 4.525 cents per kWh per month for the next 195 hours use of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 2.930 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours multiplied by the ratio of offpeak energy to total energy.
	Transition Period	6.405 cents per kWh per month for the first 425 hours use of maximum metered demand, plus 4.525 cents per kWh per month for the next 195 hours use of maximum metered demand, plus 2.930 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours.

Rate Class		Base Charge			Number of Customers
Commercial/ Industrial	**C.**	This rate shall apply to the firm electric power requirements where a customer's currently effective contract demand is greater than 15,000 kW but not more than 25,000 kW:			1
		Customer Charge:	$1,500 per delivery point per month.		
		Administrative Charge:	$700 per delivery point per month.		
		Demand Charge:	Summer Period	$16.44 per kW per month of the customer's onpeak billing demand, plus $3.91 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus $16.44 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.	
			Winter Period	$9.29 per kW per month of the customer's onpeak billing demand, plus $3.91 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus $9.29 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.	
			Transition Period	$3.91 per kW per month of the customer's offpeak billing demand, plus $9.29 per kW per month for each kW of the amount, if any, by which the customer's offpeak billing demand exceeds its offpeak contract demand.	

Energy Charge:	Summer Period	9.533 cents per kWh per month for all metered onpeak kWh, plus 6.140 cents per kWh per month for the first 425 hours of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 4.259 cents per kWh per month for the next 195 hours use of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 2.665 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours multiplied by the ratio of offpeak energy to total energy.
	Winter Period	6.521 cents per kWh per month for all metered onpeak kWh, plus 6.140 cents per kWh per month for the first 425 hours of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 4.259 cents per kWh per month for the next 195 hours use of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 2.665 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours multiplied by the ratio of offpeak energy to total energy.
	Transition Period	6.140 cents per kWh per month for the first 425 hours use of maximum metered demand, plus 4.259 cents per kWh per month for the next 195 hours use of maximum metered demand, plus 2.665 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours.

Knoxville Utilities Board Electric Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2013
(Unaudited)

Schedule 5

Rate Class		Base Charge			Number of Customers
Commercial/ Industrial	**D.**	This rate shall apply to the firm electric power requirements where a customer's currently effective contract demand is greater than 25,000 kW:			1
		Customer Charge:	$1,500 per delivery point per month.		
		Administrative Charge:	$700 per delivery point per month.		
		Demand Charge:	Summer Period	$16.87 per kW per month of the customer's onpeak billing demand, plus $4.34 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus $16.87 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.	
			Winter Period	$9.72 per kW per month of the customer's onpeak billing demand, plus $4.34 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus $9.72 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.	
			Transition Period	$4.34 per kW per month of the customer's offpeak billing demand, plus $9.72 per kW per month for each kW of the amount, if any, by which the customer's offpeak billing demand exceeds its offpeak contract demand.	

Energy Charge:	Summer Period	9.420 cents per kWh per month for all metered onpeak kWh, plus 5.922 cents per kWh per month for the first 425 hours of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 4.043 cents per kWh per month for the next 195 hours use of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 2.447 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours multiplied by the ratio of offpeak energy to total energy.
	Winter Period	6.322 cents per kWh per month for all metered onpeak kWh, plus 5.922 cents per kWh per month for the first 425 hours of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 4.043 cents per kWh per month for the next 195 hours use of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 2.447 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours multiplied by the ratio of offpeak energy to total energy.
	Transition Period	5.922 cents per kWh per month for the first 425 hours use of maximum metered demand, plus 4.043 cents per kWh per month for the next 195 hours use of maximum metered demand, plus 2.447 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours.

Knoxville Utilities Board Electric Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2013
(Unaudited)
Schedule 5

Rate Class		Base Charge			Number of Customers
Seasonal Time of Use	**A.**	This rate shall apply to the firm electric power requirements where a customer's currently effective contract demand is greater than 1,000 kW but not more than 5,000 kW:			1
		Customer Charge:	$1,500 per delivery point per month.		
		Administrative Charge:	$700 per delivery point per month.		
		Demand Charge:	Summer Period	$17.09 per kW per month of the customer's onpeak billing demand, plus $4.56 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus $17.09 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.	
			Winter Period	$9.94 per kW per month of the customer's onpeak billing demand, plus $4.56 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus $9.94 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.	
			Transition Period	$4.56 per kW per month of the customer's offpeak billing demand, plus $9.94 per kW per month for each kW of the amount, if any, by which the customer's offpeak billing demand exceeds its offpeak contract demand.	

Energy Charge:	Summer Period	9.896 cents per kWh per month for all metered onpeak kWh, plus 6.405 cents per kWh per month for the first 425 hours of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 4.525 cents per kWh per month for the next 195 hours use of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 2.930 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours multiplied by the ratio of offpeak energy to total energy.
	Winter Period	6.808 cents per kWh per month for all metered onpeak kWh, plus 6.405 cents per kWh per month for the first 425 hours of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 4.525 cents per kWh per month for the next 195 hours use of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 2.930 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours multiplied by the ratio of offpeak energy to total energy.
	Transition Period	6.405 cents per kWh per month for the first 425 hours use of maximum metered demand, plus 4.525 cents per kWh per month for the next 195 hours use of maximum metered demand, plus 2.930 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours.

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Rate Class		Base Charge			Number of Customers
Seasonal	**B.**	This rate shall apply to the firm electric power requirements where a customer's currently effective contract demand is greater than 5,000 kW but not more than 15,000 kW:			3
		Customer Charge:	$1,500 per delivery point per month.		
		Administrative Charge:	$700 per delivery point per month.		
		Demand Charge:	Summer Period	$22.31 per kW per month of the customer's billing demand, plus $22.31 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.	
			Winter Period	$15.95 per kW per month of the customer's billing demand, plus $15.95 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.	
			Transition Period	$11.15 per kW per month of the customer's billing demand, plus $11.15 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.	
		Energy Charge:	Summer Period	5.153 cents per kWh per month.	
			Winter Period	4.739 cents per kWh per month.	
			Transition Period	4.648 cents per kWh per month.	

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Rate Class		Base Charge			Number of Customers
Seasonal	**C.**	This rate shall apply to the firm electric power requirements where a customer's currently effective contract demand is greater than 15,000 kW but not more than 25,000 kW:			-
		Customer Charge:	$1,500 per delivery point per month.		
		Administrative Charge:	$700 per delivery point per month.		
		Demand Charge:	Summer Period	$21.66 per kW per month of the customer's billing demand, plus $21.66 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.	
			Winter Period	$15.30 per kW per month of the customer's billing demand, plus $15.30 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.	
			Transition Period	$10.50 per kW per month of the customer's billing demand, plus $10.50 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.	
		Energy Charge:	Summer Period	5.165 cents per kWh per month.	
			Winter Period	4.743 cents per kWh per month.	
			Transition Period	4.655 cents per kWh per month.	

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Rate Class		Base Charge			Number of Customers
Seasonal	**D.**	This rate shall apply to the firm electric power requirements where a customer's currently effective contract demand is greater than 25,000 kW:			-
		Customer Charge:	$1,500 per delivery point per month.		
		Administrative Charge:	$700 per delivery point per month.		
		Demand Charge:	Summer Period	$25.69 per kW per month of the customer's billing demand, plus $25.69 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.	
			Winter Period	$19.30 per kW per month of the customer's billing demand, plus $19.30 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.	
			Transition Period	$14.53 per kW per month of the customer's billing demand, plus $14.53 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.	
		Energy Charge:	Summer Period	4.494 cents per kWh per month.	
			Winter Period	4.127 cents per kWh per month.	
			Transition Period	4.046 cents per kWh per month.	

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Rate Class		Base Charge			Number of Customers
Manufacturing	**B.**	This rate shall apply to the firm electric power requirements where (a) a customer's currently effective contract demand is greater than 5,000 kW but not more than 15,000 kW and (b) the major use of electricity is for activities conducted at the delivery point serving that customer which are classified with a 2-digit Standard Industrial Classification Code between 20 and 39, inclusive.			-
		Customer Charge:	$1,500 per delivery point per month.		
		Administrative Charge:	$700 per delivery point per month.		
		Demand Charge:	Summer Period	$17.10 per kW per month of the customer's onpeak billing demand, plus $4.57 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus $17.10 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.	
			Winter Period	$9.95 per kW per month of the customer's onpeak billing demand, plus $4.57 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus $9.95 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.	
			Transition Period	$4.57 per kW per month of the customer's offpeak billing demand, plus $9.95 per kW per month for each kW of the amount, if any, by which the customer's offpeak billing demand exceeds its offpeak contract demand.	

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Energy Charge:	Summer Period	8.362 cents per kWh per month for all metered onpeak kWh, plus 4.909 cents per kWh per month for the first 425 hours of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 3.030 cents per kWh per month for the next 195 hours use of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 1.436 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours multiplied by the ratio of offpeak energy to total energy.
	Winter Period	5.339 cents per kWh per month for all metered onpeak kWh, plus 4.909 cents per kWh per month for the first 425 hours of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 3.030 cents per kWh per month for the next 195 hours use of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 1.436 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours multiplied by the ratio of offpeak energy to total energy.
	Transition Period	4.909 cents per kWh per month for the first 425 hours use of maximum metered demand, plus 3.030 cents per kWh per month for the next 195 hours use of maximum metered demand, plus 1.436 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours.

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Rate Class		**Base Charge**			**Number of Customers**
Manufacturing	**C.**	This rate shall apply to the firm electric power requirements where (a) a customer's currently effective contract demand is greater than 15,000 kW but not more than 25,000 kW and (b) the major use of electricity is for activities conducted at the delivery point serving that customer which are classified with a 2-digit Standard Industrial Classification Code between 20 and 39, inclusive.			-
		Customer Charge:	$1,500 per delivery point per month.		
		Administrative Charge:	$700 per delivery point per month.		
		Demand Charge:	Summer Period	$16.47 per kW per month of the customer's onpeak billing demand, plus $3.94 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus $16.47 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.	
			Winter Period	$9.32 per kW per month of the customer's onpeak billing demand, plus $3.94 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus $9.32 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.	
			Transition Period	$3.94 per kW per month of the customer's offpeak billing demand, plus $9.32 per kW per month for each kW of the amount, if any, by which the customer's offpeak billing demand exceeds its offpeak contract demand.	

Energy Charge:	Summer Period	8.445 cents per kWh per month for all metered onpeak kWh, plus 4.896 cents per kWh per month for the first 425 hours of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 3.016 cents per kWh per month for the next 195 hours use of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 1.422 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours multiplied by the ratio of offpeak energy to total energy.
	Winter Period	5.352 cents per kWh per month for all metered onpeak kWh, plus 4.896 cents per kWh per month for the first 425 hours of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 3.016 cents per kWh per month for the next 195 hours use of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 1.422 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours multiplied by the ratio of offpeak energy to total energy.
	Transition Period	4.896 cents per kWh per month for the first 425 hours use of maximum metered demand, plus 3.016 cents per kWh per month for the next 195 hours use of maximum metered demand, plus 1.422 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours.

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Rate Class		**Base Charge**			**Number of Customers**
Manufacturing	**D.**	This rate shall apply to the firm electric power requirements where (a) a customer's currently effective contract demand is greater than 25,000 kW and (b) the major use of electricity is for activities conducted at the delivery point serving that customer which are classified with a 2-digit Standard Industrial Classification Code between 20 and 39, inclusive.			-
		Customer Charge:	$1,500 per delivery point per month.		
		Administrative Charge:	$700 per delivery point per month.		
		Demand Charge:	Summer Period	$16.86 per kW per month of the customer's onpeak billing demand, plus $4.33 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus $16.86 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.	
			Winter Period	$9.71 per kW per month of the customer's onpeak billing demand, plus $4.33 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus $9.71 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.	
			Transition Period	$4.33 per kW per month of the customer's offpeak billing demand, plus $9.71 per kW per month for each kW of the amount, if any, by which the customer's offpeak billing demand exceeds its offpeak contract demand.	

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Energy Charge:	Summer Period	8.305 cents per kWh per month for all metered onpeak kWh, plus 4.760 cents per kWh per month for the first 425 hours of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 2.881 cents per kWh per month for the next 195 hours use of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 1.286 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours multiplied by the ratio of offpeak energy to total energy.
	Winter Period	5.198 cents per kWh per month for all metered onpeak kWh, plus 4.760 cents per kWh per month for the first 425 hours of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 2.881 cents per kWh per month for the next 195 hours use of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 1.286 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours multiplied by the ratio of offpeak energy to total energy.
	Transition Period	4.760 cents per kWh per month for the first 425 hours use of maximum metered demand, plus 2.881 cents per kWh per month for the next 195 hours use of maximum metered demand, plus 1.286 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours.

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Rate Class		**Base Charge**			**Number of Customers**
Manufacturing Seasonal Time of Use	**A.**	This rate shall apply to the firm electric power requirements where (a) a customer's currently effective contract demand is greater than 1,000 kW but not more than 5,000 kW and (b) the major use of electricity is for activities conducted at the delivery point serving that customer which are classified with a 2-digit Standard Industrial Classification Code between 20 and 39, inclusive.			-
		Customer Charge:	$1,500 per delivery point per month.		
		Administrative Charge:	$700 per delivery point per month.		
		Demand Charge:	Summer Period	$17.10 per kW per month of the customer's onpeak billing demand, plus $4.57 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus $17.10 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.	
			Winter Period	$9.95 per kW per month of the customer's onpeak billing demand, plus $4.57 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus $9.95 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.	
			Transition Period	$4.57 per kW per month of the customer's offpeak billing demand, plus $9.95 per kW per month for each kW of the amount, if any, by which the customer's offpeak billing demand exceeds its offpeak contract demand.	

Energy Charge:	Summer Period	8.362 cents per kWh per month for all metered onpeak kWh, plus 4.909 cents per kWh per month for the first 425 hours of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 3.030 cents per kWh per month for the next 195 hours use of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 1.435 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours multiplied by the ratio of offpeak energy to total energy.
	Winter Period	5.339 cents per kWh per month for all metered onpeak kWh, plus 4.909 cents per kWh per month for the first 425 hours of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 3.030 cents per kWh per month for the next 195 hours use of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 1.435 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours multiplied by the ratio of offpeak energy to total energy.
	Transition Period	4.909 cents per kWh per month for the first 425 hours use of maximum metered demand, plus 3.030 cents per kWh per month for the next 195 hours use of maximum metered demand, plus 1.435 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours.

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Manufacturing			**Number of Customers**
Seasonal	**B.**	This rate shall apply to the firm electric power requirements where (a) a customer's currently effective contract demand is greater than 5,000 kW but not more than 15,000 kW and (b) the major use of electricity is for activities conducted at the delivery point serving that customer which are classified with a 2-digit Standard Industrial Classification Code between 20 and 39, inclusive.	1

Customer Charge:	$1,500 per delivery point per month.	
Administrative Charge:	$700 per delivery point per month.	
Demand Charge:	Summer Period	$19.41 per kW per month of the customer's billing demand, plus $19.41 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.
	Winter Period	$13.04 per kW per month of the customer's billing demand, plus $13.04 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.
	Transition Period	$8.24 per kW per month of the customer's billing demand, plus $8.24 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.
Energy Charge:	Summer Period	4.375 cents per kWh per month.
	Winter Period	3.908 cents per kWh per month.
	Transition Period	3.799 cents per kWh per month.

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					Number of Customers
Seasonal	**C.**	This rate shall apply to the firm electric power requirements where (a) a customer's currently effective contract demand is greater than 15,000 kW but not more than 25,000 kW and (b) the major use of electricity is for activities conducted at the delivery point serving that customer which are classified with a 2-digit Standard Industrial Classification Code between 20 and 39, inclusive.			2
		Customer Charge:	$1,500 per delivery point per month.		
		Administrative Charge:	$700 per delivery point per month.		
		Demand Charge:	Summer Period	$18.78 per kW per month of the customer's billing demand, plus $18.78 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.	
			Winter Period	$12.41 per kW per month of the customer's billing demand, plus $12.41 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.	
			Transition Period	$7.61 per kW per month of the customer's billing demand, plus $7.61 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.	
		Energy Charge:	Summer Period	4.345 cents per kWh per month.	
			Winter Period	3.907 cents per kWh per month.	
			Transition Period	3.801 cents per kWh per month.	

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Manufacturing					**Number of Customers**
Seasonal	**D.**	This rate shall apply to the firm electric power requirements where (a) a customer's currently effective contract demand is greater than 25,000 kW; and (b) the major use of electricity is for activities conducted at the delivery point serving that customer which are classified with a 2-digit Standard Industrial Classification Code between 20 and 39, inclusive.			1
		Customer Charge:	$1,500 per delivery point per month.		
		Administrative Charge:	$700 per delivery point per month.		
		Demand Charge:	Summer Period	$22.08 per kW per month of the customer's billing demand, plus $22.08 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.	
			Winter Period	$15.72 per kW per month of the customer's billing demand, plus $15.72 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.	
			Transition Period	$10.92 per kW per month of the customer's billing demand, plus $10.92 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.	
		Energy Charge:	Summer Period	3.656 cents per kWh per month.	
			Winter Period	3.306 cents per kWh per month.	
			Transition Period	3.222 cents per kWh per month.	

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Rate Class	Base Charge	Number of Customers
Outdoor Lighting		
	Part A - Charges for Street and Park Lighting Systems, Traffic Signal Systems, and Athletic Field Lighting Installations	50

Energy Charge:
Summer Period 7.342 cents per kWh per month.
Winter Period 7.342 cents per kWh per month.
Transition Period 7.342 cents per kWh per month.

Facility Charge: The annual facility charge shall be 14.09 percent of the installed cost to KUB's electric system of the facilities devoted to street and park lighting service specified in this Part A. Such installed cost shall be recomputed on July 1 of each year, or more often if substantial changes in the facilities are made. Each month, one-twelfth of the then total annual facility charge shall be billed to the customer. If any part of the facilities has not been provided at the electric system's expense, or if the installed cost of any portion thereof is reflected on the books of another municipality or agency or department, the annual facility charge shall be adjusted to reflect properly the remaining cost to be borne by the electric system.

Customer Charge: $2.50.

Part B - Charges for Outdoor Lighting for Individual Customers 864

Charges Per Fixture Per Month

a.

Type of Fixture	**(Watts)**	**(Lumens)**	**Rated kWh**	**Facility Charge**	**Total Lamp Charge**
Mercury Vapor or Incandescent*	175	7,650	70	$ 4.41	$ 9.55
	400	19,100	155	6.15	17.53
	1000**	47,500	378	9.84	37.59
High Pressure Sodium	100	8,550	42	4.41	7.49
	250	23,000	105	5.23	12.94
	400	45,000	165	6.15	18.26
	1000**	126,000	385	9.84	38.11
Decorative	100	8,550	42	5.02	8.10

* Mercury Vapor and Incandescent fixtures not offered for new service.
** 1,000 watt fixtures not offered for new service.

b. Energy Charge: For each lamp size under **a.** above, 7.342 cents per rated kWh per month.
Additional pole charge: $3.00 per pole.

Rate Class	Base Charge	Number of Customers
LED Pilot Program	Service under the LED Pilot Program shall only be available for select outdoor (security) lighting facilities of governmental entities located in the KUB electric system service territory. Participation in the LED Pilot Program shall be on a voluntary basis.	
	Pilot Program Charges - No Capital Contribution	-

The following charges are applicable to those customers participating in the LED Pilot Program, for whom the installed cost of facilities for providing service under the program has been borne by the electric system. The following charges are per LED fixture per month.

LED Fixture Type	Facility Charge	Rated kWh	Energy Charge Per kWh	Total Charge
LED - 150WE - Rectangular Head	$ 11.81	38	$ 0.07342	$ 14.60
LED - 150WE - Cobra Head	10.77	38	0.07342	13.56
LED - 250WE - Rectangular Head	$ 14.20	57	$ 0.07342	$ 18.38
LED - 250WE - Cobra Head	12.94	57	0.07342	17.12

	Pilot Program Charges - Capital Contribution	-

The following charges are applicable to those customers participating in the LED Pilot Program, for whom the installed cost of facilities providing service under the program has been borne by the customer. The following charges are per LED fixture per month.

LED Fixture Type	Facility Charge	Rated kWh	Energy Charge Per kWh	Total Charge
LED - 150WE - Rectangular Head	$ 5.09	38	$ 0.07342	$ 7.88
LED - 150WE - Cobra Head	4.97	38	0.07342	7.76
LED - 250WE - Rectangular Head	$ 5.91	57	$ 0.07342	$ 10.09
LED - 250WE - Cobra Head	5.76	57	0.07342	9.94

Additional pole charge: $3.00 per pole.

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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.

Rodefer Moss & Co, PLLC

Knoxville, Tennessee
October 22, 2013

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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.

Rodefer Moss & Co, PLLC

Knoxville, Tennessee
October 22, 2013

Knoxville Utilities Board
Gas Division
Financial Statements and Supplemental Information
June 30, 2013 and 2012

Knoxville Utilities Board Gas Division
Index
June 30, 2013 and 2012

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Independent Auditors' Report

To the Board of Commissioners
Knoxville Utilities Board - Gas Division
Knoxville, Tennessee

Report on the Financial Statements

We have audited the accompanying financial statements of the Knoxville Utilities Board, Gas Division (the "Division"), 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 financial statements, which collectively comprise the Division's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 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 financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Division's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the Division'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 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 financial statements referred to above present fairly, in all material respects, the respective financial position of the Division 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 3-17 and 37 be presented to supplement the basic financial statements. Such information, although not a part of the basic 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 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 financial statements, and other knowledge we obtained during our audit of the basic 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 financial statements that collectively comprise the Division’s basic financial statements. The supplemental schedules on pages 38-45 are presented for the purpose of additional analysis and are not a required part of the basic financial statements.

The supplemental schedules have not been subjected to the auditing procedures applied in the audit of the basic 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 the Division’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 the Division’s internal control over financial reporting and compliance.

Rodefer Moss & Co, PLLC

Knoxville, Tennessee
October 22, 2013

Knoxville Utilities Board (KUB), comprised of Electric Division, Water Division, Gas 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 oversees 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. The Gas Division (Division) provides services to certain customers in Knox County and portions of Anderson and Loudon counties. The Division's accounts are maintained in conformity with the Uniform System of Accounts of the Federal Energy Regulatory Commission and the Governmental Accounting Standards Board, as applicable. The financial statements present only the Gas Division and do not purport to, and do not, present fairly the consolidated financial position of Knoxville Utilities Board at June 30, 2013 and 2012, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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

The Division's 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 the Division's financial statements.

Gas Division Highlights

System Highlights

KUB's gas system serves 98,225 customers, and its service territory covers 282 square miles. KUB maintains 2,364 miles of service mains to provide 12 million dekatherms of natural gas to its customers annually. KUB added 570 customers to its gas system in fiscal year 2013.

In April 2011, management provided an updated assessment of the overall condition of each utility system's infrastructure to the KUB Board. The assessment concluded that the gas distribution system is relatively new and that current funding levels are sufficient to support the gas infrastructure replacement program. For the fiscal year ended June 30, 2013, KUB met its target replacement level for gas main as 8 miles of cast iron/ductile iron main were replaced.

Natural gas sales were 13.8 percent higher than last year primarily due to a 24.1 percent increase in residential sales due to colder winter temperatures. The previous fiscal year included the mildest winter in the last 25 years.

In December 2012, the Division issued $10 million in gas system revenue bonds to fund capital system improvements.

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 refunding will provide debt service savings of $1.6 million over the life of the bonds.

The typical residential gas customer's average monthly gas bill was $57.07 for the twelve months ending June 30, 2013, representing a decrease of $3.04 compared to last year based on the same volumes. The decrease was attributed to lower wholesale gas costs.

Financial Highlights

The Division's net position increased $5.4 million or 3.4 percent, compared to a $0.6 million increase last fiscal year.

Operating revenue increased $16.8 million or 19.4 percent, the result of a 13.8 percent increase in sales volumes. Purchased gas expense was $11.4 million or 22.4 percent higher due to increased purchases to meet higher demand and slightly lower gas costs per unit. Margin on gas sales (operating revenue less purchased gas expense) increased $5.4 million or 15.2 percent, reflecting the higher level of gas sales volumes.

Operating expenses (excluding purchased gas expense) increased $0.7 million or 2.2 percent. Operating and maintenance (O&M) expenditures decreased $0.4 million or 2.2 percent. Depreciation expense was $0.8 million higher than the prior year. Taxes and tax equivalents were $0.2 million higher than the prior year.

The Division expended 60 percent of gas system sales revenue on wholesale gas purchases for the fiscal year ended June 30, 2013.

In July 2012, the Division issued a short-term revenue anticipation note (line of credit) for $20 million for the purpose of managing seasonal cash flow during the winter heating season. During the fiscal year, $2.6 million was drawn and repaid by the Division.

Lower interest rates on longer-term investments resulted in a $0.1 million decrease in interest income. Interest expense was consistent with the prior year, the net result of additional interest from a $10 million December 2012 bond issue and lower interest expense resulting from bond refundings in 2012 and 2013.

Total plant assets (net) increased $6.7 million or 3.2 percent over the end of the last fiscal year due to the replacement and construction of gas mains.

Long-term debt represented 36.1 percent of the Division's capital structure as of June 30, 2013, as compared to 35.6 percent last year. Capital structure equals long-term debt (which includes the current portion of revenue bonds and notes, as applicable, due to be retired next fiscal year) plus net position.

The Division's bond covenants require a debt service coverage ratio of at least 1.2 times the maximum principal and interest payments over the life of the Division's outstanding bonds. Current year debt coverage for the fiscal year was 3.00. Maximum debt service coverage was 2.88.

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Division Cash Budget Appropriations

KUB's Board of Commissioners adopted a Gas Division budget of $109.5 million for fiscal year 2013. At year end, the Division was $6 million under budget. Purchased gas costs were $5 million less than expected due to lower wholesale gas costs. Capital expenditures were under budget by $1.6 million reflecting timing of Century II gas system projects. Bond proceeds of $10.4 million from bonds sold in fiscal year 2013 were transferred into the general fund to reimburse for gas system capital expenditures. The numbers below are presented on a cash basis.

Gas Division Cash Report
As of June 30, 2013

(in thousands of dollars)	**FY 2013 Budget**	**FY 2013 Actual FYTD**	**Dollar Variance***	**Percent Variance**
Beginning Balance General Fund	$ 12,721	$ 12,721		
Operating Receipts	103,322	100,577	(2,745)	-2.7%
Disbursements				
Purchased Energy Expense	59,258	54,206	5,052	8.5%
Operation & Maintenance Expense	16,901	16,840	61	0.4%
Capital Expenditures	18,399	16,755	1,644	8.9%
Debt Service & Taxes	14,892	15,646	(754)	-5.1%
Total Disbursements	109,450	103,447	6,003	5.5%
Bond Proceeds	9,900	10,412	512	5.2%
Net Flow-throughs and Transfers	(867)	(160)	707	81.5%
Ending General Fund Balance	$ 15,626	$ 20,103	$ 4,477	28.7%

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

Knoxville Utilities Board Gas Division - Financial Statements

The Division's financial performance is reported under three basic 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

The Division 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, gas 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 represents what was previously reported as accumulated or retained earnings. Net position tells the user what the Division has done with its accumulated earnings not just the balance.

Net investment in capital assets, is the net 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 the Division'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

The Division reports its revenues and expenses (both operating and non-operating) on the Statement of Revenues, Expenses and Changes in Net Position. In addition, any contributions in aid of construction (funds received via grants, developers, etc. to fund capital projects) and associated write-downs of plant assets are reported on this statement.

Total revenue less total expense equals the change in net position for the reporting. Net position at the beginning of the period are 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

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

The statement indicates the Division's beginning cash balance and ending cash balance and how it was either increased or decreased during the reporting period.

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

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Condensed Financial Statements

Statement of Net Position

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

Statements of Net Position
As of June 30

(in thousands of dollars)	**2013**	**2012**
Current and other assets	$ 57,097	$ 49,952
Capital assets, net	215,490	208,788
Deferred outflows of resources	584	825
Total assets and deferred outflows of resources	273,171	259,565
Current and other liabilities	19,758	16,919
Long-term debt outstanding	87,565	82,845
Deferred inflows of resources	2,158	1,480
Total liabilities and deferred inflows of resources	109,481	101,244
Net position		
Net investment in capital assets	121,257	120,404
Restricted	1,602	1,476
Unrestricted	40,831	36,441
Total net position	$ 163,690	$ 158,321

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 outflows and inflows 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.

Current Year Impacts and Analysis

Current and Other Assets

Current and other assets increased $7.1 million or 14.3 percent. General fund cash and investments increased $7.4 million, due to a higher level of gas sales volumes and the use of $10 million in proceeds from revenue bonds to fund a portion of capital expenditures. Accounts receivable increased $4.5 million compared to June 2012, reflecting a higher level of balance due KUB for KUB's residential gas customers, the result of the colder winter.

The Division under recovered $0.8 million in wholesale gas costs from its customers through its Purchased Gas Adjustment mechanism in fiscal year 2013, as compared to a $2.8 million under recovery in fiscal year 2012. This under recovery of costs will be collected from customers next fiscal year through adjustments to 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 higher sales volume due to the colder winter.

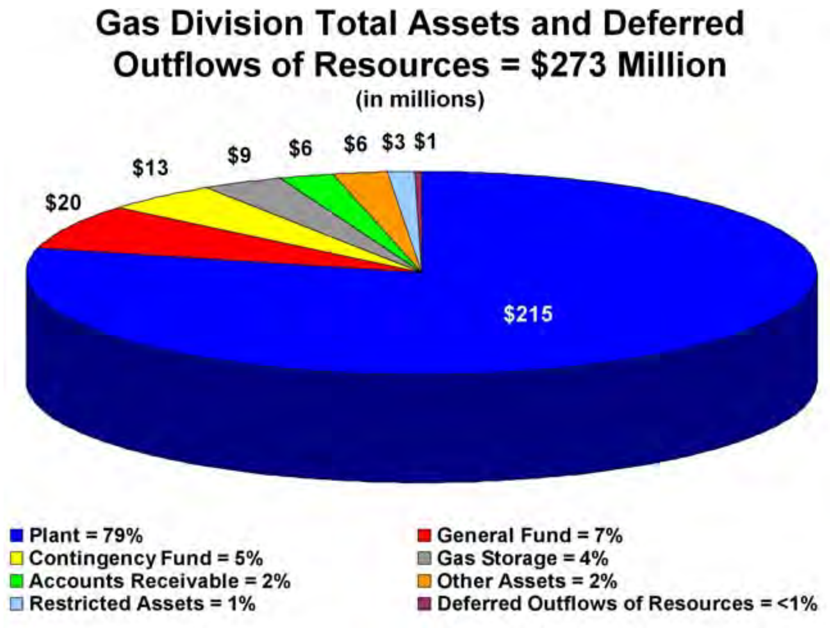
The Division contributed $0.1 million to operating contingency reserves in order to maintain the required balance in the fund, which is 60 days of operating expenses. In addition, $1 million was contributed to the rainy day cash reserves, which totaled $3.6 million as of June 30, 2013.

Capital Assets

Capital assets increased $6.7 million or 3.2 percent. Major capital expenditures during the year included $8.3 million for gas main replacement and $4.5 million for the construction of mains and service extensions. The Division also retired $2.1 million of assets during the year.

Deferred Outflows of Resources

Deferred outflows of resources were $0.6 million, which was down $0.2 million compared to the prior year.



Current and Other Liabilities

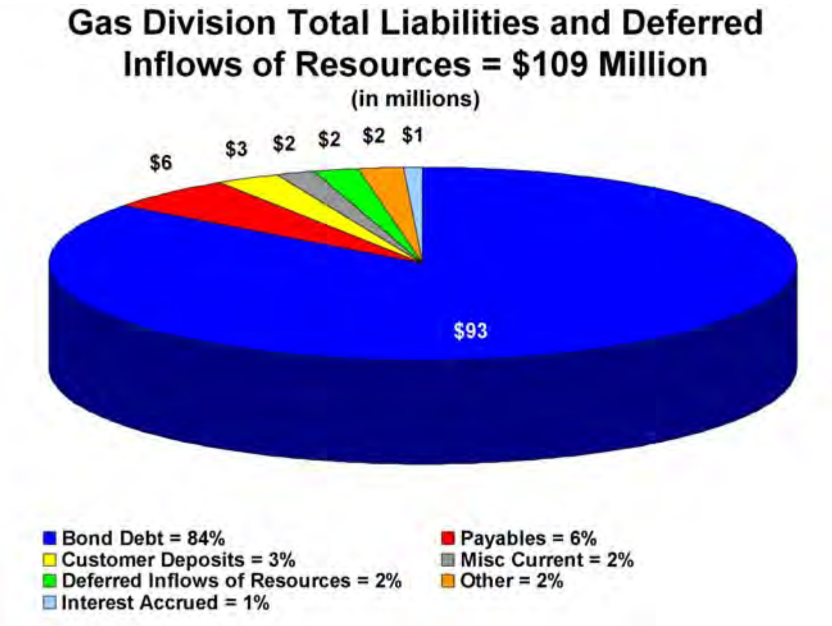
Current and other liabilities increased $2.8 million or 16.8 percent. Accounts payable rose $2 million, due to higher purchased gas expenses, the result of more volumes purchased for injection into storage in June 2013 compared with last fiscal year. In addition, the Division’s share of KUB’s liability for pension benefits was $0.4 million higher than the prior year, while the liability for other post-employment benefits was reduced by $0.2 million.

Long-Term Debt

Long-term debt was $4.7 million or 5.7 percent higher than the prior year, the net result of $10 million of additional debt, the scheduled repayment of bond debt during the fiscal year, and a $0.5 million reduction in principal as a result of the March 2013 debt refunding.

Deferred Inflows of Resources

Deferred inflows of resources totaled $2.2 million as of June 30, 2013 compared to $1.5 million in June of the prior year. The $0.7 million increase reflects premiums incurred with the March 2013 debt refunding.



Net Position

Invested in capital assets, net of debt increased $0.9 million or 0.7 percent, primarily attributed to an increase in net plant in service of $6.7 million offset by a $4.7 million increase in long term debt. Restricted net position was up $0.1 million based on the net increase of the bond fund and accrued interest payable. Unrestricted net position increased $4.4 million primarily due to a $7.4 million rise in general fund cash compared to June of the prior year.

Statement of Revenues, Expenses and Changes in Net Position

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

Statements of Revenues, Expenses and Changes in Net Position
For the Years Ended June 30

(in thousands of dollars)	2013	2012
Operating revenues	$ 103,597	$ 86,761
Less: Purchased gas expense	62,415	51,006
Margin from sales	41,182	35,755
Operating expenses		
Distribution	7,897	7,386
Customer service	2,484	2,448
Administrative and general	6,333	7,255
Depreciation and amortization	9,113	8,278
Taxes and tax equivalents	6,275	6,042
Total operating expenses	32,102	31,409
Operating income	9,080	4,346
Interest income	149	239
Interest expense	(3,780)	(3,826)
Other income/(expense)	(80)	(207)
Change in net position	$ 5,369	$ 552

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 natural gas sales for the fiscal year. Any change (increase/decrease) in retail gas rates would also be a cause of change in operating revenue. The Division utilizes a Purchased Gas Adjustment (PGA) mechanism in setting its monthly retail gas rates. Through the PGA, the Division adjusts its retail rates each month based on current wholesale gas prices. If wholesale gas prices increase/decrease, the Division increases/decreases its retail gas rates accordingly.

- Volumes of gas purchased from the Division's wholesale gas suppliers for resale to customers impact purchased gas expense. The Division purchases gas for resale to its customers from a variety of wholesale suppliers. Changes (increase/decrease) in wholesale gas prices would also result in a change in purchased gas expense.

- Operating expenses (distribution, customer service, administrative and general) are normally impacted by changes in areas including, but not limited to, labor costs (staffing, wage rates), active employee and retiree medical costs, and gas distribution system maintenance.

- Depreciation expense is impacted by plant additions and retirements during the fiscal year.

- Taxes & tax equivalents are impacted by plant additions/retirements, changes in property tax rates, and gross margin levels.

- Interest income is impacted by the level of interest rates and investments.

- Interest expense on debt is impacted by the level of outstanding debt and the interest rates on the outstanding debt.

- Other income/(expense) is impacted by miscellaneous non-operating revenues and expenses.

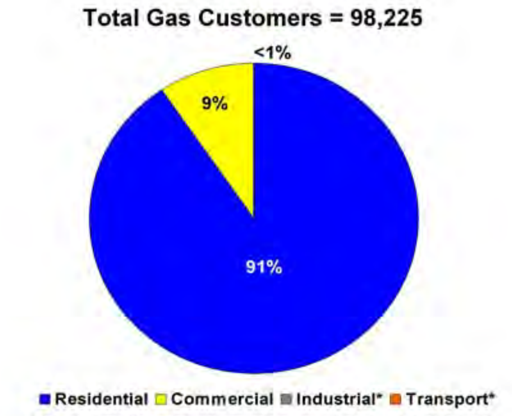
Current Year Impacts and Analysis

The Division's net position increased $5.4 million. This increase was $4.8 million greater than the prior year's change in net position. The growth in earnings was the result of an increase in margin on sales.

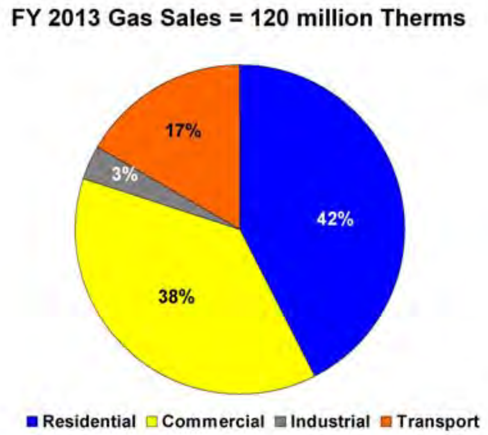
Margin on gas sales (operating revenue less purchased gas expense) increased $5.4 million or 15.2 percent due to a 13.7 percent increase in billed sales volumes. The increased sales volume resulted from normal winter weather in fiscal year 2013 compared to the mildest winter in KUB's service territory over the last twenty-five years in the previous fiscal year.

Operating revenue increased $16.8 million or 19.4 percent for the fiscal year ending June 30, 2013, the net effect of higher sales volumes and the flow-through of slightly lower wholesale natural gas prices to customers through the Purchased Gas Adjustment. Rebates on bond interest payments from the federal government for federally taxable Build America Bonds (BABs) are reported as revenue in accordance with GASB. KUB recognized $0.2 million in revenue for BABs rebates in fiscal year 2013.

Purchased gas expense increased $11.4 million or 22.4 percent, due to higher customer demand reduced slightly by lower wholesale gas costs per unit. Although KUB purchased four percent less gas from its suppliers in 2013, the increased customer demand was met by a significantly higher draw down of gas in storage compared to fiscal year 2012. The net result was a 1 million dekatherm or 9.4 percent increase in total volumes delivered to KUB's gas distribution system. The Division's weighted average cost of gas purchased for fiscal year 2013 was $3.61 per dekatherm, as compared to $3.73 per dekatherm last year.

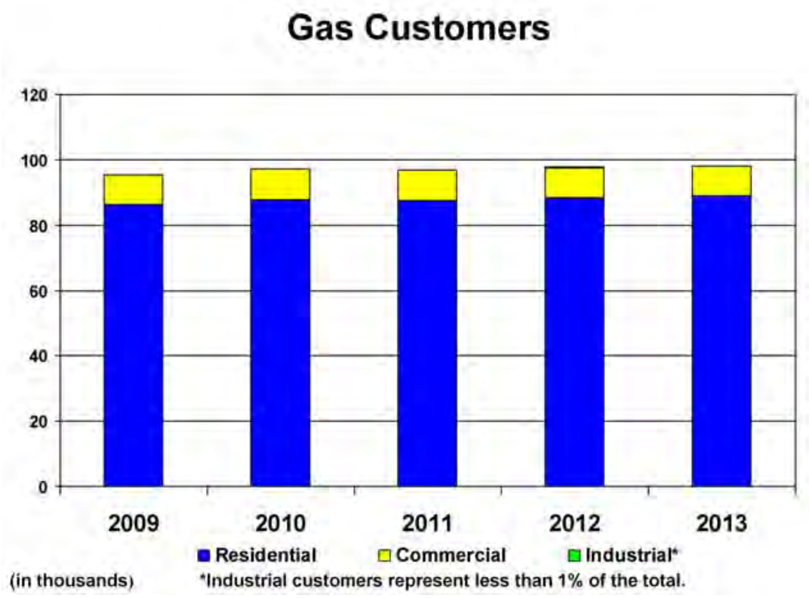


*Industrial and Transport customers represent less than 1% of the total.

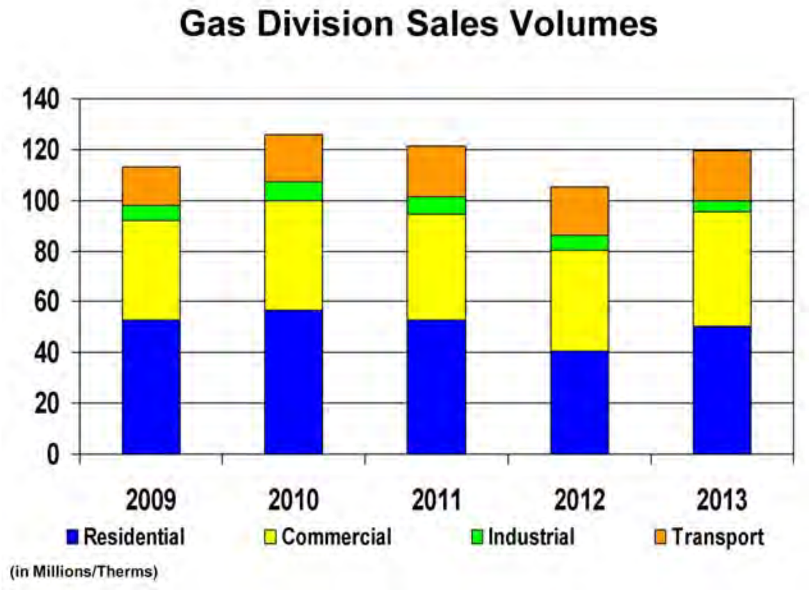


Residential customers, whose natural gas is primarily used as a heat source during winter months, accounted for 91 percent of customers billed and 42 percent of total volumes sold during the year. Residential sales volumes were consistent with the prior year for the first half of the fiscal year. Sales throughout the winter heating season of fiscal year 2013 were higher than fiscal year 2012, resulting in an overall 24.1 percent increase for the year.

Commercial and Industrial sales volumes (including transportation customers) were up 7.2 percent compared to the prior year.



The gas system has added approximately 1,600 customers over the past five years representing annual growth of 0.4 percent. System growth has been limited over the five year period due to the economic recession.

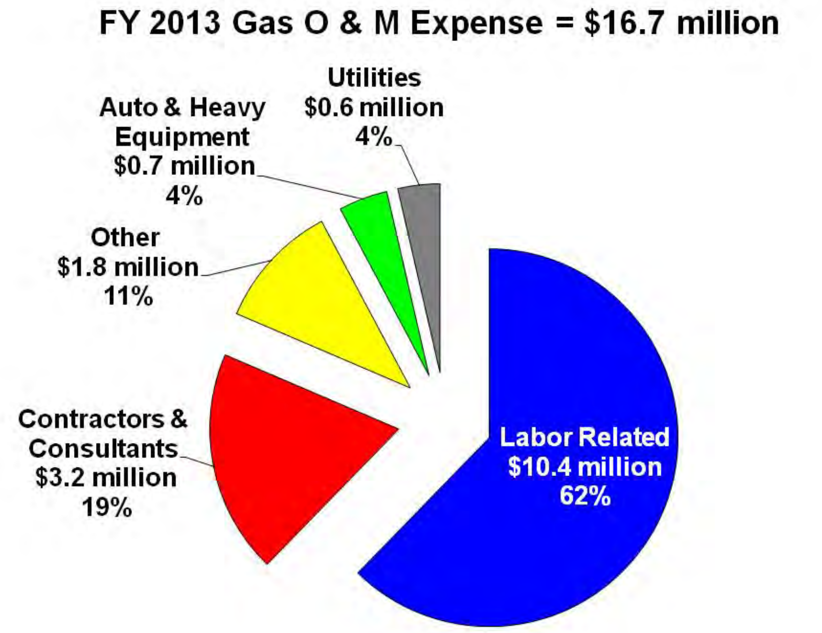


Gas sales volumes have fluctuated over the past five years, due to variation in winter weather. In fiscal year 2013, winter weather was relatively normal compared to a significantly mild winter in fiscal year 2012. Sales volumes were higher for both residential and commercial customers. KUB's ten largest gas customers accounted for 24.7 percent of KUB's billed gas volumes. Those ten customers are comprised of five industrial and five commercial customers including one governmental customer. KUB also has 15 transport customers who purchase gas directly from a supplier other than KUB. KUB provides transportation service on its gas distribution system to those customers.

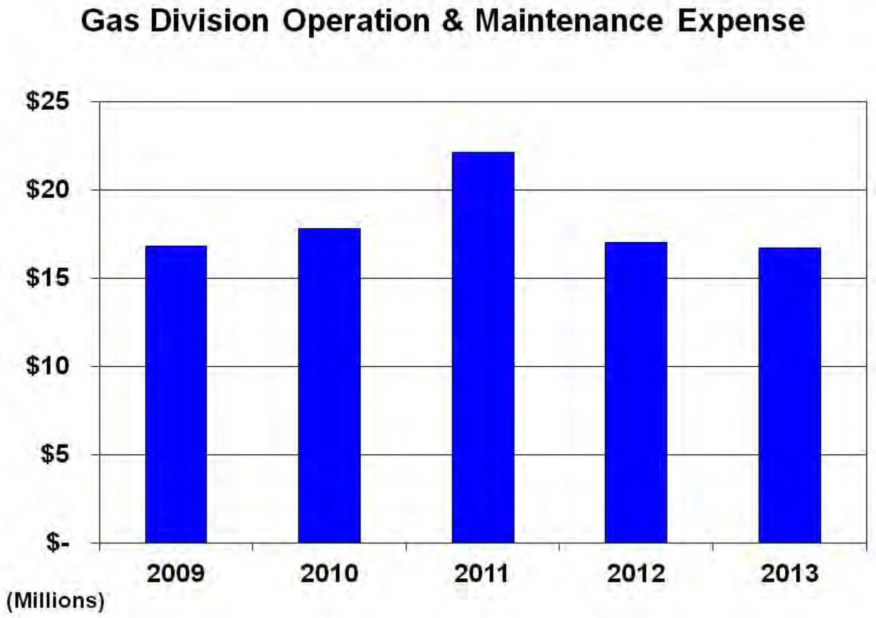
Operating Expenses

Operating expenses (excluding purchased gas expense) increased $0.7 million or 2.2 percent over last fiscal year. Operating expenses are categorized as the following:

- Distribution system operating and maintenance expenses were $0.5 million higher than last fiscal year, due in part to the cost of a gas distribution system assessment.
- Customer service expenses were flat compared to last fiscal year.
- Administrative and general expenses declined $0.9 million or 12.7 percent, reflecting a $0.7 million reduction in the Division's portion of shared costs.



Labor-related expenses accounted for 62 percent of fiscal year 2013 O&M expense. O&M expense decreased $0.4 million in fiscal year 2013, the result of a reduction to the Division's allocation of shared costs.



- Depreciation expense was $0.8 million higher than the prior year, the result of a full year of depreciation for $6 million of assets added to plant in service in fiscal year 2012 and a partial year of depreciation for $17.4 million of assets added to plant in service in fiscal year 2013. In addition, the Division retired $2.1 million of assets during the year.

- Taxes and tax equivalents were up $0.2 million as a result of higher tax equivalent payments due to increased net plant value.

Other Income and Expense

Interest income decreased $0.1 million. This decrease was due to lower interest rates on longer-term investments.

Interest expense was consistent with the prior year, the net result of a partial year's additional interest on $10 million of new debt in December 2012 and a reduction in expense from debt refinancings in 2012 and 2013.

Other income (net) was $0.1 million lower than the prior fiscal year.

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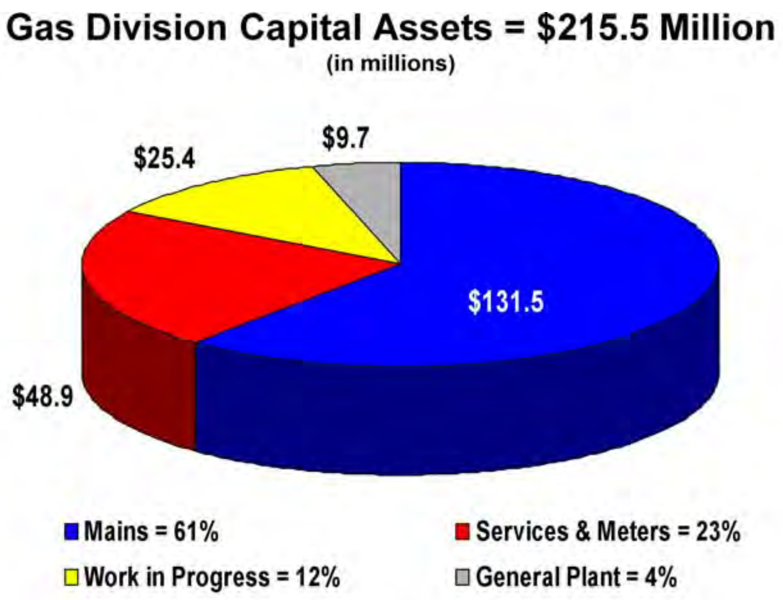
Capital Assets and Debt Administration

Capital Assets

As of June 30, 2013, the Division had $215.5 million invested in a variety of capital assets, as reflected in the schedule below, which represents a net increase (including additions, retirements, and depreciation) of $6.7 million or 3.2 percent over the end of last fiscal year.

Capital Assets
As of June 30
(Net of Depreciation)

(in thousands of dollars)	**2013**	**2012**
Distribution plant:		
Mains	$ 131,533	$ 124,045
Services and meters	48,911	47,963
Others	940	851
Total distribution plant	181,384	172,859
General plant	8,718	8,822
Total plant	190,102	181,681
Work in progress	25,388	27,107
Total net plant	$ 215,490	$ 208,788



Major capital asset expenditures during the year were as follows:

- $8.3 million for main replacement
- $4.5 million for installation of new main and service extensions

Debt Administration

As of June 30, 2013, the Division had $92.4 million in outstanding debt (including current portions of revenue bonds), compared to $87.4 million last year, representing an increase of $5 million or 5.7 percent. The Division's weighted average cost of debt as of June 30, 2013 was 3.8 percent.

In July 2012, the Gas Division issued a $20 million line of credit. The line of credit was issued in anticipation of funding purchased gas costs during the off-peak sales months. The Division drew down and repaid $2.6 million on the line of credit during the year.

In December 2012, the Division issued $10 million in gas system revenue bonds to fund capital system improvements.

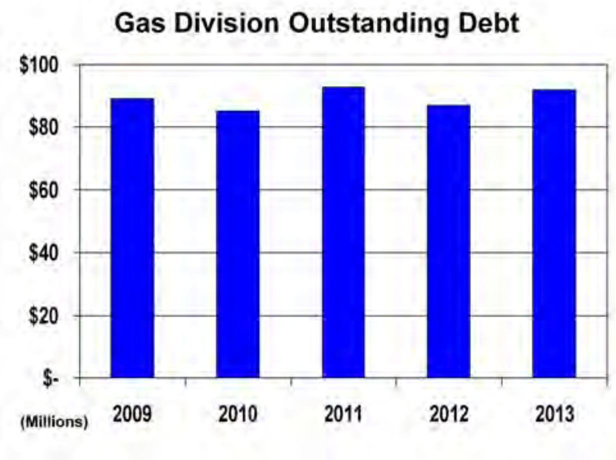
The Division sold $11.6 million in revenue refunding bonds in March 2013 for the purpose of refunding outstanding bonds at lower interest rates. The refunding will result in total debt service savings of $1.6 million over the life of the bonds (or $1 million on a net present value basis).

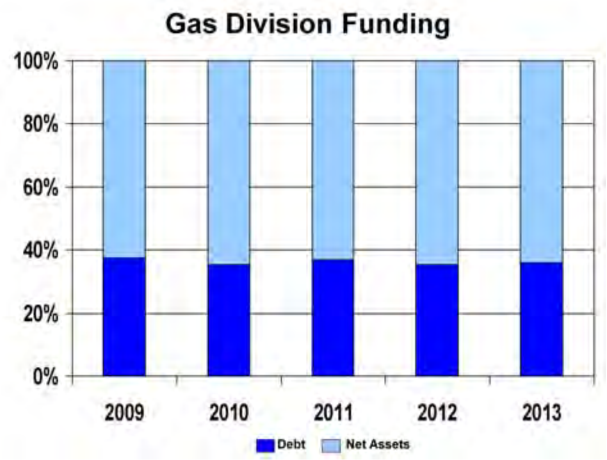
The Division's outstanding debt is rated by Standard & Poor's and Moody's Investors Service. As of June 30, 2013, the Division's revenue bonds were rated AA by Standard & Poor's and Aa2 by Moody's Investors Service.

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

Outstanding Debt
As of June 30

(in thousands of dollars)	**2013**	**2012**
Revenue bonds	$ 92,350	$ 87,360
Total outstanding debt	$ 92,350	$ 87,360


Gas Division Outstanding Debt


Gas Division Funding

The Gas Division's level of debt has fluctuated slightly during the past five years from $88.6 million in fiscal year 2009 to its current level of $92.4 million. However, the Division's debt to capitalization ratio has declined from 37.5 percent in 2009 to 36.1 percent in 2013. The increase in debt has been used to fund capital improvements for the gas system.

The Division will pay $53.2 million in principal payments over the next ten years, representing 58 percent of the outstanding bonds. KUB's Debt Management Policy requires a minimum of 30 percent of gas debt principal be repaid over the next ten years.

Impacts on Future Financial Position

The Division expects to add 500 new gas customers during the course of the next fiscal year.

In June 2013, the Board of Commissioners adopted a five percent rate increase, effective on October 2013 customer bills. The Division anticipates $5.5 million of additional margin annually as a result of the rate increase. This will represent the first gas margin increase since 2007. The rate increase will add $3 to each residential customer's average monthly bill.

KUB sold $25 million in gas system revenue bonds in September 2013 for the purpose of funding gas system capital improvements in fiscal year 2014. The bonds were sold to the low cost bidder through public competitive sale resulting in the average interest rate of 4.276 percent.

KUB debt portfolio includes $12 million of Gas Division 2010 Build America Bonds (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 the Division's financial position or results of operations during fiscal year 2014.

Financial Contact

The Division's financial statements are designed to present users (citizens, customers, investors, and creditors) with a general overview of the Division'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 Gas Division
Statements of Net Position
June 30, 2013 and 2012

	2013	2012
Assets and Deferred Outflows of Resources		
Current assets:		
Cash and cash equivalents	$ 20,102,921	$ 9,721,275
Short-term investments	-	3,000,000
Short-term contingency fund investments	4,276,090	5,112,602
Other current assets	1,372,857	2,146,735
Accrued interest receivable	1,239	12,974
Accounts receivable, less allowance of uncollectible accounts of $75,732 in 2013 and $86,071 in 2012	7,520,573	3,022,018
Inventories	327,066	347,735
Gas storage	9,333,190	13,789,493
Prepaid expenses	604,310	53,619
Total current assets	43,538,246	37,206,451
Restricted assets:		
Gas bond fund	2,748,243	2,551,537
Other funds	10,226	1,623
Total restricted assets	2,758,469	2,553,160
Gas plant in service	286,601,236	271,310,274
Less accumulated depreciation	(96,499,232)	(89,629,690)
	190,102,004	181,680,584
Retirement in progress	186,237	340,492
Construction in progress	25,201,593	26,766,994
Net plant in service	215,489,834	208,788,070
Other assets:		
Long-term contingency fund investments	8,559,641	6,685,621
Under recovered purchased gas costs	841,779	2,825,163
Other	1,398,835	681,848
Total other assets	10,800,255	10,192,632
Total assets	272,586,804	258,740,313
Deferred outflows of resources:		
Unamortized bond refunding costs	583,939	824,615
Total deferred outflows of resources	583,939	824,615
Total assets and deferred outflows of resources	$ 273,170,743	$ 259,564,928

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

Knoxville Utilities Board Gas Division
Statements of Net Position
June 30, 2013 and 2012

	2013	2012
Liabilities, Deferred Inflows, and Capitalization		
Current liabilities:		
Current portion of revenue bonds	$ 4,785,000	$ 4,515,000
Sales tax collections payable	73,820	68,825
Accounts payable	6,192,203	4,198,375
Accrued expenses	2,404,472	1,995,744
Customer deposits plus accrued interest	3,343,786	3,241,641
Accrued interest on revenue bonds	1,156,173	1,076,437
Total current liabilities	17,955,454	15,096,022
Other liabilities:		
Accrued compensated absences	1,415,557	1,400,043
Customer advances for construction	308,087	368,757
Other	78,396	53,901
Total other liabilities	1,802,040	1,822,701
Long-term debt:		
Gas revenue bonds	87,565,000	82,845,000
Total long-term debt	87,565,000	82,845,000
Total liabilities	107,322,494	99,763,723
Deferred inflows of resources:		
Unamortized costs	2,158,467	1,480,367
Total deferred inflows of resources	2,158,467	1,480,367
Total liabilities and deferred inflows of resources	109,480,961	101,244,090
Net position		
Net investment in capital assets	121,257,219	120,403,561
Restricted for:		
Debt service	1,592,070	1,475,100
Other	10,226	1,623
Unrestricted	40,830,267	36,440,554
Total net position	163,689,782	158,320,838
Total liabilities, deferred inflows, and net position	$ 273,170,743	$ 259,564,928

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

Knoxville Utilities Board Gas Division
Statements of Revenues, Expenses and Changes in Net Position
Years Ended June 30, 2013 and 2012

	2013	2012
Operating revenues	$ 103,597,256	$ 86,760,687
Operating expenses		
Purchased gas	62,415,207	51,006,266
Distribution	7,896,781	7,385,570
Customer service	2,483,563	2,447,805
Administrative and general	6,333,489	7,255,134
Provision for depreciation and amortization	9,112,867	8,277,943
Taxes and tax equivalents	6,275,336	6,042,429
Total operating expenses	94,517,243	82,415,147
Operating income	9,080,013	4,345,540
Non-operating revenues (expenses)		
Contributions in aid of construction	1,528,863	890,983
Interest and dividend income	148,552	239,596
Interest expense	(3,779,522)	(3,825,625)
Write-down of plant for costs recovered through contributions	(1,528,863)	(890,983)
Other	(80,099)	(208,031)
Total non-operating revenues (expenses)	(3,711,069)	(3,794,060)
Change in net position	5,368,944	551,480
Net position, beginning of year	158,320,838	157,769,358
Net position, end of year	$ 163,689,782	$ 158,320,838

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

Knoxville Utilities Board Gas Division
Statements of Cash Flows
June 30, 2013 and 2012

	2013	2012
Cash flows from operating activities:		
Cash receipts from customers	$ 98,583,683	$ 89,443,390
Cash (payments to) receipts from other operations	1,053,980	1,270,540
Cash payments to suppliers of goods or services	(63,752,779)	(70,128,776)
Cash payments to employees for services	(7,721,873)	(9,198,452)
Payment in lieu of taxes	(5,735,914)	(5,522,954)
Net cash provided by operating activities	22,427,097	5,863,748
Cash flows from capital and related financing activities:		
Net proceeds from bond issuance	10,412,480	-
Principal paid on revenue bonds and notes payable	(4,515,000)	(4,165,000)
(Increase) decrease in unused bond proceeds	-	3,699,364
Interest paid on revenue bonds and notes payable	(3,699,787)	(4,123,782)
Acquisition and construction of gas plant	(17,463,871)	(22,283,643)
Changes in gas bond fund, restricted	(196,706)	211,490
Customer advances for construction	(60,670)	138,360
Proceeds received on disposal of plant	5,920	10,999
Cash received from developers and individuals for capital purposes	1,528,863	890,983
Net cash used in capital and related financing activities	(13,988,771)	(25,621,229)
Cash flows from investing activities:		
Changes in deposit and investment accounts:		
Purchase of investment securities	1,834,727	(1,097,464)
Maturities of investment securities	127,765	141,473
Interest received	160,287	239,596
Other property and investments	(179,459)	(49,080)
Net cash provided by (used in) investing activities	1,943,320	(765,475)
Net increase (decrease) in cash and cash equivalents	10,381,646	(20,522,956)
Cash and cash equivalents, beginning of year	9,721,275	30,244,231
Cash and cash equivalents, end of year	$ 20,102,921	$ 9,721,275
Reconciliation of operating income to net cash provided by operating activities		
Operating income	$ 9,080,013	$ 4,345,540
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization expenses	9,337,980	8,498,122
Changes in operating assets and liabilities:		
Accounts receivable	(4,498,557)	3,123,181
Inventories	20,670	34,839
Prepaid expenses	3,905,612	(2,945,521)
Other assets	48,289	310,908
Sales tax collections payable	4,995	(1,964)
Accounts payable and accrued expenses	2,418,071	(3,786,557)
Underrecovered gas costs	1,983,384	(3,892,237)
Customer deposits plus accrued interest	102,146	190,181
Other liabilities	24,494	(12,744)
Net cash provided by operating activities	$ 22,427,097	$ 5,863,748
Noncash capital activities:		
Acquisition of plant assets through developer contributions	$ -	$ -

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

1. Description of Business

Knoxville Utilities Board (KUB), comprised of Electric Division, Water Division, Gas 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, gas, and wastewater services. A seven-member Board of Commissioners oversees 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. The Gas Division (Division) provides services to certain customers in Knox County and in two surrounding counties in East Tennessee. The Division's accounts are maintained in conformity with the Uniform System of Accounts of the Federal Energy Regulatory Commission (FERC) and the Governmental Accounting Standards Board (GASB), as applicable. The financial statements present only the Gas Division and do not purport to, and do not, present fairly the consolidated financial position of Knoxville Utilities Board at June 30, 2013 and 2012, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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 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 to the Division is determined by measurement focus. The transactions of the Division 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.

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.

Gas Plant

Gas plant and other property are stated on the basis of original cost. The cost of current repairs and minor replacements is charged to operating expense. The cost of renewals and improvements is 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 gas plant in service is based on the estimated useful lives of the assets, which range from three to thirty-three years, and is computed using the straight-line method. Pursuant to FERC, the caption "Provision for depreciation" in the statements of revenues, expenses and changes in net position does not include depreciation for transportation equipment of

$225,113 in fiscal year 2013 and $220,179 in fiscal year 2012. Interest costs are expensed as incurred.

Operating Revenue

Operating revenue consists primarily of charges for services provided by the principal operations of the KUB Gas Division. 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 $48,460 in fiscal year 2013 and $10,597 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 net assets available, it is KUB's policy to apply those expenses to restricted net assets to the extent such are available and then to unrestricted net assets.

Contributions in Aid of Construction

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

The Division'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). The Division'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 carrier. Additionally, KUB provides certain lifetime health benefits to eligible retired employees under a self-insurance plan administered by a third party.

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.

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.

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 fiscal year 2012 balances to conform to fiscal year 2013 presentation.

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.

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.

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 a 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.

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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:

	Carrying Value	**Bank Balance**
Deposits		
Deposits in financial institutions	$ 20,112,786	$ 20,842,740
Investments		
Certificates of Deposits	7,085,782	7,085,782
State Treasurer's Investment Pool	988,282	988,282
Agency Bonds	7,475,570	7,475,570
	$ 35,662,420	$ 36,392,374

Classification of deposits and investments:

Depository Account	**Bank Balance**
Insured	$ 346,368
Collateralized:	
Collateral held by pledging bank's trust department in KUB's name	7,475,570
Collateral held by pledging bank's trust department not in KUB's name*	28,570,436
Total deposits and investments	$ 36,392,374

* - Deposits are collaterlized with the Tenneesse State Investment Pool in the name of the pledging bank in accordance with Tennessee Code Annotated, Title 9, Chapter 4, parts 1 and 4. KUB deposits with First Tennessee Bank are collateralized at 115 percent of their total value.

Classification of deposits and investments per statement of net position:

	2013	**2012**
Current assets		
Cash and cash equivalents	$ 20,102,921	$ 9,721,275
Short-term investments	-	3,000,000
Short-term contingency fund investments	4,276,090	5,112,602
Other assets		
Long-term contingency fund investments	8,524,940	6,643,220
Restricted assets		
Gas bond fund	2,748,243	2,551,537
Other funds	10,226	1,623
	$ 35,662,420	$ 27,030,257

The above amounts do not include accrued interest of $34,701 in fiscal year 2013 and $42,401 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.

	Deposit and Investment Maturities (in Years)		
	Fair Value	**Less Than 1**	**1-5**
Supersweep NOW and Other Deposits	$ 20,842,740	$ 20,842,740	$ -
State Treasurer's Investment Pool	988,282	988,282	-
Agency Bonds	7,475,570	3,282,095	4,193,475
Certificates of deposits	7,085,782	2,757,671	4,328,111
	$ 36,392,374	$ 27,870,788	$ 8,521,586

Interest Rate Risk. KUB's primary investment objectives 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 limiting investments to those types described above and limiting maturity horizons. 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 investments are rated Aaa by Moody's Investors Service.

4. Accounts Receivable

Accounts receivable consists of the following:

	2013	**2012**
Wholesale and retail customers		
Billed services	$ 6,131,190	$ 1,728,934
Unbilled services	1,154,898	897,698
Other	310,217	481,457
Allowance for uncollectible accounts	(75,732)	(86,071)
	$ 7,520,573	$ 3,022,018

5. Accounts Payable and Accruals

Accounts payable and accruals were composed of the following:

	2013	2012
Trade accounts	$ 6,192,203	$ 4,198,375
Salaries and wages	128,028	90,806
Self-insurance liabilities	331,386	368,673
Other current liabilities	1,945,058	1,536,265
	$ 8,596,675	$ 6,194,119

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
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	$ 87,360,000	$ 21,580,000	$ 16,590,000	$ 92,350,000	$ 4,785,000

Other liabilities consist of the following:

	Balance June 30, 2012	Increase	Decrease	Balance June 30, 2013	Amounts Due Within One Year
Accrued compensated absences	$ 1,400,043	$ 2,524,126	$ (2,508,612)	$ 1,415,557	$ 350,000
Customer advances for construction	368,757	114,289	(174,959)	308,087	16,000
Other	53,901	104,368	(79,873)	78,396	35,000
	$ 1,822,701	$ 2,742,783	$ (2,763,444)	$ 1,802,040	$ 401,000

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

Fiscal	**Total**		**Grand**
Year	**Principal**	**Interest**	**Total**
2014	$ 4,785,000	$ 3,497,926	$ 8,282,926
2015	4,950,000	3,368,555	8,318,555
2016	5,120,000	3,250,767	8,370,767
2017	4,850,000	3,092,005	7,942,005
2018	5,050,000	2,915,497	7,965,497
2019 - 2023	28,480,000	11,502,401	39,982,401
2024 - 2028	25,175,000	5,771,070	30,946,070
2029 - 2033	13,940,000	1,392,188	15,332,188
Total	$ 92,350,000	$ 34,790,409	$ 127,140,409

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

During fiscal year 2006, KUB's Gas Division issued Series L 2005 bonds to retire certain existing debt and fund gas system capital improvements. 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 revenue bonds.

During fiscal year 2008, KUB's Gas Division issued Series N 2007 bonds 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. 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 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 general obligation 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.

7. Lease Commitments

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

2014	$ 13,421
2015	10,821
2016	3,903
2017	407
Total operating minimum lease payments	$ 28,552

8. Capital Assets

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

	Beginning 6/30/2012	Increase	Decrease	Ending 06/30/2013
Production Plant	$ 14,640	$ -	$ -	$ 14,640
Distribution Plant				
Mains	175,025,674	12,730,798	(1,267,654)	186,488,818
Services and Meters/Regulators	73,611,213	2,921,945	(528,990)	76,004,168
Other Accounts	1,356,325	137,188	(95)	1,493,418
Total Distribution Plant	$ 249,993,212	$ 15,789,931	$ (1,796,739)	$ 263,986,404
Total General Plant	21,302,422	1,560,299	(262,529)	22,600,192
Total Plant Assets	$ 271,310,274	$ 17,350,230	$ (2,059,268)	$ 286,601,236
Less Accumulated Depreciation	(89,629,690)	(8,826,320)	1,956,778	(96,499,232)
Net Plant Assets	$ 181,680,584	$ 8,523,910	$ (102,490)	$ 190,102,004
Work In Progress	27,107,486	15,177,326	(16,896,982)	25,387,830
Total Net Plant	$ 208,788,070	$ 23,701,236	$ (16,999,472)	$ 215,489,834

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.

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 $331,386 resulting from the following changes:

		2013		**2012**
Balance, beginning of year	$	368,673	$	456,808
Current year claims and changes in estimates		2,303,947		2,623,245
Claims payments		(2,341,234)		(2,711,380)
Balance, end of year	$	331,386	$	368,673

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 Pension Division, 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 Division 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 Division Plan A active employees, vested terminated employees, retirees, and beneficiaries. Plan A is a closed plan.

All employees participating in the City Division 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 earnings and 4 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 Division Plan B active employees, vested terminated employees, retirees, and beneficiaries. Plan B is a closed plan.

All employees participating in the City Division 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 Gas Division's portion of this contribution is $1,045,509. 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. Of these amounts, $1,045,509 and $682,724 are attributable to the Gas Division.

Subsequent to June 30, 2013, the actuarial valuation for the Plan year ending December 31, 2013 was completed. For the Plan year ending December 31, 2013, a contribution of $6,314,399 is recommended for the Plan sponsor's fiscal year ending June 30, 2015. The Gas Division's portion of this recommended contribution is $1,199,736. 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 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.

Total contributions to the OPEB Trust for the fiscal year ended June 30, 2013 were $4.4 million (Division's share $0.8 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 (Division's share $0.6 million). As of June 30, 2013, the employer's net OPEB obligation was $0.6 million (Division's share $0.1 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 (Division's share $0.6 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 (Division's share $12 million). The actuarial value of the Plan's assets was $38.6 million (Division's share $7.3 million). As a result, the Plan's unfunded actuarial accrued liability was $24.8 million (Division's share $4.7 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 (Division's share $0.7 million). See Required Supplementary Information for OPEB Schedule of Funding Progress.

13. Related Party Transactions

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

	2013	2012
City of Knoxville		
Amounts billed by the Division for utilities and related services	$ 533,974	$ 440,968
Payments by the Division in lieu of property tax	3,027,717	2,980,679
Payments by the Division for services provided	126,801	139,257
Other divisions of KUB		
Amounts billed to other divisions for utilities and related services provided	315,592	1,234,140
Interdivisional rental expense	428,310	464,288
Amounts billed to the Division by other divisions for utilities services provided	298,123	272,278

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

	2013	2012
Accounts receivable	$ 13,949	$ 9,969

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.

The Gas Division 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	$ 22,143,808	$ 22,002,793	$ 8,095,730	$ 1,353,720	$ 1,015,290

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	$ 11,573,837	$ -	$ -	$ -	$ -

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.

Knoxville Utilities Board Gas Division
Required Supplemental Information - Schedule of Funding Progress
June 30, 2013
(Unaudited)

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%

Knoxville Utilities Board Gas Division
Supplemental Information - Schedule of Insurance in Force
June 30, 2013
(Unaudited) Schedule 1

Insurance coverage is for KUB as a consolidated entity.

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.

Knoxville Utilities Board Gas Division
Supplemental Information - Schedule of Debt Maturities by Fiscal Year
June 30, 2013

Schedule 2

Continued on Next Page

	L-2005		N-2007		O-2010		P-2010		
FY	**Principal**	**Interest**	**Principal**	**Interest**	**Principal**	**Interest**	**Principal**	**Interest**	**Rebate***
13-14	$ 645,000	$ 534,903	$	$ 541,706	$ 3,225,000	$ 268,000	$	$ 645,843	$ 216,212
14-15	665,000	505,878		541,706	3,350,000	171,250		645,843	226,045
15-16	695,000	474,290		541,706	3,475,000	104,250		645,843	226,045
16-17	725,000	441,278	550,000	541,706			540,000	645,843	226,045
17-18	760,000	406,840	575,000	514,206			570,000	628,023	219,808
18-19	795,000	372,640	625,000	491,206			595,000	606,363	212,227
19-20	830,000	336,865	650,000	465,425			620,000	581,075	203,376
20-21	865,000	299,515	675,000	437,800			645,000	553,175	193,611
21-22	910,000	260,590	700,000	408,269			670,000	521,731	182,606
22-23	945,000	223,053	750,000	377,469			695,000	488,231	170,881
23-24	980,000	182,890	775,000	343,719			725,000	453,481	158,718
24-25	1,025,000	141,240	825,000	308,844			750,000	413,606	144,762
25-26	1,065,000	96,140	875,000	271,719			785,000	372,358	130,325
26-27	1,120,000	49,280	900,000	231,250			815,000	328,200	114,870
27-28			1,000,000	189,625			845,000	279,300	97,755
28-29			1,000,000	143,375			880,000	228,600	80,010
29-30			1,000,000	97,125			915,000	175,800	61,530
30-31			1,100,000	50,875			950,000	120,900	42,315
31-32							1,000,000	62,000	21,700
32-33									
Total	$ 12,025,000	$ 4,325,402	$ 12,000,000	$ 6,497,731	$ 10,050,000	$ 543,500	$ 12,000,000	$ 8,396,215	$ 2,928,841

*Series P-2010 bonds were issued as federally taxable Build America Bonds. KUB will receive a 35 percent interest rebate payment 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 in effect until September 30, 2013 or intervening Congressional action, at which time the sequestration rate is subject to change. The rebate payments are scheduled to total $3,433,047 over the life of the bonds. The net cost of issuing the bonds is $6,393,919.

Knoxville Utilities Board Gas Division
Supplemental Information - Schedule of Debt Maturities by Fiscal Year
June 30, 2013

Schedule 2

Continued from Previous Page

	Q-2012		R-2012		S-2013		Totals		Grand Total (P + I)	Grand Total (Less Rebate)
FY	**Principal**	**Interest**	**Principal**	**Interest**	**Principal**	**Interest**	**Principal**	**Interest**		
13-14	$ 665,000	$ 847,548	$ 200,000	$ 296,530	$ 50,000	$ 363,396	$ 4,785,000	$ 3,497,926	$ 8,282,926	$ 8,066,714
14-15	685,000	834,248	200,000	292,530	50,000	377,100	4,950,000	3,368,555	8,318,555	8,092,510
15-16	700,000	820,548	200,000	288,530	50,000	375,600	5,120,000	3,250,767	8,370,767	8,144,722
16-17	2,065,000	806,548	400,000	282,530	570,000	374,100	4,850,000	3,092,005	7,942,005	7,715,960
17-18	2,125,000	744,598	425,000	270,530	595,000	351,300	5,050,000	2,915,497	7,965,497	7,745,689
18-19	2,190,000	680,848	425,000	257,780	615,000	327,500	5,245,000	2,736,337	7,981,337	7,769,110
19-20	2,260,000	615,148	450,000	240,781	645,000	302,900	5,455,000	2,542,194	7,997,194	7,793,818
20-21	2,350,000	524,748	475,000	222,781	695,000	277,100	5,705,000	2,315,119	8,020,119	7,826,508
21-22	2,445,000	430,748	475,000	203,781	715,000	249,300	5,915,000	2,074,419	7,989,419	7,806,813
22-23	2,540,000	332,948	500,000	184,781	730,000	227,850	6,160,000	1,834,332	7,994,332	7,823,451
23-24	2,645,000	231,348	525,000	169,781	745,000	205,950	6,395,000	1,587,169	7,982,169	7,823,451
24-25	760,000	125,548	550,000	159,281	790,000	183,600	4,700,000	1,332,119	6,032,119	5,887,357
25-26	780,000	102,748	575,000	142,781	800,000	159,900	4,880,000	1,145,646	6,025,646	5,895,321
26-27	800,000	79,348	575,000	130,560	840,000	135,900	5,050,000	954,538	6,004,538	5,889,668
27-28	830,000	54,348	600,000	117,625	875,000	110,700	4,150,000	751,598	4,901,598	4,803,843
28-29	855,000	27,788	625,000	99,625	905,000	84,450	4,265,000	583,838	4,848,838	4,768,828
29-30			650,000	84,000	940,000	57,300	3,505,000	414,225	3,919,225	3,857,695
30-31			675,000	64,500	970,000	29,100	3,695,000	265,375	3,960,375	3,918,060
31-32			725,000	44,250			1,725,000	106,250	1,831,250	1,809,550
32-33			750,000	22,500			750,000	22,500	772,500	772,500
Total	$ 24,695,000	$ 7,259,058	$ 10,000,000	$ 3,575,457	$ 11,580,000	$ 4,193,046	$ 92,350,000	$ 34,790,409	$ 127,140,409	$ 124,211,568

Knoxville Utilities Board Gas Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2013
(Unaudited)

Schedule 3

Rate Class	Base Charge	Number of Customers
Residential (G-2)	For the regular monthly billing period for the months of November to April, inclusive: Customer charge per month $5.30 First 30 therms per month at 128.78 cents per therm Excess over 30 therms per month at 107.56 cents per therm For the regular monthly billing periods for the months of May to October, inclusive: First 50 therms per month 110.91 cents per therm Excess over 50 therms per month at 99.05 cents per therm	88,912
Commercial (G-4)	Available to any commercial or industrial customer: Customer charge per month $5.30 First 250 therms per month at 116.25 cents per therm Excess over 250 therms per month at 105.38 cents per therm	8,989
Commercial (G-6)	Available to any commercial or industrial customer incurring a demand of 27 therms or more during the current monthly billing period or during any of the eleven net preceding monthly billing periods. The net rate is the sum of the following demand and commodity charges: Customer charge: $105.00 per month Demand charge: $1.70 per therm of demand Commodity charge: First 30,000 therms per month at 79.63 cents per therm Excess over 30,000 therms per month at 71.10 cents per therm	294
Industrial (G-7)	Service under Rate Schedule G-7 shall be available to any customer who meets the following conditions: (a) Customer's annual Interruptible Gas use, on an actual or projected basis, shall not be less than 25,000 dekatherms; (b) Customer shall be permitted to purchase only one (1) dekatherm of Firm Gas under Rate Schedule G-7 for each two (2) dekatherms of Interruptible Gas which are purchased; (c) Customer must have standby equipment of sufficient capacity capable of providing the customer's normal gas service requirements for a period of five (5) working days without replenishment when Interruptible Gas is completely interrupted. Customer shall maintain such equipment ready for operation at any time and shall utilize a fuel other than gas furnished by KUB and shall be subject to periodic inspections by KUB to ensure compliance with this provision; and (d) KUB must determine that its existing distribution system facilities are adequate and available for the requested service.	15

Knoxville Utilities Board Gas Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2013
(Unaudited)

Schedule 3

Rate Class	Base Charge		Number of Customers
	The net rate is the sum of the following demand and commodity charges:		
	Customer charge:	$180.00 per month	
	Demand charge:	$17.00 per month per dekatherm of demand	
	Commodity charge:	(a) Firm Gas - $7.110 per dekatherm (b) Interruptible Gas - (i) First 3,000 dekatherms per month at $5.652 per dekatherm; excess of 3,000 to 20,000 dekatherms per month at $5.165 per dekatherm; plus excess over 20,000 to 50,000 dekatherms per month at $4.589 per dekatherm; excess over 50,000 dekatherms per month at $4.483 per dekatherm (c) Supplemental Gas - The Commodity Charge for Supplemental Gas shall be the total of: (a) the cost per dekatherm to KUB for the applicable Day of acquiring Supplemental Gas on the open market, subject to the approval of the Customer to purchase Supplemental Gas at or above such price and (b) the costs incurred by KUB in transporting such Supplemental Gas via connecting pipelines to one or more of KUB's delivery points.	
	Transportation charge:	$1.599 per dekatherm for the first 3,000 dekatherms of gas Redelivered plus Unauthorized Gas; plus $1.112 per dekatherm for each dekatherm from 3,000 to and including 20,000 dekatherms of gas Redelivered plus Unauthorized Gas; plus $.536 per dekatherm for each dekatherm from 20,000 to and including 50,000 dekatherms of gas Redelivered plus Unauthorized Gas; plus $.430 per dekatherm for the excess over 50,000 dekatherms of gas Redelivered plus Unauthorized Gas.	
	Unauthorized Gas charge:	$15.00 per dekatherm of Unauthorized Gas as a penalty, plus the total of: (a) the cost per dekatherm of obtaining such gas on the open market as determined by the higher of (1) the applicable Gulf Coast Price Index for the applicable Day as published in *Gas Daily* or, if *Gas Daily* is no longer published, in a comparable reliable source for natural gas prices or (2) the applicable first of the month Gulf Coast Price Index as published in *Inside FERC*, or if *Inside FERC* is no longer published, in a comparable reliable source for natural gas prices and (b) the costs incurred by KUB in transporting such Unauthorized Gas via connecting pipelines to one or more of KUB's delivery points.	

Knoxville Utilities Board Gas Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2013
(Unaudited)

Schedule 3

Rate Class	Base Charge	Number of Customers
G-11	Service under Rate Schedule G-11 shall be available to any customer who meets the following conditions: (a) Customer's annual gas usage (excluding Firm Gas), on an actual or projected basis, shall not be less than 25,000 dekatherms; (b) Customer shall be permitted to purchase only one (1) dekatherm of Firm Gas under Rate Schedule G-11 for each two (2) dekatherms of Transport Gas delivered by KUB to the Customer; (c) Customer must have standby equipment of sufficient capacity capable of providing the customer's normal gas service requirements for a period of five (5) working days without replenishment when Transport Gas is completely interrupted. Customer shall maintain such equipment ready for operation at any time and shall utilize a fuel other than gas furnished by KUB and shall be subject to periodic inspections by KUB to ensure compliance with this provision; (d) Customer's use under this rate shall not work a hardship on any other customers of KUB, nor adversely affect any other class of KUB's customers and further provided the Customer's use under this rate shall not adversely affect KUB's gas purchase plans and/or effective utilization of the daily demands under KUB's gas purchase contracts with its suppliers, as solely determined by KUB. (e) KUB must determine that its existing distribution system facilities are adequate and available for the requested service; and (f) Customer must execute a Transportation Service Agreement for interruptible transportation gas service. The net rate is the sum of the following charges: Customer charge: $265.00 Demand charge: $17.00 per dekatherm of demand Firm Gas charge: $7.110 per dekatherm Transportation charge: $1.599 per dekatherm for the first 3,000 dekatherms of non-Firm gas delivered to Customer; plus $1.112 per dekatherm for each dekatherm from 3,000 to and including 20,000 dekatherms of non-Firm gas delivered to Customer; plus $.536 per dekatherm for each dekatherm from 20,000 to and including 50,000 dekatherms of non-Firm gas delivered to Customer; plus $.430 per dekatherm for the excess over 50,000 dekatherms of non-Firm gas delivered to Customer. Standby Gas charge: The charge for Standby Gas shall be the total of: (a) the cost per dekatherm to KUB for the applicable Day of acquiring Standby Gas on the open market, subject to the approval of the Customer to purchase Standby Gas at or above such price and (b) the costs incurred by KUB in transporting such Standby Gas via connecting pipelines to one or more of KUB's delivery points.	11

Rate Class	Base Charge	Number of Customers
	Unauthorized Gas charge: $15.00 per dekatherm of Unauthorized Gas as a penalty, plus the total of: (a) the cost per dekatherm of obtaining such gas on the open market as determined by the higher of (1) the applicable Gulf Coast Price Index for the applicable Day as published in *Gas Daily* or, if *Gas Daily* is no longer published, in a comparable reliable source for natural gas prices or (2) the applicable first of the month Gulf Coast Price Index as published in *Inside FERC*, or if *Inside FERC* is no longer published, in a comparable reliable source for natural gas prices and (b) the costs incurred by KUB in transporting such Unauthorized Gas via connecting pipelines to one or more of KUB's delivery points. Other charges: Imbalance Charges, and any pipeline scheduling, balancing, transportation, or other similar charges incurred by KUB in connection with the transportation of gas on behalf of the Customer, as applicable.	
G-12	Service under Rate Schedule G-12 shall be available to any customer when the following conditions are met: (a) Customer's annual gas usage, on an actual or projected basis, shall not be less than 12,500 dekatherms; (b) KUB must determine that its existing distribution system facilities are adequate and available for the requested service; (c) Customer must execute a Transportation Service Agreement for firm transportation gas service; and (d) Customer's use under this rate shall not work a hardship on any other customers of KUB, nor adversely affect any other class of KUB's customers and further provided the Customer's use under this rate shall not adversely affect KUB's gas purchase plans and/or effective utilization of the daily demands under KUB's gas purchase contracts with its suppliers, as solely determined by KUB. The net rate is the sum of the following charges: Customer charge: $265.00 Demand charge: $5.70 per dekatherm of demand Transportation charge: $1.808 per dekatherm for the first 3,000 dekatherms of gas delivered to Customer; plus $1.292 per dekatherm for each dekatherm from 3,000 to and including 10,000 dekatherms of gas delivered to Customer; plus $1.072 per dekatherm for each dekatherm from 10,000 to an including 20,000 dekatherms of gas delivered to Customer; plus $.717 per dekatherm for the excess over 20,000 dekatherms of gas delivered to Customer.	4

Knoxville Utilities Board Gas Division

Supplemental Information - Schedule of Current Rates in Force

June 30, 2013

(Unaudited)

Schedule 3

Rate Class	Base Charge		Number of Customers
	Standby Gas charge:	The charge for Standby Gas shall be the total of: (a) the cost per dekatherm to KUB for the applicable Day of acquiring Standby Gas on the open market, subject to the approval of the Customer to purchase Standby Gas at or above such price and (b) the costs incurred by KUB in transporting such Standby Gas via connecting pipelines to one or more of KUB's delivery points.	
	Unauthorized Gas charge:	$15.00 per dekatherm of Unauthorized Gas as a penalty, plus the total of: (a) the cost per dekatherm of obtaining such gas on the open market as determined by the higher of (1) the applicable Gulf Coast Price Index for the applicable Day as published in *Gas Daily* or, if *Gas Daily* is no longer published, in a comparable reliable source for natural gas prices or (2) the applicable first of the month Gulf Coast Price Index as published in *Inside FERC*, or if *Inside FERC* is no longer published, in a comparable reliable source for natural gas prices and (b) the costs incurred by KUB in transporting such Unauthorized Gas via connecting pipelines to one or more of KUB's delivery points.	
	Other charges:	Imbalance Charges, and any pipeline scheduling, balancing, transportation, or other similar charges incurred by KUB in connection with the transportation of gas on behalf of the Customer, as applicable.	

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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.

Rodefer Moss & Co, PLLC

Knoxville, Tennessee
October 22, 2013

Knoxville Utilities Board
Water Division
Financial Statements and Supplemental Information
June 30, 2013 and 2012

Knoxville Utilities Board Water Division
Index
June 30, 2013 and 2012

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Independent Auditors' Report

To the Board of Commissioners
Knoxville Utilities Board - Water Division
Knoxville, Tennessee

Report on the Financial Statements

We have audited the accompanying financial statements of the Knoxville Utilities Board, Water Division (the "Division"), 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 financial statements, which collectively comprise the Division's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 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 financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Division's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the Division'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 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 financial statements referred to above present fairly, in all material respects, the respective financial position of the Division 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 3-17 and 36 be presented to supplement the basic financial statements. Such information, although not a part of the basic 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 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 financial statements, and other knowledge we obtained during our audit of the basic 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 financial statements that collectively comprise the Division's basic financial statements. The supplemental schedules on pages 38-44 are presented for the purpose of additional analysis and are not a required part of the basic financial statements. The schedule of expenditures of federal awards on page 37 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 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 financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic 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 financial statements or to the basic 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 financial statements as a whole.

The supplemental schedules have not been subjected to the auditing procedures applied in the audit of the basic 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 the Division'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 the Division's internal control over financial reporting and compliance.

Rodefer Moss & Co, PLLC

Knoxville, Tennessee
October 22, 2013

Knoxville Utilities Board (KUB), comprised of the Electric Division, Water Division, Gas 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. The Water Division (Division) provides services to certain customers in Knox County and in two surrounding counties in East Tennessee. The Division's accounts are maintained in conformity with the Uniform System of Accounts of the National Association of Regulatory Utility Commissioners (NARUC) and the Governmental Accounting Standards Board (GASB), as applicable. The financial statements present only the Water Division and do not purport to, and do not, present fairly the consolidated financial position of Knoxville Utilities Board at June 30, 2013 and 2012, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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

The Division's 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 the Division's financial statements.

Water Division Highlights

System Highlights

KUB serves 78,250 water system customers over a 188 square mile service area. KUB maintains 1,453 miles of service mains, 28 storage facilities, 28 booster pump stations, and 1 treatment plant, which provided 12.1 billion gallons of water to KUB's water customers in fiscal year 2013. The average daily flow for fiscal year 2013 was 33.2 million gallons.

KUB added approximately 250 customers to its water system during the fiscal year.

In 2007 KUB launched Century II, a new infrastructure management program, which includes the assessment of each utility system's infrastructure and the appropriateness of current life cycle replacement programs. For fiscal year 2013, KUB exceeded its target replacement goals for the water system for the replacement of galvanized and cast iron water main while remaining under the total water capital budget.

The second of three water rate increases adopted by the KUB Board of Commissioners in 2011 went into effect January 1, 2013. KUB generated $1.7 million of additional revenue during the fiscal year as a result of the 2012 and 2013 water rate increases.

The historically low level of interest rates prompted KUB to issue $9.3 million in water system revenue refunding bonds in March 2013 to refinance outstanding bonds sold in 2005 at lower rates. This refunding will provide debt service savings of $1.3 million over the life of the bonds.

The typical residential water customer's average monthly bill was $18.45 for the twelve months ending June 30, 2013 (based on monthly use of 500 cubic feet or 3,740 gallons).

Water sales volumes have been impacted by the use of more efficient appliances and the conservation efforts of customers. As a result, water sales volumes have declined at an annual rate of 1 percent over the past decade.

The State of Tennessee required KUB to adopt the American Water Works Association (AWWA) water loss methodology for inclusion in any audited financial statements received by the State Comptroller on or after January 1, 2013 (as reported on Schedule 6 of Supplemental Information).

Century II Infrastructure Program

KUB initially launched Century II for the water distribution system in 2007, beginning a phased-in increase in the level of water main replacement that would occur over the next several years. In early 2009, due to the impact of the economic recession on the community and KUB's customers, KUB temporarily deferred the Century II water program, but maintained its historical level of capital investment in the water system.

In April 2011, management provided an updated assessment of the overall condition of each utility system's infrastructure to the KUB Board, including a recommendation to resume the Century II program for the water system.

The water distribution system is an aging system, with approximately 50 percent of the water system consisting of old pipe, including galvanized, cast iron, and cement-lined water main. Although it represents less than half of the water system, older pipe, particularly galvanized main, accounts for approximately 90 percent of water main breaks. As a result of the aging pipe system, the water system's water loss ratio has increased steadily over the past 20 years to the point where the water system loses approximately 30 percent of the water input into its system from the water plant.

Ten years of Century II water funding will remove all remaining galvanized water main. It will also remove approximately 50 miles of cast iron pipe. At the end of ten years, the composition of the water system will be dramatically different with approximately two-thirds of the system consisting of newer pipe.

In September 2011, the Board adopted a resolution which endorsed the Century II water program and the ten-year funding plan. The resolution also adopted the initial three water rate increases, the first two of which were effective January 1, 2012 and January 1, 2013, respectively. The remaining increase will be effective January 1, 2014. Each of the 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 bill each year.

Financial Highlights

The Division's net position increased $3 million or 2 percent, compared to a $4.7 million increase last fiscal year.

Operating revenue increased $0.6 million or 1.6 percent, the net result of additional revenue from the Century II water rate increases, which were effective January 2012 and 2013, respectively, and a 4.3 percent decrease in water sales volumes.

Operating expenses increased $1 million or 3.2 percent. Operating and maintenance expenses ("O&M") increased $0.2 million or 1.1 percent compared to the prior year. Depreciation expense increased $0.7 million or 11.3 percent. Taxes and tax equivalents were $0.1 million higher than the prior year.

Lower interest rates on longer-term investments resulted in a $0.1 million decrease in interest income. Interest expense was $0.4 million higher than the prior year, the net result of additional interest from a $25 million December 2011 bond issue and expense reductions from March 2013 and April 2012 debt refundings.

Capital contributions decreased $0.8 million, the result of a reduction in contributed assets from developers.

Total plant assets (net) increased $18.1 million or 8.7 percent due to main replacement and treatment plant improvements.

Long-term debt represented 40.3 percent of the Division's capital structure as of June 30, 2013, as compared to 41.6 percent last year. Capital structure equals long-term debt (which includes the current portion of revenue bonds and notes, as applicable, due to be retired the next fiscal year) plus net position.

The Division's bond covenants require a debt service coverage ratio of at least 1.2 times the maximum principal and interest payments over the life of the division's outstanding bonds. Current year debt coverage for the fiscal year was 2.18. Maximum debt service coverage was 2.25.

Division Cash Budget Appropriations

KUB's Board of Commissioners adopted a Water Division budget of $56.3 million for fiscal year 2013. Operating receipts were $0.6 million lower than expected, primarily due to lower than expected sales volumes. At year end, the Division's actual cash expenditures were $0.5 million under budget. O&M expenditures were $0.5 million lower than expected, primarily due to lower labor-related expenses. Capital expenditures were $0.8 million under budget. In total, $13.8 million in bond proceeds were transferred to the general fund for capital expenditures in fiscal year 2013. The amount transferred was $2.5 million greater than anticipated. As a result, the year end general fund balance was $2.2 million higher than expected. The numbers below are presented on a cash basis.

Water Division Cash Report
As of June 30, 2013

(in thousands of dollars)	FY 2013 Budget	FY 2013 Actual FYTD	Dollar Variance*	Percent Variance
Beginning Balance General Fund	$ 19,384	$ 19,384		
Operating Receipts	39,986	39,346	(640)	-1.6%
Disbursements				
Operation & Maintenance Expense	21,970	21,472	498	2.3%
Capital Expenditures	24,003	23,175	828	3.4%
Debt Service & Taxes	10,369	11,194	(825)	-7.9%
Total Disbursements	56,342	55,841	501	0.9%
Bond Proceeds	11,341	13,816	2,475	21.8%
Net Flow-Throughs and Transfers	(993)	(1,082)	(89)	-9.0%
Ending General Fund Balance	$ 13,376	$ 15,623	$ 2,247	16.8%

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

Knoxville Utilities Board Water Division - Financial Statements

The Division's financial performance is reported under three basic 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

The Division 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, water 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 the Division has done with its accumulated earnings, not just the balance.

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 are assets that have been limited to specific uses by the Division's bond covenants or through resolutions passed by the KUB Board of Commissioners.

Unrestricted net position are 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

The Division 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

The Division 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 Division's sources and uses of cash during the reporting period.

The statement indicates the Division's 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.

Condensed Financial Statements

Statement of Net Position

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

Statements of Net Position
As of June 30

(in thousands of dollars)	2013	2012
Current and other assets	$ 35,862	$ 51,812
Capital assets, net	226,022	207,969
Deferred outflows of resources	280	304
Total assets and deferred outflows of resources	262,164	260,085
Current and other liabilities	12,152	9,977
Long-term debt outstanding	98,785	102,075
Deferred inflows of resources	594	393
Total liabilities and deferred inflows of resources	111,531	112,445
Net position		
Net investment in capital assets	123,858	102,645
Restricted	1,027	1,070
Unrestricted	25,748	43,925
Total net position	$ 150,633	$ 147,640

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 Change 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.

Current Year Impacts and Analysis

Current and Other Assets

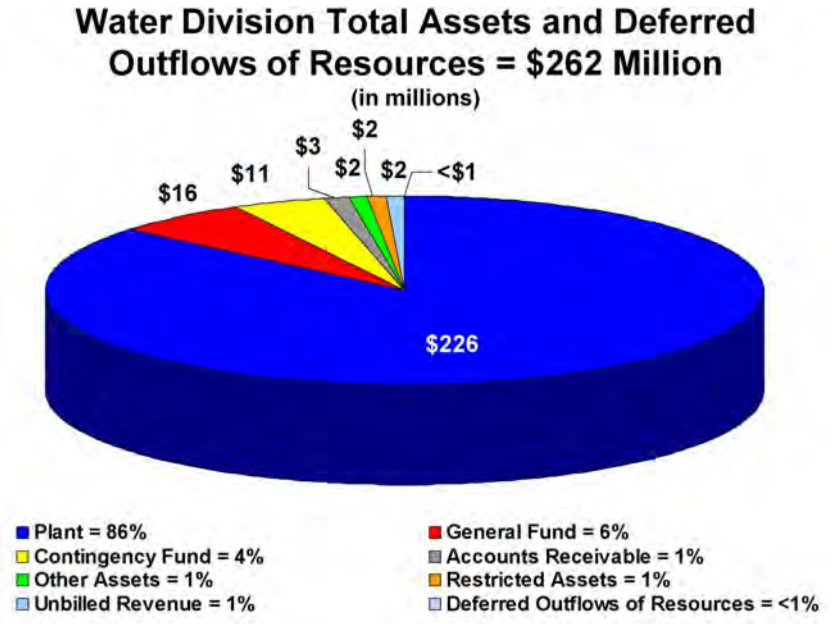
Current and other assets decreased $15.9 million, largely due to the expending of $13.8 million of bond proceeds from a prior year debt issue. The Division's general fund cash (consisting of cash and cash equivalents, short-term investments, and long-term investments) decreased $3.8 million compared to last year, as general fund cash was used to fund a portion of Century II capital projects. The Division contributed $1 million to rainy day cash reserves, which totaled $3.6 million as of June 30, 2013.

Capital Assets

Capital assets, net of depreciation, increased $18.1 million or 8.7 percent. Capital expenditures included $11.5 million for water main replacement, $10.1 million for plant and system improvements, and $0.9 million for the relocation of water system assets in coordination with Tennessee Department of Transportation projects. The Division retired $5.1 million of assets during the fiscal year.

Deferred Outflows of Resources

Deferred outflows of resources were $0.3 million, which was consistent with the prior fiscal year.



Water Division Total Assets and Deferred Outflows of Resources = $262 Million

(in millions)

Current and Other Liabilities

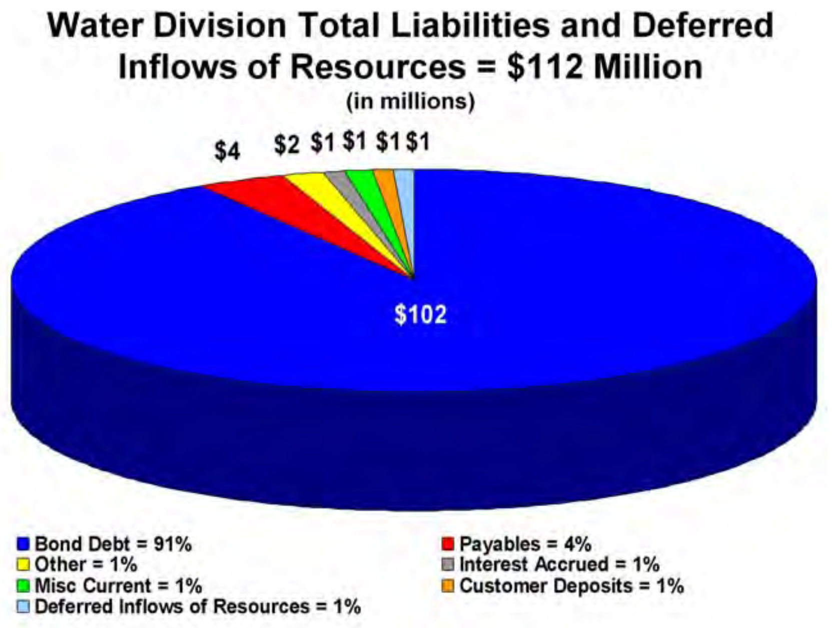
Current and other liabilities increased $2.2 million primarily due to a rise in accounts payable resulting from a higher level of contractor expense in June 2013 compared to June of the prior year.

Long-Term Debt

Long-term debt decreased $3.3 million or 3.2 percent, the combined result of scheduled repayment of outstanding revenue bonds during the fiscal year and a $0.2 million debt reduction due to the refunding of outstanding bonds.

Deferred Inflows of Resources

The Division also incurred $0.3 million of unamortized premium expense as part of the refunding of $9.5 million in outstanding bonds, which is reflected in the $0.2 million increase in deferred inflows compared to the prior year.



Net Position

Net position increased $3 million this fiscal year. Net investment in capital assets rose $21.2 million, as net plant in service increased $18.1 million, while debt and deferred amounts decreased $3.1 million. Unrestricted net position decreased $18.2 million, as unused bond proceeds were used for capital improvements. Restricted assets remained flat.

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Statement of Revenues, Expenses, and Changes in Net Position

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

Statements of Revenues, Expenses, and Changes in Net Position
For the Years Ended June 30

(in thousands of dollars)	2013	2012
Operating revenues	$ 38,063	$ 37,476
Operating expenses		
Treatment	2,954	3,440
Distribution	12,760	11,806
Customer service	1,462	1,402
Administrative and general	4,252	4,542
Depreciation and amortization	6,419	5,768
Taxes and tax equivalents	2,960	2,883
Total operating expenses	30,807	29,841
Operating income	7,256	7,635
Interest income	140	200
Interest expense	(4,364)	(3,948)
Other income/(expense)	(96)	(106)
Change in net position before capital contributions	2,936	3,781
Capital Contributions	57	913
Change in net position	$ 2,993	$ 4,694

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 Change in Net Position presentation.

- Operating revenues are largely determined by the volumes of water sold during the fiscal year. Any change (increase/decrease) in retail water rates would also be a cause of change in operating revenue.

- Operating expenses (treatment, 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 costs, chemicals, and water system maintenance.

- Depreciation expense is impacted by plant additions and retirements during the fiscal year.

- Taxes and tax equivalents are impacted by plant additions/retirements and changes in property tax rates.

- Interest expense is impacted by the level of interest rates and investments.

- Interest expense on debt is impacted by the level of outstanding debt and the interest rates on the outstanding debt.

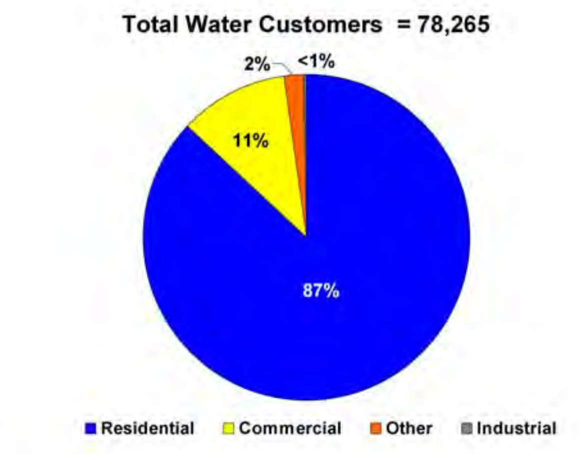
- Other income (net) is impacted by non-operating revenues, netted against miscellaneous operating expenses.

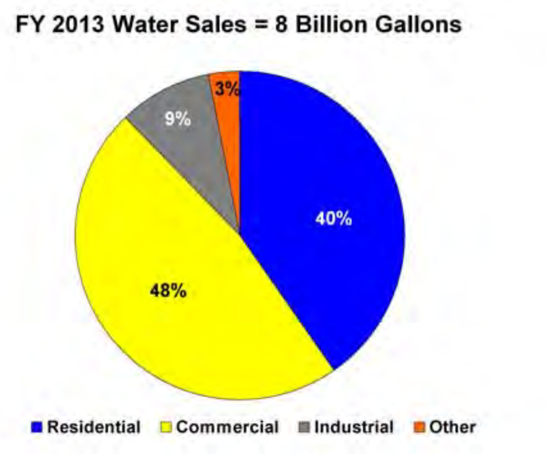
- Capital contributions are impacted by a donation of facilities/infrastructure to KUB by developers and governmental agencies. The contributions are recognized as revenue and recorded as plant in service based on the fair market value of the asset(s).

Current Year Impacts and Analysis

The Division's change in net position was $3 million this fiscal year, which is $1.7 million less than last year's $4.7 million increase. While operating revenues increased $0.6 million, operating expenses rose $1 million, interest expense increased $0.4 million, and capital contributions from developers declined $0.8 million.

Operating revenue increased $0.6 million or 1.6 percent, the result of additional revenue from two five percent rate increases, which were effective on customers' bills in January 2012 and January 2013, respectively. The additional revenue from the rate increases was partially offset by a 4.3 percent reduction in water sales volumes compared to the prior year.





Residential customers represented 87 percent of water customers and accounted for 40 percent of water sales volumes for the year. Commercial and industrial customers accounted for the largest portion (57 percent) of total sales volumes during the year.

KUB's ten largest water customers accounted for 8.1 percent of KUB's billed water volumes. Those ten customers are comprised of ten industrial customers including one governmental customer.

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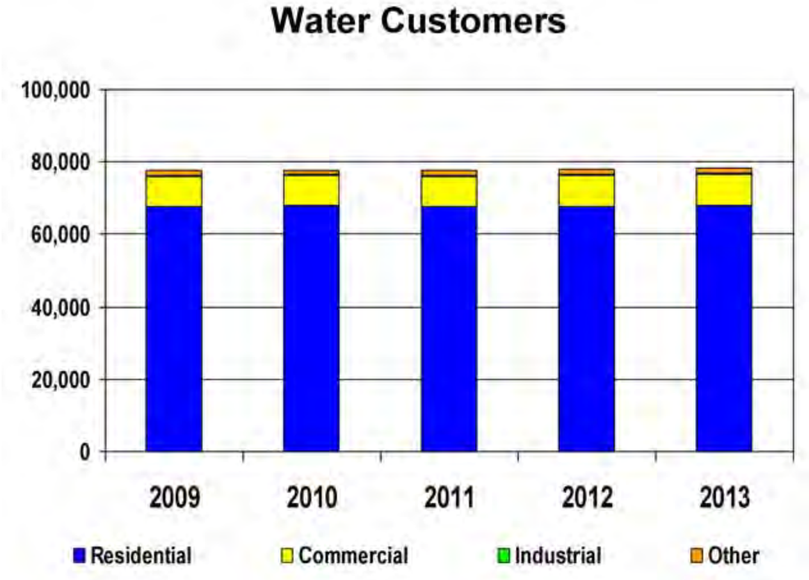
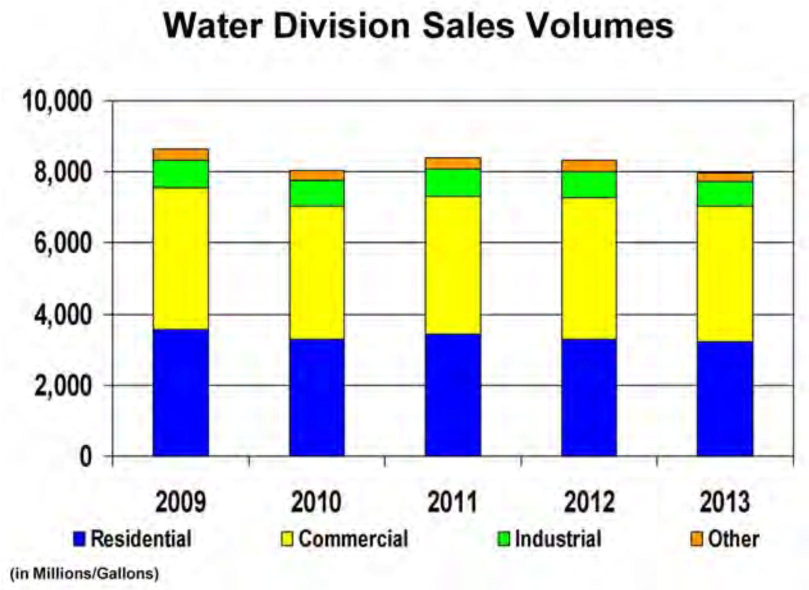


KUB has added 745 water customers over the past five years, representing annual growth of less than 1 percent. Water system growth has slowed in recent years, in large part due to the slowdown of new housing construction.



Fiscal year 2013 water sales volumes were less than the prior fiscal year, due to lower water sales for all rate classes. Sales volumes have remained relatively consistent by customer class over the last five years.

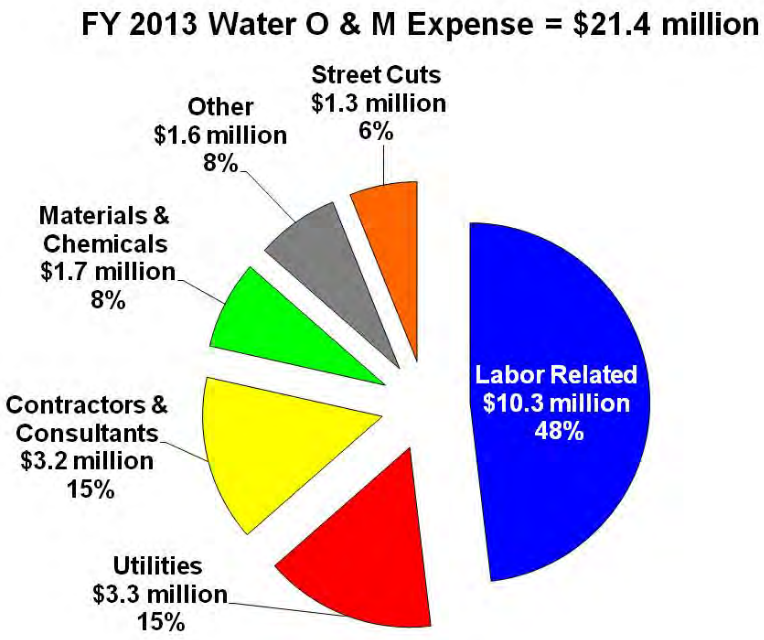
Residential water sales volumes were 2.7 percent lower than the prior fiscal year. Residential sales were lower throughout the majority of the year, but especially in the spring due to higher than normal precipitation levels.

Commercial sales volumes decreased 3.9 percent compared to the prior year. Industrial sales volumes decreased 4.2 percent compared to the prior year.

Operating Expenses

Operating expenses increased $1 million or 3.2 percent. Operating expenses are categorized as the following:

- Treatment expenses decreased $0.5 million or 14.1 percent, reflecting lower labor-related expenses.
- Distribution expenses were $1 million or 8.1 percent higher than the prior fiscal year, partially due to increased costs for street-cuts and utilities.
- Customer service expenses increased $0.1 million, the result of increased meter reading expenses.
- Administrative and general expenses decreased $0.3 million or 6.4 percent, partially due to a $0.2 million decrease in damage claims.



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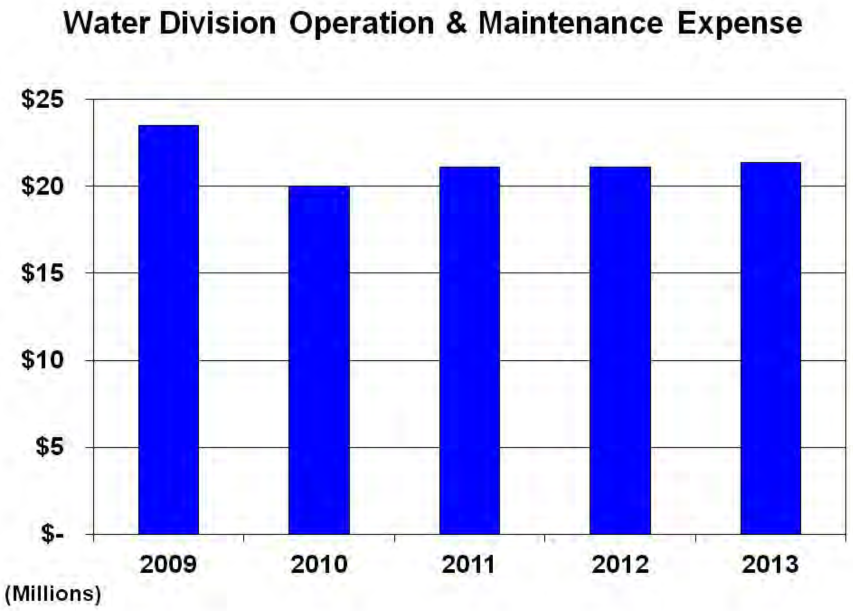
O&M expense for fiscal year 2013 was slightly higher compared with the prior year and below the level of O&M in fiscal year 2009. The decline in fiscal year 2010 O&M reflected a lower shared cost allocation for the Water Division. Since 2010, O&M has grown at an annual rate of 2.2 percent, reflecting a modest increase in water distribution system maintenance expenses.



- Depreciation expense was up $0.7 million reflecting a full year of depreciation on $9.9 million of water system assets added the previous fiscal year and a partial year of depreciation on $21.4 million of assets added the current fiscal year. In addition, $5.1 of assets were retired during fiscal year 2013.

- Taxes and tax equivalents were up $0.1 million or 2.7 percent based on higher net plant values.

Other Income and Expense

Interest income was $0.1 million lower than the prior year due to an overall lower level of cash investments and lower longer-term interest rates.

Interest expense increased $0.4 million, reflecting interest expense on $25 million in water bonds sold during the previous fiscal year.

Other income (net) was consistent with the prior fiscal year.

Capital contributions (KUB records the fair market value of assets contributed to the water system by developers) were $0.8 million lower than fiscal year 2012.

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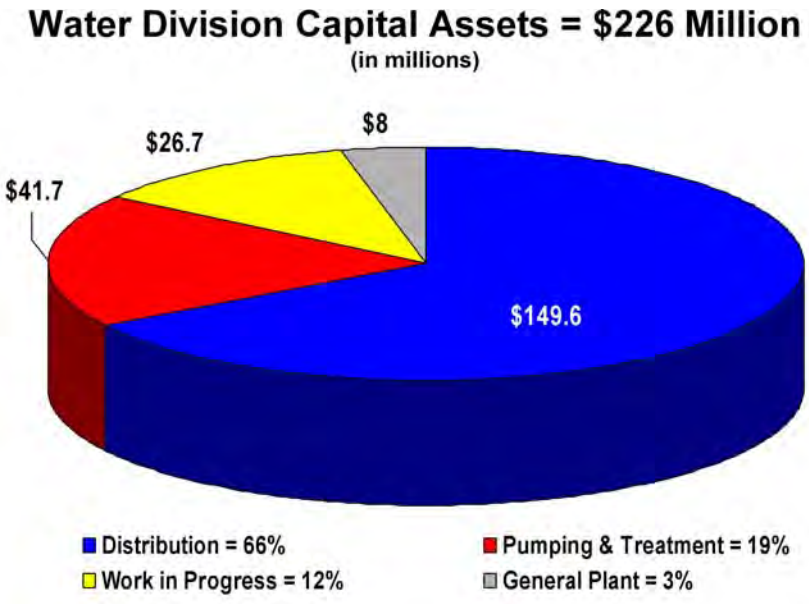
Capital Assets and Debt Administration

Capital Assets

As of June 30, 2013, the Division had $226 million invested in a variety of capital assets, as reflected in the schedule below, which represented a net increase (including additions, retirements, and depreciation) of $18.1 million or 8.7 percent over the end of the last fiscal year.

Capital Assets
As of June 30
(Net of Depreciation)

(in thousands of dollars)	**2013**	**2012**
Production plant	$ 90	$ 103
Pumping & treatment plant	41,719	41,028
Distribution plant:		
Distribution Mains	102,333	92,994
Transmission Mains	19,401	17,942
Services and meters	17,427	16,563
Others	10,483	10,470
Total distribution plant	149,644	137,969
General plant	7,868	7,638
Total plant	199,321	186,738
Work in progress	26,701	21,231
Total net plant	$ 226,022	$ 207,969



Major capital asset expenditures during the year were as follows:

- $11.5 million for galvanized and cast iron water main replacement
- $10.1 million for major plant and system improvements
- $0.9 million for relocation of assets in coordination with the Tennessee Department of Transportation projects

Debt Administration

As of June 30, 2013, the Division had $101.9 million in outstanding debt (including the current portion of revenue bonds), compared to $105.2 million last year, a decrease of $3.3 million or 3.1 percent. The Division's weighted average cost of debt as of June 30, 2013 was 4.02 percent.

This decrease in debt was attributable to the scheduled repayment of bond debt during the fiscal year and the refunding of outstanding bonds.

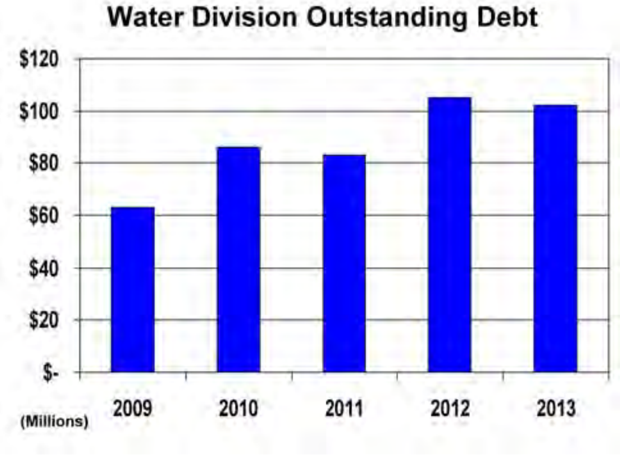
In March 2013, KUB issued $9.3 million in water system revenue refunding bonds, which when combined with a $0.3 million reoffering premium, refunded $9.5 million in outstanding water system bonds and covered the underwriter's discount and costs of issuance. The refunding will save $1.3 million in debt service over the life of the bonds ($0.8 million on a net present value basis).

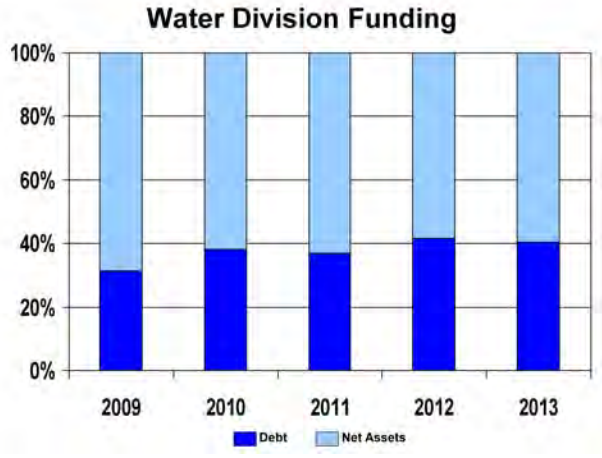
The Division's outstanding debt is rated by Standard & Poor's and Moody's Investors Service. As of June 30, 2013, the Division's revenue bonds were rated AA+ by Standard & Poor's and Aa2 by Moody's Investors Service.

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

Outstanding Debt
As of June 30

(in thousands of dollars)	2013	2012
Revenue bonds	$ 101,850	$ 105,235
Total outstanding debt	$ 101,850	$ 105,235





The Water Division’s level of debt has increased from a low of $62.9 million in fiscal year 2009 to a high of $105.2 million in fiscal year 2012. The increase in debt has been used to fund capital improvements for the water system. As a result, the Division’s debt to capitalization ratio has risen from 31.5 percent in 2009 to 41.6 percent in 2012.

The Division will pay $36.7 million in principal payments over the next ten years, representing 36 percent of the outstanding bonds. KUB’s Debt Management Policy requires a minimum of 30 percent of water debt principal be repaid over the next ten years.

Impacts on Future Financial Position

KUB anticipates adding 230 additional water system customers during fiscal year 2014.

A previously adopted five percent rate increase, to help fund Century II water projects, will be effective January 1, 2014. The rate increase is anticipated to result in additional annual water revenue of $1.7 million.

KUB sold $25 million in water system revenue bonds in September 2013. The proceeds of the bonds will be used to fund water system capital improvements. The bonds, which were sold through a competitive bidding process, will mature over the years 2014 through 2035. The true interest cost of the bonds is 4.276 percent.

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 the Division’s financial position or results of operations during fiscal year 2014.

Financial Contact

The Division’s financial statements are designed to present users (citizens, customers, investors, and creditors) with a general overview of the Division’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 Water Division
Statements of Net Position
June 30, 2013 and 2012

	2013	2012
Assets and Deferred Outflows of Resources		
Current assets:		
Cash and cash equivalents	$ 12,123,240	$ 17,884,010
Short-term investments	3,500,000	1,500,000
Short-term contingency fund investments	4,985,531	3,000,434
Other current assets	74,160	281,732
Accrued interest receivable	6,025	7,307
Accounts receivable, less allowance of uncollectible accounts of $52,800 in 2013 and $57,071 in 2012	4,391,101	4,499,387
Inventories	932,104	890,897
Prepaid expenses	470,667	33,191
Total current assets	26,482,828	28,096,958
Restricted assets:		
Water bond fund	2,374,996	2,434,669
Other funds	6,997	16,830
Unused bond proceeds	-	13,803,726
Total restricted assets	2,381,993	16,255,225
Water plant in service	292,307,539	276,026,709
Less accumulated depreciation	(92,986,123)	(89,289,039)
	199,321,416	186,737,670
Retirement in progress	159,124	257,849
Construction in progress	26,541,345	20,973,112
Net plant in service	226,021,885	207,968,631
Other assets:		
Long-term contingency fund investments	6,003,006	6,993,404
Other	994,669	466,956
Total other assets	6,997,675	7,460,360
Total assets	261,884,381	259,781,174
Deferred outflows of resources:		
Unamortized bond refunding costs	280,012	304,091
Total deferred outflows of resources	280,012	304,091
Total assets and deferred outflows of resources	$ 262,164,393	$ 260,085,265

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

Knoxville Utilities Board Water Division
Statements of Net Position
June 30, 2013 and 2012

	2013	2012
Capitalization and Liabilities		
Current liabilities:		
Current portion of revenue bonds	$ 3,065,000	$ 3,160,000
Sales tax collections payable	224,527	227,526
Accounts payable	3,859,030	1,574,400
Accrued expenses	1,242,853	1,237,230
Customer deposits plus accrued interest	726,433	702,356
Accrued interest on revenue bonds	1,354,745	1,381,236
Total current liabilities	10,472,588	8,282,748
Other liabilities:		
Accrued compensated absences	1,586,092	1,623,913
Other	93,817	70,336
Total other liabilities	1,679,909	1,694,249
Long-term debt:		
Water revenue bonds	98,785,000	102,075,000
Total long-term debt	98,785,000	102,075,000
Total liabilities	110,937,497	112,051,997
Deferred inflows of resources:		
Unamortized costs	593,592	392,866
Total deferred inflows of resources	593,592	392,866
Total liabilities and deferred inflows of resources	111,531,089	112,444,863
Net position		
Net investment in capital assets	123,858,306	102,644,856
Restricted for:		
Debt service	1,020,251	1,053,433
Other	6,997	16,830
Unrestricted	25,747,750	43,925,283
Total net position	150,633,304	147,640,402
Total liabilities, deferred inflows, and net position	$ 262,164,393	$ 260,085,265

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

Knoxville Utilities Board Water Division

Statements of Revenues, Expenses and Changes in Net Position

Years Ended June 30, 2013 and 2012

	2013	2012
Operating revenues	$ 38,063,528	$ 37,475,750
Operating expenses		
Treatment	2,954,150	3,439,473
Distribution	12,760,266	11,805,687
Customer service	1,461,949	1,402,123
Administrative and general	4,251,375	4,542,353
Provision for depreciation and amortization	6,419,430	5,768,349
Taxes and tax equivalents	2,959,900	2,882,492
Total operating expenses	30,807,070	29,840,477
Operating income	7,256,458	7,635,273
Non-operating revenues (expenses)		
Contributions in aid of construction	703,844	470,062
Interest and dividend income	139,775	200,362
Interest expense	(4,363,951)	(3,947,812)
Write-down of plant for costs recovered through contributions	(703,844)	(470,062)
Other	(96,232)	(106,608)
Total non-operating revenues (expenses)	(4,320,408)	(3,854,058)
Change in net position before capital contributions	2,936,050	3,781,215
Capital contributions	56,852	913,066
Change in net position	2,992,902	4,694,281
Net position, beginning of year	147,640,402	142,946,121
Net position, end of year	$ 150,633,304	$ 147,640,402

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

Knoxville Utilities Board Water Division
Statements of Cash Flows
Years Ended June 30, 2013 and 2012

		2013		2012
Cash flows from operating activities:				
Cash receipts from customers	$	37,676,306	$	36,742,833
Cash receipts from other operations		1,169,939		1,408,234
Cash payments to suppliers of goods or services		(12,115,361)		(12,620,580)
Cash payments to employees for services		(8,831,362)		(9,398,310)
Payment in lieu of taxes		(2,335,619)		(2,220,441)
Net cash provided by operating activities		15,563,903		13,911,736
Cash flows from capital and related financing activities:				
Net proceeds from bond issuance		-		24,978,728
Principal paid on revenue bonds and notes payable		(3,160,000)		(2,440,000)
Decrease (increase) in unused bond proceeds		13,803,726		(13,803,518)
Interest paid on revenue bonds and notes payable		(4,390,442)		(3,734,043)
Acquisition and construction of water plant		(25,618,359)		(15,543,797)
Changes in water bond fund, restricted		59,673		(453,791)
Customer advances for construction		-		(1,890)
Proceeds received on disposal of plant		24,171		7,653
Cash received from developers and individuals for capital purposes		703,844		470,062
Net cash used in capital and related financing activities		(18,577,387)		(10,520,596)
Cash flows from investing activities:				
Purchase of investment securities		(3,063,869)		(1,578,061)
Maturities of investment securities		69,170		100,434
Interest received		141,057		200,362
Other property and investments		106,356		(33,221)
Net cash used in investing activities		(2,747,286)		(1,310,486)
Net (decrease) increase in cash and cash equivalents		(5,760,770)		2,080,654
Cash and cash equivalents, beginning of year		17,884,010		15,803,356
Cash and cash equivalents, end of year	$	12,123,240	$	17,884,010
Reconciliation of operating income to net cash provided by operating activities				
Operating income	$	7,256,458	$	7,635,273
Adjustments to reconcile operating income to net cash provided by operating activities:				
Depreciation and amortization expenses		6,691,156		6,063,201
Changes in operating assets and liabilities:				
Accounts receivable		108,286		(19,727)
Inventories		(41,207)		124,902
Prepaid expenses		(437,475)		4,545
Other assets		(310,305)		217,654
Sales tax collections payable		(2,999)		10,883
Accounts payable and accrued expenses		2,252,431		(224,373)
Customer deposits plus accrued interest		24,077		45,553
Other liabilities		23,481		53,825
Net cash provided by operating activities	$	15,563,903	$	13,911,736
Noncash capital activities:				
Acquisition of plant assets through developer contributions	$	56,852	$	913,066

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

1. Description of Business

Knoxville Utilities Board (KUB), comprised of the Electric Division, Water Division, Gas 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. The Water Division (Division) provides services to certain customers in Knox County and in two surrounding counties in East Tennessee. The Division's accounts are maintained in conformity with the Uniform System of Accounts of the National Association of Regulatory Utility Commissioners (NARUC) and the Governmental Accounting Standards Board (GASB), as applicable. The financial statements present only the Water Division and do not purport to, and do not, present fairly the consolidated financial position of Knoxville Utilities Board at June 30, 2013 and 2012, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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 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 to the Division is determined by measurement focus. The transactions of the Division 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.

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.

Water Plant

Water plant and other property are stated on the basis of original cost. The cost of current repairs and minor replacements is charged to operating expense. The cost of renewals and improvements is 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 water plant 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 NARUC, the caption "Provision for depreciation" in the statements of revenues, expenses and changes in net position does not include depreciation for transportation equipment of $271,726 in fiscal year 2013 and $294,852 in fiscal year 2012. Interest costs are expensed as incurred.

Operating Revenue

Operating revenue consists primarily of charges for services provided by the principal operations of the KUB Water Division. 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 $122,196 in fiscal year 2013 and $98,393 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 net assets available, it is KUB's policy to apply those expenses to restricted net assets to the extent such are available and then to unrestricted net 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

The Division'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). The Division'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 carrier. Additionally, KUB provides certain lifetime health benefits to eligible retired employees under a self-insurance plan administered by a third party.

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.

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.

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 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.

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 a 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:

	Carrying Value	Bank Balance
Deposits		
Deposits in financial institutions	$ 12,130,057	$ 12,573,871
Investments		
Certificates of Deposits	11,504,135	11,504,135
State Treasurer's Investment Pool	943,031	943,031
Agency Bonds	4,370,106	4,370,106
	$ 28,947,329	$ 29,391,143

Classification of deposits and investments:

Depository Account	**Bank Balance**
Insured	$ 236,988
Collateralized:	
Collateral held by pledging bank's trust department in KUB's name	4,370,106
Collateral held by pledging bank's trust department not in KUB's name*	24,784,049
Total deposits and investments	$ 29,391,143

* - Deposits 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. KUB deposits with First Tennessee Bank are collateralized at 115 percent of their total value.

Classification of deposits and investments per statement of net position:

		2013		2012
Current assets				
Cash and cash equivalents	$	12,123,240	$	17,884,010
Short-term investments		3,500,000		1,500,000
Short-term contingency fund investments		4,985,531		3,000,434
Other assets				
Long-term contingency fund investments		5,956,565		6,968,350
Restricted assets				
Unused bond proceeds		-		13,789,178
Water bond fund		2,374,996		2,434,669
Other funds		6,997		16,830
	$	28,947,329	$	45,593,471

The above amounts do not include accrued interest of $46,441 in fiscal year 2013 and $39,602 in fiscal year 2012.

KUB follows the provisions of Statement No. 40 (Statement 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.

	Deposit and Investment Maturities (in Years)					
		Fair Value		Less Than 1		1-5
Supersweep NOW and Other Deposits	$	12,573,871	$	12,573,871	$	-
State Treasurer's Investment Pool		943,031		943,031		-
Agency Bonds		4,370,106		1,460,972		2,909,134
Certificates of deposits		11,504,135		8,459,451		3,044,684
	$	29,391,143	$	23,437,325	$	5,953,818

Interest Rate Risk. KUB’s primary investment objectives 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 limiting investments to those types described above and limiting maturity horizons. 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.

4. Accounts Receivable

Accounts receivable consists of the following:

	2013	2012
Wholesale and retail customers		
Billed services	$ 2,734,309	$ 2,711,003
Unbilled services	1,528,922	1,604,591
Other	180,670	240,864
Allowance for uncollectible accounts	(52,800)	(57,071)
	$ 4,391,101	$ 4,499,387

5. Accounts Payable and Accruals

Accounts payable and accruals were composed of the following:

	2013	2012
Trade accounts	$ 3,859,030	$ 1,574,400
Salaries and wages	207,229	186,559
Self-insurance liabilities	225,417	237,628
Other current liabilities	810,207	813,043
	$ 5,101,883	$ 2,811,630

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
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	$ 105,235,000	$ 9,285,000	$ 12,670,000	$ 101,850,000	$ 3,065,000

Other liabilities consist of the following:

	Balance June 30, 2012	Increase	Decrease	Balance June 30, 2013	Amounts Due Within One Year
Accrued compensated absences	$ 1,623,913	$ 2,201,103	$ (2,238,924)	$ 1,586,092	$ 400,000
Other	70,336	251,538	(228,057)	93,817	40,000
	$ 1,694,249	$ 2,452,641	$ (2,466,981)	$ 1,679,909	$ 440,000

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

Fiscal Year	Total Principal	Total Interest	Grand Total
2014	$ 3,065,000	$ 4,086,917	$ 7,151,917
2015	3,190,000	3,985,684	7,175,684
2016	3,265,000	3,863,565	7,128,565
2017	3,435,000	3,726,865	7,161,865
2018	3,595,000	3,565,715	7,160,715
2019 - 2023	20,165,000	15,484,163	35,649,163
2024 - 2028	24,355,000	11,299,494	35,654,494
2029 - 2033	26,780,000	6,202,589	32,982,589
2034 - 2038	10,000,000	2,000,000	12,000,000
2039 - 2040	4,000,000	240,000	4,240,000
Total	$ 101,850,000	$ 54,454,992	$ 156,304,992

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

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. 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 water system 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.

7. Lease Commitments

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

2014	$	9,183
2015		7,404
2016		2,671
2017		278
Total operating minimum lease payments	$	19,536

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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
Production Plant	$ 727,863	$ -	$ -	$ 727,863
Pumping & Treatment Plant	62,087,764	4,648,014	(2,361,315)	64,374,463
Distribution Plant				
Distribution Mains	119,604,367	11,198,306	(1,054,235)	129,748,438
Transmission Mains	25,546,081	1,851,803	(602,471)	26,795,413
Services & Meters	27,213,088	1,624,662	(192,794)	28,644,956
Other Accounts	20,445,256	535,267	(122,763)	20,857,760
Total Distribution Plant	$ 192,808,792	$ 15,210,038	$ (1,972,263)	$ 206,046,567
Total General Plant	20,402,290	1,507,541	(751,185)	21,158,646
Total Water Plant	$ 276,026,709	$ 21,365,593	$ (5,084,763)	$ 292,307,539
Less Accumulated Depreciation	(89,289,039)	(7,317,326)	3,620,242	(92,986,123)
Net Plant Assets	$ 186,737,670	$ 14,048,267	$ (1,464,521)	$ 199,321,416
Work In Progress	21,230,961	24,746,939	(19,277,431)	26,700,469
Total Net Plant	$ 207,968,631	$ 38,795,206	$ (20,741,952)	$ 226,021,885

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.

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 $225,417 resulting from the following changes:

	2013	2012
Balance, beginning of year	$ 237,628	$ 282,785
Current year claims and changes in estimates	1,598,466	1,632,866
Claims payments	(1,610,677)	(1,678,023)
Balance, end of year	$ 225,417	$ 237,628

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 Division 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 Division Plan A active employees, vested terminated employees, retirees, and beneficiaries. Plan A is a closed plan.

All employees participating in the City Division 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 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 Division Plan B active employees, vested terminated employees, retirees, and beneficiaries. Plan B is a closed plan.

All employees participating in the City Division 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 Water Division's portion of this contribution is $715,348. 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. Of these amounts, $715,348 and $467,127 are attributable to the Water Division.

Subsequent to June 30, 2013, the actuarial valuation for the Plan year ending December 31, 2013 was completed. Based on this actuarial valuation, a contribution of $6,314,399 is recommended for the fiscal year ending June 30, 2015 based on KUB's current plan funding policy. The Water Division's portion of this recommended contribution is $820,872. 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 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. Based on the 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.

Total contributions to the OPEB Trust for the fiscal year ended June 30, 2013 were $4.4 million (Division's share $0.6 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 (Division's share $0.4 million). As of June 30, 2013, the employer's net OPEB obligation was $0.6 million (Division's share $ 0.1 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 (Division's share $0.4 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 (Division's share $8.2 million). The actuarial value of the Plan's assets was $38.6 million (Division's share $5.1 million). As a result, the Plan's unfunded actuarial accrued liability was $24.8 million (Division's share $3.2 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 (Division's share $0.5 million). See Required Supplementary Information for OPEB Schedule of Funding Progress.

13. Related Party Transactions

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

	2013	2012
City of Knoxville		
Amounts billed by the Division for utilities and related services	$ 3,447,230	$ 3,360,826
Payments by the Division in lieu of property tax	2,335,619	2,220,441
Payments by the Division for services provided	343,159	475,644
Other divisions of KUB		
Amounts billed to other divisions for utilities and related services provided	327,946	300,591
Interdivisional rental expense	147,724	155,703
Interdivisional rental income	101,944	83,714
Amounts billed to the Division by other divisions for utilities services provided	2,997,490	2,988,475

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

	2013	2012
Accounts receivable	$ 291,817	$ 275,310

14. Unaccounted for Water Schedule

As required by Tennessee Code Annotated, KUB is required to include a Supplemental Schedule in the annual audited financial statements for the Schedule of Unaccounted for Water. For reports submitted January 1, 2013 and later, the American Water Works Association (AWWA) water loss reporting model must be used. For fiscal year 2013, water utilities are required to have a Validity Score greater than 65 and maintain non-revenue water as a percent by cost of operating system of less than 30%. For fiscal year 2013, KUB reported a Validity Score of 88 and non-revenue water as a percent by cost of operating system of 10.4%. See Supplemental Information Schedule 6 for the AWWA Reporting Worksheet.

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.

Knoxville Utilities Board Water Division
Required Supplementary Information – Schedule of Funding Progress
June 30, 2013
(Unaudited)

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%

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

Schedule 1

KUB was 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.

Program Name	Federal/State Agency	CFDA Number	Contract Number	Beginning Receivable	Cash Receipts	Expenditures	Adjustments	Ending Receivable
U.S. Department of Homeland Security	Tennessee Emergency Management	97.036	34101-0000009205	$ 32,701	$ -	$ -	$ (24,526)	$ 8,175
U.S. Department of Homeland Security	Tennessee Emergency Management	97.036	34101-0000009832	$ 833	$ -	$ -	$ -	$ 833
		Total Program 97.036		$ 33,534	$ -	$ -	$ (24,526)	$ 9,008
		Total Federal Awards		$ 33,534	$ -	$ -	$ (24,526)	$ 9,008

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.

Knoxville Utilities Board Water Division
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:

CFDA Number	Name of Federal Program
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? ___Yes ✓___ No

Findings – Financial Statements Audit

None

Findings and Questioned Costs – Major Federal Award Programs Audit

None

Knoxville Utilities Board Water Division

Supplemental Information - Schedule of Insurance in Force

June 30, 2013

(Unaudited) Schedule 3

Insurance coverage is for KUB as a consolidated entity.

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.

Knoxville Utilities Board Water Division
Supplemental Information - Schedule of Debt Maturities by Fiscal Year
June 30, 2013

Schedule 4

Continued on Next Page

	R-2005		S-2005		T-2007		U-2009			W-2011
FY	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest
13-14	$ 235,000	$ 17,469	$ 415,000	$ 323,121	$ 650,000	$ 1,129,644	$ 750,000	$ 1,011,125	$ 550,000	$ 910,250
14-15	255,000	9,244	425,000	306,521	675,000	1,103,644	800,000	988,625	550,000	893,750
15-16			440,000	289,521	700,000	1,066,519	825,000	964,625	550,000	882,750
16-17			465,000	267,521	750,000	1,028,019	875,000	931,625	550,000	871,750
17-18			485,000	244,271	800,000	986,769	925,000	896,625	550,000	844,250
18-19			500,000	224,871	825,000	942,769	950,000	859,625	550,000	827,750
19-20			520,000	204,871	875,000	909,769	1,000,000	821,625	550,000	805,750
20-21			545,000	183,421	900,000	874,769	1,050,000	781,625	550,000	789,250
21-22			570,000	160,940	950,000	837,644	1,125,000	739,625	550,000	772,750
22-23			590,000	137,428	1,000,000	798,456	1,175,000	694,625	500,000	756,250
23-24			615,000	112,353	1,050,000	755,956	1,225,000	647,625	500,000	741,250
24-25			640,000	86,215	1,100,000	711,331	1,300,000	598,625	500,000	726,250
25-26			665,000	58,695	1,150,000	664,031	1,350,000	546,625	500,000	710,625
26-27			700,000	30,100	1,200,000	610,844	1,425,000	492,625	500,000	693,125
27-28					1,225,000	555,344	1,500,000	435,625	500,000	673,125
28-29					1,250,000	501,750	1,575,000	375,625	500,000	655,625
29-30					1,300,000	445,500	1,650,000	308,688	500,000	635,625
30-31					2,750,000	387,000	1,750,000	238,563	500,000	617,500
31-32					2,850,000	263,250	1,825,000	164,188	500,000	598,750
32-33					3,000,000	135,000	1,925,000	86,625	500,000	580,000
33-34									2,000,000	560,000
34-35									2,000,000	480,000
35-36									2,000,000	400,000
36-37									2,000,000	320,000
37-38									2,000,000	240,000
38-39									2,000,000	160,000
39-40									2,000,000	80,000
	$ 490,000	$ 26,713	$ 7,575,000	$ 2,629,849	$ 25,000,000	$ 14,708,008	$ 25,000,000	$ 12,584,564	$ 24,450,000	$ 17,226,375

Knoxville Utilities Board Water Division
Supplemental Information - Schedule of Debt Maturities by Fiscal Year
June 30, 2013

Schedule 4

Continued from Previous Page

	X-2012		Y-2013		TOTAL		Grand
FY	Principal	Interest	Principal	Interest	Principal	Interest	Total
13-14	$ 440,000	$ 415,000	$ 25,000	$ 280,308	$ 3,065,000	$ 4,086,917	$ 7,151,917
14-15	460,000	393,000	25,000	290,900	3,190,000	3,985,684	7,175,684
15-16	485,000	370,000	265,000	290,150	3,265,000	3,863,565	7,128,565
16-17	515,000	345,750	280,000	282,200	3,435,000	3,726,865	7,161,865
17-18	535,000	320,000	300,000	273,800	3,595,000	3,565,715	7,160,715
18-19	565,000	293,250	320,000	261,800	3,710,000	3,410,065	7,120,065
19-20	590,000	265,000	340,000	249,000	3,875,000	3,256,015	7,131,015
20-21	625,000	235,500	350,000	235,400	4,020,000	3,099,965	7,119,965
21-22	655,000	204,250	375,000	221,400	4,225,000	2,936,609	7,161,609
22-23	670,000	184,600	400,000	210,150	4,335,000	2,781,509	7,116,509
23-24	690,000	164,500	415,000	198,150	4,495,000	2,619,834	7,114,834
24-25	710,000	143,800	435,000	185,700	4,685,000	2,451,921	7,136,921
25-26	735,000	120,725	450,000	172,650	4,850,000	2,273,351	7,123,351
26-27	765,000	95,000	470,000	159,150	5,060,000	2,080,844	7,140,844
27-28	790,000	64,400	1,250,000	145,050	5,265,000	1,873,544	7,138,544
28-29	820,000	32,800	1,300,000	107,550	5,445,000	1,673,350	7,118,350
29-30			2,285,000	68,550	5,735,000	1,458,363	7,193,363
30-31					5,000,000	1,243,063	6,243,063
31-32					5,175,000	1,026,188	6,201,188
32-33					5,425,000	801,625	6,226,625
33-34					2,000,000	560,000	2,560,000
34-35					2,000,000	480,000	2,480,000
35-36					2,000,000	400,000	2,400,000
36-37					2,000,000	320,000	2,320,000
37-38					2,000,000	240,000	2,240,000
38-39					2,000,000	160,000	2,160,000
39-40					2,000,000	80,000	2,080,000
	$ 10,050,000	$ 3,647,575	$ 9,285,000	$ 3,631,908	$ 101,850,000	$ 54,454,992	$ 156,304,992

Knoxville Utilities Board Water Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2013
(Unaudited)
Schedule 5

Rate Class	Base Charge	Number of Customers
Residential Inside City rate	For water furnished to premises entirely within the corporate limits of the City of Knoxville:	55,708

Commodity Charge

First	0 to 2	100 Cubic Feet Per Month at $0.25 Per 100 Cubic Feet
Over	2	100 Cubic Feet Per Month at $2.65 Per 100 Cubic Feet

Additional Monthly Customer Charge

For	5/8" meter	$ 10.00
For	1" meter	24.10
For	1 1/2" meter	36.00
For	2" meter	52.00

Rate Class	Base Charge	Number of Customers
Residential Outside City rate	For water furnished to premises upon which any water faucet or other outlet is outside the corporate limits of the City of Knoxville:	13,220

Commodity Charge

First	0 to 2	100 Cubic Feet Per Month at $0.30 Per 100 Cubic Feet
Over	2	100 Cubic Feet Per Month at $3.20 Per 100 Cubic Feet

Additional Monthly Customer Charge

For	5/8" meter	$ 11.40
For	1" meter	28.40
For	1 1/2" meter	42.40
For	2" meter	61.40

Knoxville Utilities Board Water Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2013
(Unaudited)
Schedule 5

Rate Class	Base Charge	Number of Customers
Non-Residential Inside City rate/ Industrial Park rate	For water furnished to premises entirely within the corporate limits of the City of Knoxville or within the boundaries of an area recognized as an industrial park by the Tennessee Department of Economic and Community Development:	8,399

Commodity Charge

First	2	100 Cubic Feet Per Month at $0.80 Per 100 Cubic Feet
Next	8	100 Cubic Feet Per Month at $2.75 Per 100 Cubic Feet
Next	90	100 Cubic Feet Per Month at $3.30 Per 100 Cubic Feet
Next	300	100 Cubic Feet Per Month at $2.35 Per 100 Cubic Feet
Next	4,600	100 Cubic Feet Per Month at $1.65 Per 100 Cubic Feet
Next	5,000	100 Cubic Feet Per Month at $1.00 Per 100 Cubic Feet

Additional Monthly Customer Charge

For	5/8" meter	$ 10.00
For	1" meter	24.10
For	1 1/2" meter	36.00
For	2" meter	52.00
For	3" meter	105.00
For	4" meter	173.00
For	6" meter	379.00
For	8" meter	667.00
For	10" meter	1,015.00
For	12" meter	1,503.00

Rate Class	Base Charge	Number of Customers
Non-Residential Outside City rate	For water furnished to premises upon which any water faucet or other outlet is outside the corporate limits of the City of Knoxville, excluding premises within the boundaries of an area recognized as an industrial park by the Tennessee Department of Economic and Community Development:	638

Commodity Charge

First	2	100 Cubic Feet Per Month at $0.95 Per 100 Cubic Feet
Next	8	100 Cubic Feet Per Month at $3.25 Per 100 Cubic Feet
Next	90	100 Cubic Feet Per Month at $3.95 Per 100 Cubic Feet
Next	300	100 Cubic Feet Per Month at $2.85 Per 100 Cubic Feet
Next	4,600	100 Cubic Feet Per Month at $2.00 Per 100 Cubic Feet
Next	5,000	100 Cubic Feet Per Month at $1.20 Per 100 Cubic Feet

Additional Monthly Customer Charge

For	5/8" meter	$ 11.40
For	1" meter	28.40
For	1 1/2" meter	42.40
For	2" meter	61.40
For	3" meter	125.00
For	4" meter	209.00
For	6" meter	455.00
For	8" meter	800.00
For	10" meter	1,218.00
For	12" meter	1,805.00

Knoxville Utilities Board Water Division
Supplemental Information - Schedule of Unaccounted for Water
June 30, 2013
(Unaudited)
Schedule 6

AWWA WLCC Free Water Audit Software: Reporting Worksheet

Water Audit Report for: Knoxville Utilities Board
Reporting Year: FY13 | 7/2012 - 6/2013

Please enter data in the white cells below. Where available, metered values should be used; if metered values are unavailable please estimate a value. Indicate your confidence in the accuracy of the input data by grading each component (1-10) using the drop-down list to the left of the input cell. Hover the mouse over the cell to obtain a description of the grades

All volumes to be entered as: MILLION GALLONS (US) PER YEAR

WATER SUPPLIED << Enter grading in column 'E'

Volume from own sources:	10	12,110.030	Million gallons (US)/yr (MG/Yr)
Master meter error adjustment (enter positive value):	5	96.880	over-registered MG/Yr
Water imported:	n/a	0.000	MG/Yr
Water exported:	10	245.486	MG/Yr
WATER SUPPLIED:		11,767.664	MG/Yr

AUTHORIZED CONSUMPTION

Click here: for help using option buttons below

				Pcnt:		Value:
Billed metered:	10	7,739.270	MG/Yr			
Billed unmetered:	10	43.555	MG/Yr			
Unbilled metered:	10	163.060	MG/Yr			
Unbilled unmetered:		147.096	MG/Yr	1.25%	● ○	

Default option selected for Unbilled unmetered - a grading of 5 is applied but not displayed

AUTHORIZED CONSUMPTION:	8,092.981	MG/Yr

Use buttons to select percentage of water supplied **OR** value

WATER LOSSES (Water Supplied - Authorized Consumption)	3,674.683	MG/Yr

Apparent Losses

				Pcnt:		Value:
Unauthorized consumption:		29.419	MG/Yr	0.25%	● ○	

Default option selected for unauthorized consumption - a grading of 5 is applied but not displayed

Customer metering inaccuracies:	6	101.651	MG/Yr	1.27%	● ○	
Systematic data handling errors:	7	23.535	MG/Yr			
Apparent Losses:		154.605				

Choose this option to enter a percentage of billed metered consumption. This is NOT a default value

Real Losses (Current Annual Real Losses or CARL)

Real Losses = Water Losses - Apparent Losses:	3,520.078	MG/Yr
WATER LOSSES:	3,674.683	MG/Yr

NON-REVENUE WATER

NON-REVENUE WATER:	3,984.839	MG/Yr

= Total Water Loss + Unbilled Metered + Unbilled Unmetered

SYSTEM DATA

Length of mains:	10	1,452.6	miles
Number of active AND inactive service connections:	10	91,655	
Connection density:		63	conn./mile main
Average length of customer service line:	10	0.0	ft (pipe length between curbstop and customer meter or property boundary)
Average operating pressure:	10	79.0	psi

COST DATA

Total annual cost of operating water system:	10	$28,844,420	$/Year
Customer retail unit cost (applied to Apparent Losses):	8	$8.36	$/100 cubic feet (ccf)
Variable production cost (applied to Real Losses):	10	$332.12	$/Million gallons

PERFORMANCE INDICATORS

Financial Indicators

Non-revenue water as percent by volume of Water Supplied:	33.9%
Non-revenue water as percent by cost of operating system:	10.4%
Annual cost of Apparent Losses:	$1,727,815
Annual cost of Real Losses:	$1,169,088

Operational Efficiency Indicators

Apparent Losses per service connection per day:	4.62	gallons/connection/day
Real Losses per service connection per day*:	105.22	gallons/connection/day
Real Losses per length of main per day*:	N/A	
Real Losses per service connection per day per psi pressure:	1.33	gallons/connection/day/psi
Unavoidable Annual Real Losses (UARL):	623.03	million gallons/year
From Above, Real Losses = Current Annual Real Losses (CARL):	3,520.08	million gallons/year
Infrastructure Leakage Index (ILI) [CARL/UARL]:	5.65	

* only the most applicable of these two indicators will be calculated

WATER AUDIT DATA VALIDITY SCORE:

***** YOUR SCORE IS: 88 out of 100 *****

A weighted scale for the components of consumption and water loss is included in the calculation of the Water Audit Data Validity Score

PRIORITY AREAS FOR ATTENTION:

Based on the information provided, audit accuracy can be improved by addressing the following components:

1: Master meter error adjustment
2: Customer metering inaccuracies
3: Unauthorized consumption

• Certified Public Accountants
• Business Advisors

p: 865.583.0091
f: 865.583.0560
w: rodefermoss.com
608 Mabry Hood Road
Knoxville, TN 37932

RM
RODEFER MOSS & CO, PLLC

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.

Rodefer Moss & Co, PLLC

Knoxville, Tennessee
October 22, 2013

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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.

Rodefer Moss & Co, PLLC

Knoxville, Tennessee
October 22, 2013

Knoxville Utilities Board Wastewater Division

Financial Statements and Supplemental Information

June 30, 2013 and 2012

Knoxville Utilities Board Wastewater Division
Index
June 30, 2013 and 2012

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Independent Auditors' Report

To the Board of Commissioners
Knoxville Utilities Board - Wastewater Division
Knoxville, Tennessee

Report on the Financial Statements

We have audited the accompanying financial statements of the Knoxville Utilities Board, Wastewater Division (the "Division"), 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 financial statements, which collectively comprise the Division's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 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 financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Division's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the Division'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 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 financial statements referred to above present fairly, in all material respects, the respective financial position of the Division 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 3-18 and 39 be presented to supplement the basic financial statements. Such information, although not a part of the basic 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 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 financial statements, and other knowledge we obtained during our audit of the basic 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 financial statements that collectively comprise the Division's basic financial statements. The supplemental schedules on pages 41-48 are presented for the purpose of additional analysis and are not a required part of the basic financial statements. The schedule of expenditures of federal awards on page 40 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 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 financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic 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 financial statements or to the basic 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 financial statements as a whole.

The supplemental schedules have not been subjected to the auditing procedures applied in the audit of the basic 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 the Division'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 the Division's internal control over financial reporting and compliance.

Rodefer Moss & Co, PLLC

Knoxville, Tennessee
October 22, 2013

Knoxville Utilities Board (KUB), comprised of the Electric Division, Water Division, Gas 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. The Wastewater Division (Division) provides services to certain customers in Knox County and in two surrounding counties in East Tennessee. The Division's accounts are maintained in conformity with the Uniform System of Accounts of the National Association of Regulatory Utility Commissioners (NARUC) and the Governmental Accounting Standards Board (GASB), as applicable. The financial statements present only the Wastewater Division and do not purport to, and do not, present fairly the consolidated financial position of Knoxville Utilities Board at June 30, 2013 and 2012, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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

The Division's 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 the Division's financial statements.

Wastewater Division Highlights

System Highlights

The wastewater service area covers 242 square miles and includes 69,530 wastewater customers. KUB maintains 1,330 miles of services mains, 68 pump stations, and 4 treatment plants to treat 15.9 billion gallons of wastewater on an annual basis. The average daily flow is 43.6 million gallons daily. The wastewater system added 350 customers during fiscal year 2013.

The Board of Commissioners adopted a twelve percent rate increase, effective on October 2012 customer bills, to help fund requirements of the Consent Decree. The Division generated $5.9 million of additional margin during the fiscal year as a result of the rate increase.

In December 2012, the Division issued $65 million in wastewater system revenue bonds to fund capital system improvements.

KUB sold $113.3 million in revenue refunding bonds in March 2013 to refinance outstanding bonds at lower interest rates. This refunding will result in a savings of $20.5 million over the term of the bonds.

The typical residential wastewater customer's average monthly bill was $47.50 at fiscal year end, representing an increase of $5.20 compared with last year's average monthly bill.

KUB completed its ninth full year of wastewater operations under the requirements of the federal Consent Decree. KUB continues to be on time and on budget in meeting the operating and capital requirements of the Consent Degree.

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 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.

KUB continued to maintain certification with the National Biosolids Partnership certification following a rigorous review process and independent audit. (Biosolids are nutrient-rich organic matter produced by wastewater treatment that can be recycled as fertilizer).

Financial Highlights

The Division's net position increased $8.8 million or 3.7 percent, compared to a $12 million increase last fiscal year.

Operating revenue increased $4.1 million or 5.8 percent, the result of additional revenue from the 12 percent rate increase effective on October 2012 customer bills. Wastewater billed sales were consistently below prior years' levels for the majority of fiscal year 2013 and significantly lower in the spring, due to lower water sales resulting from higher than normal precipitation levels.

Operating expenses increased $4.7 million or 11.3 percent. Operating and maintenance (O&M) expenditures increased $2.9 million or 11.6 percent. Depreciation expense rose $1.5 million or 12 percent. Taxes and tax equivalents increased $0.2 million or 6.4 percent.

Non-operating revenues decreased $0.9 million from the prior year. Lower interest rates on longer-term investments resulted in a $0.2 million decrease in interest income. Interest expense increased $0.5 million or 2.7 percent, due to interest costs associated with the issuance of $65 million in bonds in December 2012.

Capital contributions decreased $1.7 million, the result of a decline in donated assets from developers compared to the previous fiscal year.

Total plant assets (net) increased $43.8 million or 7.6 percent since the end of last fiscal year.

Long-term debt represented 64.9 percent of the Division's capital structure as of June 30, 2013, as compared to 62 percent last year. The increase is the net result of the $65 million bond issue in December 2012, a portion of refunding bonds sold in March 2013 to cover interest expense on the bonds prior to the call date, and the scheduled repayment of debt during the fiscal year. Capital structure equals long-term debt (which includes the current portion of revenue bonds and notes, as applicable, due to be retired the next fiscal year) plus net position.

The Division's bond covenants require a debt service coverage ratio of at least 1.2 times the maximum principal and interest payments over the life of the Division's outstanding bonds. Current year debt coverage for the fiscal year was 1.75. Maximum debt service coverage was 1.64.

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 provides 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 including inspection, cleaning, grease control, and private lateral enforcement. The result of the PACE 10 program is 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.

Division Cash Budget Appropriations

KUB's Board of Commissioners adopted a Wastewater Division budget of $116.7 million for fiscal year 2013. Cash operating receipts for the fiscal year were $3.9 million less than estimated due to lower sales revenue. At year end, the Division was $2 million under budget. Capital spending was $1.3 million less than planned and debt service was $0.7 million under budget. O&M spending was on budget. Bond proceeds of $65.1 million were transferred to the general fund to pay for capital expenditures during fiscal year 2013, which was greater than anticipated due to timing issues. The Division's general fund balance ended the year $9.5 million higher than budgeted. The numbers below are presented on a cash basis.

Wastewater Division Cash Report
As of June 30, 2013

(in thousands of dollars)	**FY 2013 Budget**	**FY 2013 Actual FYTD**	**Dollar Variance***	**Percent Variance**
Beginning Balance General Fund	$ 24,997	$ 24,997		
Operating Receipts	78,700	74,831	(3,869)	(4.9%)
Disbursements				
Operation & Maintenance Expense	28,217	28,190	27	0.1%
Capital Expenditures	56,613	55,347	1,266	2.2%
Debt Service & Taxes	31,856	31,141	715	2.2%
Total Disbursements	116,686	114,678	2,008	1.7%
Bond Proceeds	55,963	65,064	9,101	16.3%
Net Flow-throughs and Transfers	(4,588)	(2,303)	2,285	49.8%
Ending General Fund Balance	$ 38,386	$ 47,911	$ 9,525	24.8%

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

Knoxville Utilities Board Wastewater Division - Financial Statements

The Division's financial performance is reported under three basic 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

The Division 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, wastewater 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 the Division has done with its accumulated earnings, not just the balance.

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 are assets that have been limited to specific uses by the Division’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 is either invested in capital or restricted is reported there.

Statement of Revenues, Expenses and Changes in Net Position

The Division 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

The Division 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 Division’s sources and uses of cash during the reporting period.

The statement indicates the Division’s 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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Condensed Financial Statements

Statement of Net Position

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

Statements of Net Position
As of June 30

(in thousands of dollars)	2013	2012
Current and other assets	$ 94,800	$ 67,629
Capital assets, net	618,134	574,384
Deferred outflows of resources	10,533	666
Total assets and deferred outflows of resources	723,467	642,679
Current and other liabilities	24,967	19,419
Long-term debt outstanding	450,050	383,705
Deferred inflows of resources	125	-
Total liabilities and deferred inflows of resources	475,142	403,124
Net position		
Net investment in capital assets	169,625	183,964
Restricted	2,148	1,756
Unrestricted	76,552	53,835
Total net position	$ 248,325	$ 239,555

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 outflows and inflows 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.

Current Year Impacts and Analysis

Current and Other Assets

Current and other assets increased $27.2 million or 40.2 percent. General fund cash increased $22.9 million, due to the use of bond proceeds in lieu of cash from system revenues to fund capital expenditures during the year.

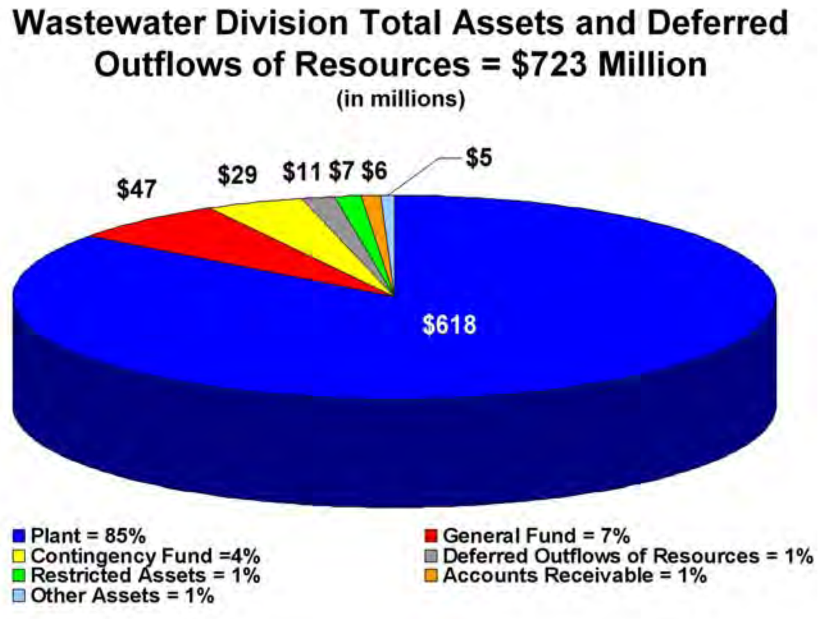
The Division contributed $2.1 million to operating contingency reserves in order to maintain the required balance in the fund, which is equivalent to the Division's annual maximum debt service obligation. In addition, $1 million was contributed to the Division's rainy day reserves, which totaled $3.3 million as of June 30, 2013.

Capital Assets

Capital assets increased $43.8 million or 7.6 percent, the result of capital expenditures, net of depreciation. Major capital expenditures during the year included $38.4 million for major system improvements related to PACE 10 and $16 million for Composite Correction Plan projects, both of which were required under the Consent Decree.

Deferred Outflows of Resources

Deferred outflows of resources total $10.5 million, which was up $9.9 million compared to the prior year, reflecting $10.1 million of unamortized costs related to additional principal from the March 2013 advance refunding bonds to cover debt service on the bonds to be refunded prior to the call date on the bonds.



Current and Other Liabilities

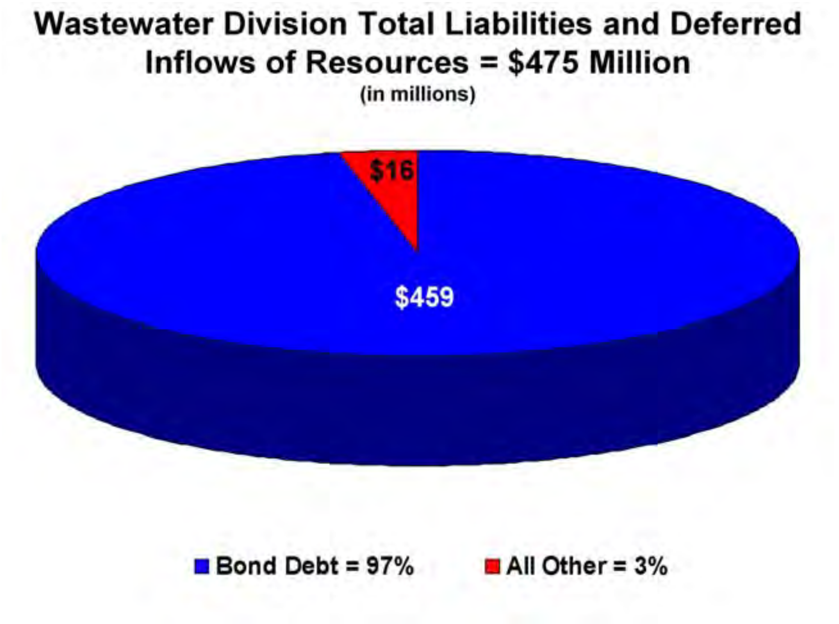
Current and other liabilities increased $5.5 million, which was the combined result of a $3.3 million rise in accounts payable, a $1.5 million increase in the current portion of bond debt and a $0.4 million increase in the Division's share of liability for pension benefits.

Long-Term Debt

The Division's outstanding long-term debt increased $66.3 million or 17.3 percent. A $65 million bond issue in December 2012 added to KUB's outstanding debt, while scheduled debt repayments throughout the year reduced the amount outstanding. Refunding bonds issued in March 2013 included additional principal amounts of $9.9 million necessary to cover scheduled interest payments to be made prior to the call date on the bonds.

Deferred Inflows of Resources

Deferred inflows of resources were $0.1 million as of June 30, 2013, which reflects premiums incurred as part of the March 2013 debt refunding.



Net Position

Net investment in capital assets decreased by $14.3 million or 7.8 percent. The decrease was the result of $43.7 million of net plant additions offset by an increase in debt costs of $58 million. Unrestricted assets increased $22.7 million due to a $22.9 million increase in general fund cash compared with the prior year. Restricted net position was $0.4 million higher than the previous fiscal year, based on increases in the bond fund.

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Statement of Revenues, Expenses and Changes in Net Position

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

Statements of Revenues, Expenses and Changes in Net Position
For the Years Ended June 30

(in thousands of dollars)	2013	2012
Operating revenues	$ 74,579	$ 70,502
Operating expenses		
Treatment	10,402	9,256
Collection	7,266	7,441
Customer service	2,458	1,945
Administrative and general	7,697	6,278
Depreciation and amortization	14,455	12,911
Taxes and tax equivalents	3,856	3,625
Total operating expenses	46,134	41,456
Operating income	28,445	29,046
Interest income	373	562
Interest expense	(19,841)	(19,314)
Other income/(expense)	(351)	(202)
Change in net position before capital contributions	8,626	10,092
Capital contributions	144	1,867
Change in net position	$ 8,770	$ 11,959

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 primarily determined by the amount of water usage billed during the fiscal year. The Division has certain commercial and industrial customers whose wastewater usage is metered separately from their water usage. Any change (increase/decrease) in wastewater rates would also cause a change in operating revenue.

- Operating expenses (treatment, collection system expense, 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 health insurance costs, chemicals, and wastewater system maintenance.

- Depreciation expense is impacted by plant additions and retirements during the fiscal year.

- Taxes & tax equivalents are impacted by plant additions/retirements and changes in property tax rates.

- Interest income is impacted by the level of interest rates and investments.

- Interest expense is impacted by the level of outstanding debt and interest rates on the outstanding debt.

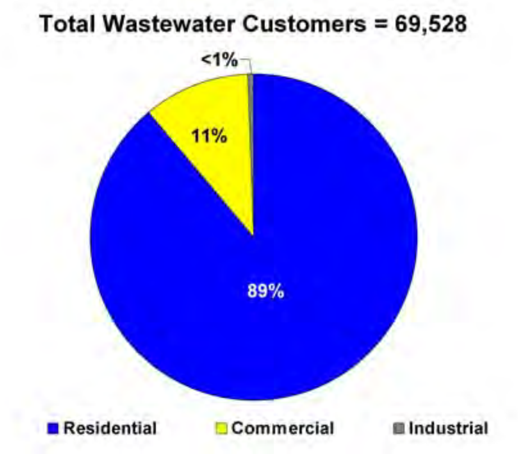
- Other income/(expense) is impacted by miscellaneous non-operating revenues and expenses.

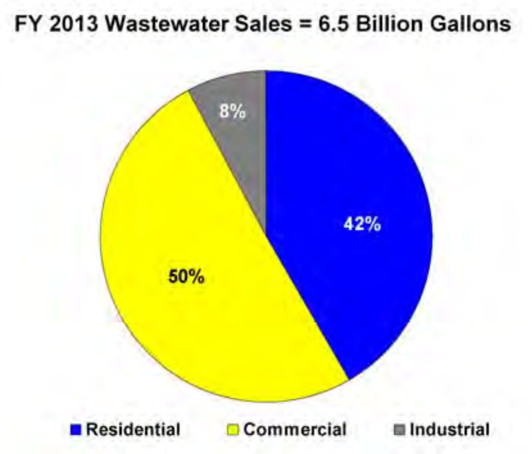
- Capital contributions are impacted by a donation of facilities/infrastructure to KUB by developers and governmental agencies. The contributions are recognized as revenue and recorded as plant in service based on the fair market value of the asset(s).

Current Year Impacts and Analysis

The Division's net position increased $8.8 million this fiscal year compared to earnings of $12 million last fiscal year.

Operating revenue increased $4.1 million or 5.8 percent for the fiscal year ending June 30, 2013, reflecting additional revenue from the 12 percent October 2012 rate increase. Rebates on bond interest payments from the federal government for federally taxable Build America Bonds (BABs) are reported as revenue in accordance with GASB. KUB recognized $1.9 million in revenue for BABs rebates in fiscal year 2013.





Residential customers accounted for 89 percent of wastewater customers and 42 percent of total billed sales for the year. Commercial customers accounted for the largest portion of total sales for the year.

KUB's ten largest wastewater customers accounted for 6.2 percent of KUB's billed wastewater volumes. Those ten customers are comprised of ten industrial customers including one governmental customer.

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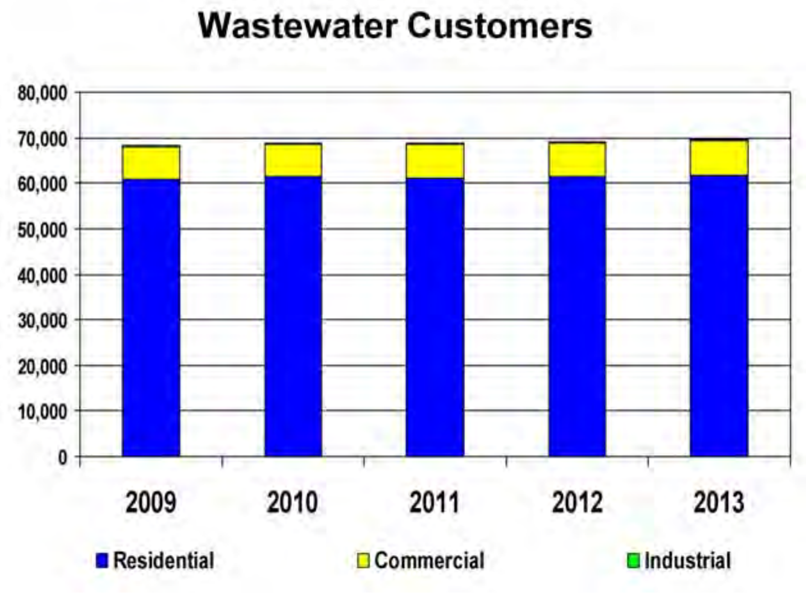
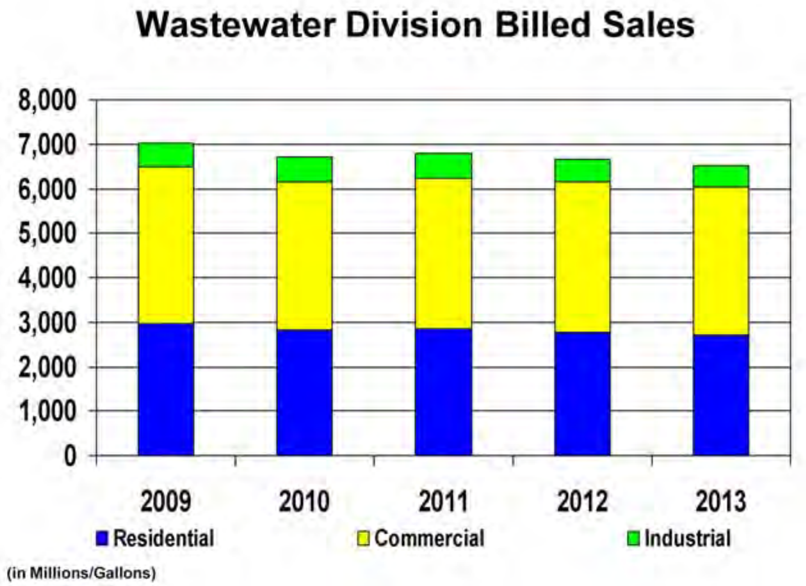


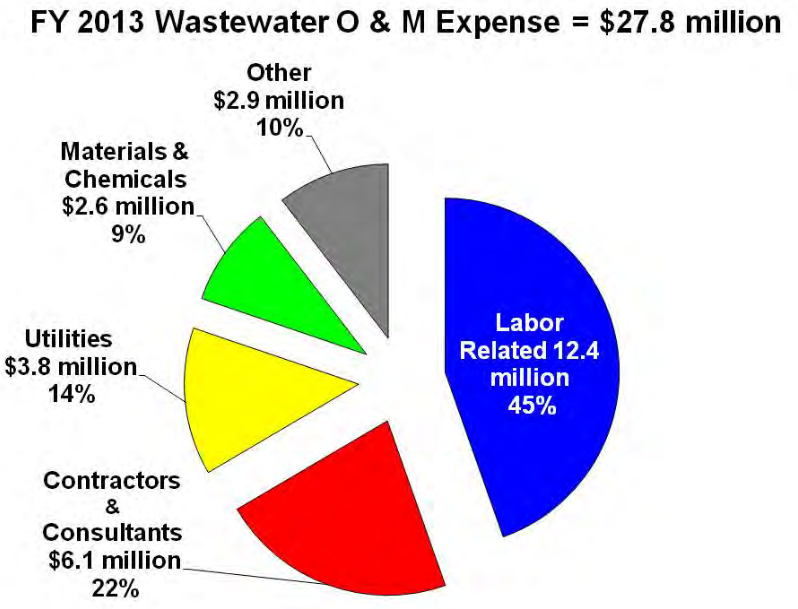
The Division has added 1,200 customers over the past five years, representing annual growth of 0.4 percent. Billed wastewater sales have declined steadily over the past five years, reflecting declining water usage due to more efficient appliances, conservation efforts, and the economic recession.



Operating Expenses

Operating expenses increased $4.7 million or 11.3 percent compared to the prior year. Operating expenses are categorized as the following:

- Treatment expenses were up $1.1 million, the result of higher labor-related expenses and utility expenses.
- Collection system expenses decreased $0.2 million, driven by a $0.1 million reduction in labor related expenses.
- Customer service expenses increased $0.5 million, reflecting the Division's share of meter reading, telephone, software, and labor-related expenses.
- Administrative and general expenses were up $1.4 million, due to approximately $1.4 million of additional expense resulting from a four percent increase to the Division's allocation of shared costs effective July 1, 2012.



O&M expense has grown at a rate of 3.4 percent per year over the past five years. Expense growth over this period was relatively stable through fiscal year 2012, reflecting KUB cost management efforts over this time period. However, the Division's portion of organizational shared costs increased by four percent beginning in fiscal year 2013, based on an organizational-wide cost allocation assessment.

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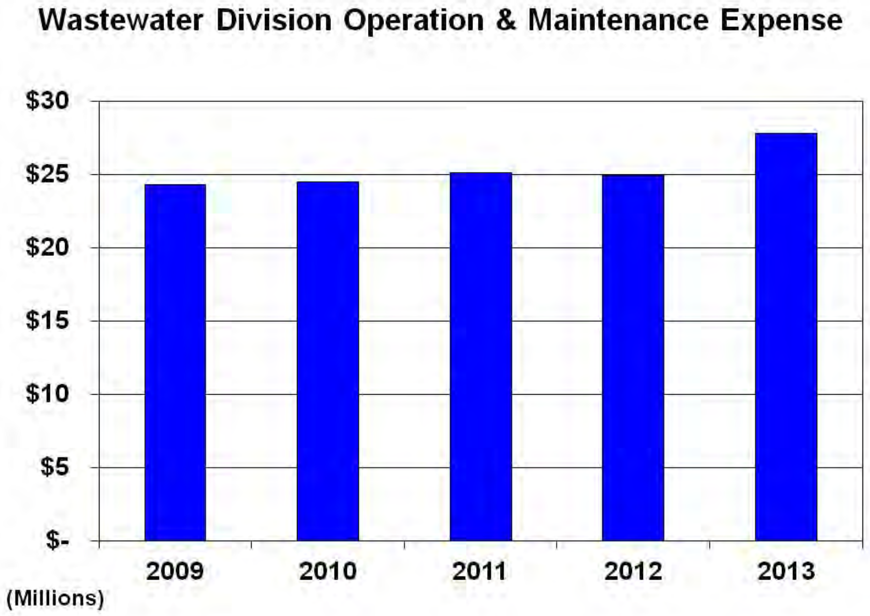

- Depreciation expense increased $1.5 million or 12 percent, the result of a full year of depreciation on $62 million of wastewater system assets placed in service during fiscal year 2012, and a partial year of depreciation on $61 million placed in service during fiscal year 2013. The Division also retired $8.2 million of assets during the fiscal year.

- Taxes and tax equivalents increased $0.2 million, due to increased plant values.

Other Income and Expense

Interest income decreased $0.2 million, the result of lower long-term interest rates.

Interest expense increased $0.5 million or 2.7 percent, the net result of additional interest on $65 million of bonds issued during the fiscal year and debt service savings results from the refunding of outstanding bonds in 2012 and 2013.

Other income (net) was $0.1 million lower than the prior year.

Capital contributions decreased $1.7 million compared to last fiscal year as a result of fewer assets received from developers and other governmental entities.

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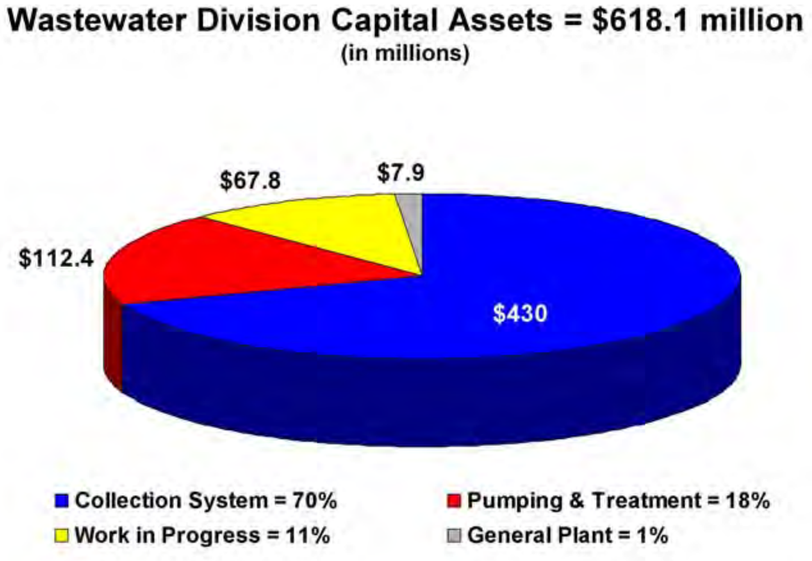
Capital Assets and Debt Administration

Capital Assets

As of June 30, 2013, the Division had $618.1 million invested in a variety of capital assets, as reflected in the schedule below, which represents a net increase (including additions, retirements, and depreciation) of $43.8 million or 7.6 percent over the end of the last fiscal year.

Capital Assets
As of June 30
(Net of Depreciation)

(in thousands of dollars)	**2013**	**2012**
Pumping and treatment plant	$ 112,438	$ 104,955
Collection plant:		
Mains	359,166	328,495
Others	70,857	67,000
Total collection plant	430,023	395,495
General plant	7,853	7,619
Total plant	550,314	508,069
Work in progress	67,820	66,315
Total net plant	$ 618,134	$ 574,384



Major capital asset expenditures during the year were as follows:

- $38.4 million related to PACE 10 projects.
  - $15.1 million for sewer mini-basin rehabilitation 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 Wastewater Treatment Plant

Debt Administration

As of June 30, 2013, the Division had $458.6 million in outstanding debt (including the current portion of revenue bonds), compared to $390.7 million last year, representing an increase of $67.9 million or 17.4 percent. The Division's weighted average cost of debt as of June 30, 2013 was 4.22 percent.

The increase in debt is attributable to the scheduled repayment of bond debt during the fiscal year, a $65 million December 2012 bond issue to fund wastewater system capital improvements, and the March 2013 refunding of outstanding bonds.

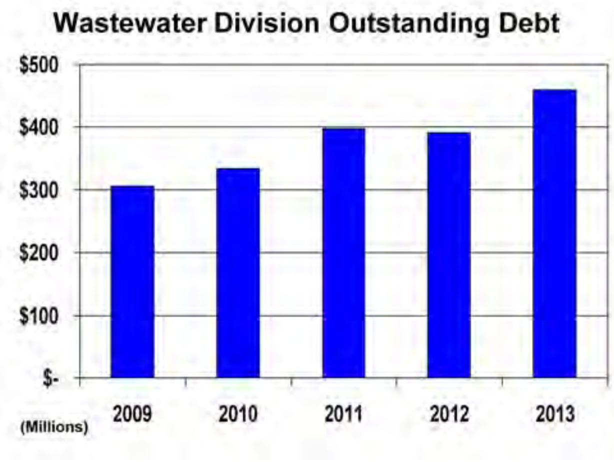
KUB sold $113.3 million in revenue refunding bonds to retire bonds issued in 2005 at lower interest rates. The proceeds of the bonds were placed in an irrevocable escrow and will be used to refund $103.5 million in outstanding bonds in 2015 and pay debt service on the outstanding bonds prior to the 2015 call date. The Division will realize a total debt service savings of $20.5 million over the life of the bonds ($14.4 million on a net present value basis).

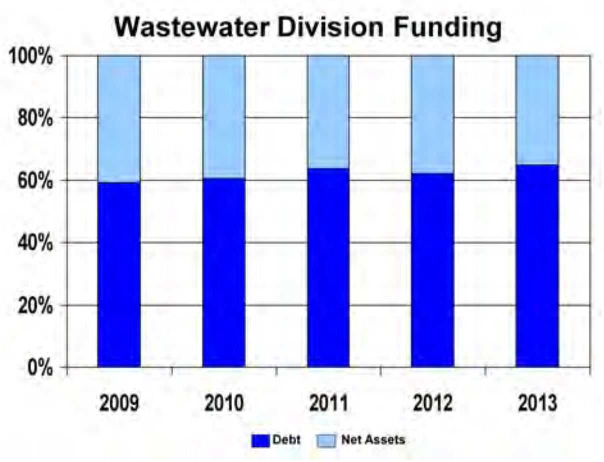
The Division's outstanding debt is rated by Standard & Poor's and Moody's Investors Service. As of June 30, 2013, the Division's revenue bonds were rated AA+ by Standard & Poor's and Aa2 by Moody's Investors Service.

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

Outstanding Debt
As of June 30

(in thousands of dollars)	2013	2012
Revenue bonds	$ 458,595	$ 390,745
Total outstanding debt	$ 458,595	$ 390,745





The Division’s outstanding debt level has increased from $306.3 million in 2009 to $458.6 million by fiscal year end 2013. The majority of the debt proceeds have been used to fund capital requirements under the Consent Decree. The Division’s debt to capitalization ratio has increased from 59.3 percent to 64.9 percent over the same time period.

The Division will pay $105.6 million in principal payments over the next ten years, representing 23 percent of the outstanding bonds. KUB’s Debt Management Policy requires a minimum of 20 percent of wastewater debt principal be repaid over the next ten years.

Impacts on Future Financial Position

KUB anticipates adding 300 wastewater customers in fiscal year 2014.

KUB does not anticipate a wastewater rate increase or the issuance of debt in fiscal year 2014.

KUB debt portfolio includes $97.9 million of Wastewater Division 2010 Build America Bonds (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 the Division’s financial position or results of operations during fiscal year 2014.

Financial Contact

The Division’s financial statements are designed to present users (citizens, customers, investors, and creditors) with a general overview of the Division’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 Wastewater Division
Statements of Net Position
June 30, 2013 and 2012

	2013	2012
Assets and Deferred Outflows of Resources		
Current assets:		
Cash and cash equivalents	$ 32,911,366	$ 14,997,191
Short-term investments	15,000,000	10,000,000
Short-term contingency fund investments	12,955,337	11,099,010
Other current assets	7,405	223,135
Accrued interest receivable	22,592	30,917
Accounts receivable, less allowance of uncollectible accounts of $113,372 in 2013 and $105,622 in 2012	8,977,425	8,594,708
Inventories	174,479	121,008
Prepaid expenses	74,415	43,275
Total current assets	70,123,019	45,109,244
Restricted assets:		
Wastewater bond fund	7,130,242	6,484,629
Other funds	11,302	718
Unused bond proceeds	206	-
Total restricted assets	7,141,750	6,485,347
Wastewater plant in service	700,133,805	647,343,880
Less accumulated depreciation	(149,819,959)	(139,274,178)
	550,313,846	508,069,702
Retirement in progress	122,152	131,554
Construction in progress	67,697,621	66,183,184
Net plant in service	618,133,619	574,384,440
Other assets:		
Long-term contingency fund investments	16,380,326	15,279,785
Other	1,155,509	753,968
Total other assets	17,535,835	16,033,753
Total assets	712,934,223	642,012,784
Deferred outflows of resources:		
Unamortized bond refunding costs	10,532,610	606,449
Unamortized costs	-	59,898
Total deferred outflows of resources	10,532,610	666,347
Total assets and deferred outflows of resources	$ 723,466,833	$ 642,679,131

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

Knoxville Utilities Board Wastewater Division
Statements of Net Position
June 30, 2013 and 2012

	2013	2012
Liabilities, Deferred Inflows, and Capitalization		
Current liabilities:		
Current portion of revenue bonds	$ 8,545,000	$ 7,040,000
Accounts payable	6,898,846	3,571,664
Accrued expenses	1,829,334	1,480,178
Customer deposits plus accrued interest	967,329	733,584
Accrued interest on revenue bonds	4,993,892	4,729,302
Total current liabilities	23,234,401	17,554,728
Other liabilities:		
Accrued compensated absences	1,385,951	1,447,257
Customer advances for construction	321,000	342,000
Other	25,331	75,317
Total other liabilities	1,732,282	1,864,574
Long-term debt:		
Wastewater revenue bonds	450,050,000	383,705,000
Total long-term debt	450,050,000	383,705,000
Total liabilities	475,016,683	403,124,302
Deferred inflows of resources:		
Unamortized costs	124,830	-
Total deferred inflows of resources	124,830	-
Total liabilities and deferred inflows of resources	475,141,513	403,124,302
Net position		
Net investment in capital assets	169,625,399	183,963,788
Restricted for:		
Debt service	2,136,350	1,755,328
Other	11,302	717
Unrestricted	76,552,269	53,834,996
Total net position	248,325,320	239,554,829
Total liabilities, deferred inflows, and net position	$ 723,466,833	$ 642,679,131

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

Knoxville Utilities Board Wastewater Division
Statements of Revenues, Expenses and Changes in Net Position
Years Ended June 30, 2013 and 2012

	2013	2012
Operating revenues	$ 74,579,313	$ 70,502,494
Operating expenses		
Treatment	10,402,381	9,255,855
Collection	7,265,544	7,441,286
Customer service	2,457,565	1,944,802
Administrative and general	7,697,218	6,278,420
Provision for depreciation and amortization	14,454,762	12,911,050
Taxes and tax equivalents	3,856,206	3,624,508
Total operating expenses	46,133,676	41,455,921
Operating income	28,445,637	29,046,573
Non-operating revenues (expenses)		
Contributions in aid of construction	225,764	247,356
Interest and dividend income	372,644	561,662
Interest expense	(19,841,107)	(19,313,566)
Write-down of plant for costs recovered through contributions	(225,764)	(247,356)
Other	(350,663)	(202,824)
Total non-operating revenues (expenses)	(19,819,126)	(18,954,728)
Change in net position before capital contributions	8,626,511	10,091,845
Capital contributions	143,980	1,866,665
Change in net position	8,770,491	11,958,510
Net position, beginning of year	239,554,829	227,596,319
Net position, end of year	$ 248,325,320	$ 239,554,829

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

Knoxville Utilities Board Wastewater Division
Statements of Cash Flows
Years Ended June 30, 2013 and 2012

	2013	2012
Cash flows from operating activities:		
Cash receipts from customers	$ 71,576,107	$ 68,553,022
Cash (payments to) receipts from other operations	2,408,922	2,133,675
Cash payments to suppliers of goods or services	(15,430,777)	(15,694,798)
Cash payments to employees for services	(9,080,474)	(8,436,800)
Payment in lieu of taxes	(3,182,147)	(3,002,025)
Net cash provided by operating activities	46,291,631	43,553,074
Cash flows from capital and related financing activities:		
Net proceeds from bond issuance	65,053,835	-
Principal paid on revenue bonds and notes payable	(7,040,000)	(6,730,000)
(Increase) decrease in unused bond proceeds	(206)	34,236,295
Interest paid on revenue bonds and notes payable	(19,576,517)	(19,446,436)
Acquisition and construction of wastewater plant	(58,642,874)	(59,403,083)
Changes in wastewater bond fund, restricted	(645,613)	59,392
Customer advances for construction	(21,000)	(6,000)
Proceeds received on disposal of plant	4,502	27,513
Cash received from developers and individuals for capital purposes	225,764	247,356
Net cash used in capital and related financing activities	(20,642,109)	(51,014,963)
Cash flows from investing activities:		
Purchase of investment securities	(8,262,656)	(6,234,955)
Maturities of investment securities	305,788	364,059
Interest received	380,969	561,662
Other property and investments	(159,448)	(87,154)
Net cash used in investing activities	(7,735,347)	(5,396,388)
Net increase (decrease) in cash and cash equivalents	17,914,175	(12,858,277)
Cash and cash equivalents, beginning of year	14,997,191	27,855,468
Cash and cash equivalents, end of year	$ 32,911,366	$ 14,997,191
Reconciliation of operating income to net cash provided by operating activities		
Operating income	$ 28,445,637	$ 29,046,573
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization expenses	14,710,927	13,189,107
Changes in operating assets and liabilities:		
Accounts receivable	(382,717)	(24,834)
Inventories	(53,471)	50,707
Prepaid expenses	(31,141)	6,259
Other assets	(196,396)	268,074
Accounts payable and accrued expenses	3,615,032	928,418
Customer deposits plus accrued interest	233,746	50,608
Other liabilities	(49,986)	38,162
Net cash provided by operating activities	$ 46,291,631	$ 43,553,074
Noncash capital activities:		
Acquisition of plant assets through developer contributions	$ 143,980	$ 1,866,665

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

1. Description of Business

Knoxville Utilities Board (KUB), comprised of the Electric Division, Water Division, Gas 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. The Wastewater Division (Division) provides services to certain customers in Knox County and in two surrounding counties in East Tennessee. The Division's accounts are maintained in conformity with the Uniform System of Accounts of the National Association of Regulatory Utility Commissioners (NARUC) and the Governmental Accounting Standards Board (GASB), as applicable. The financial statements present only the Wastewater Division and do not purport to, and do not, present fairly the consolidated financial position of Knoxville Utilities Board at June 30, 2013 and 2012, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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 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 to the Division is determined by measurement focus. The transactions of the Division 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.

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.

Wastewater Plant

Wastewater plant and other property are stated on the basis of original cost. The cost of current repairs and minor replacements is charged to operating expense. The cost of renewals and improvements is 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 wastewater plant in service is based on the estimated useful lives of the assets, which range from three to fifty years, and is computed using the straight-line method. Pursuant to NARUC, the caption "Provision for depreciation" in the statements of revenue, expenses and change in net position does not include depreciation for transportation equipment of $256,165 in fiscal year 2013 and $278,058 in fiscal year 2012. Interest costs are expensed as incurred.

Operating Revenue

Operating revenue consists primarily of charges for services provided by the principal operations of the KUB Wastewater Division. 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 $235,922 in fiscal year 2013 and $215,679 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 net assets available, it is KUB’s policy to apply those expenses to restricted net assets to the extent such are available and then to unrestricted net 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

The Division’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). The Division’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.

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.

Restricted and Designated Assets

Certain assets are restricted by bond resolutions for utility plant construction 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.

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 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.

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 a 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:

	Carrying Value	Bank Balance
Deposits		
Deposits in financial institutions	$ 32,922,381	$ 34,101,295
Investments		
Certificates of Deposits	32,477,873	32,477,873
State Treasurer's Investment Pool	1,617,378	1,617,378
Agency Bonds	17,298,246	17,298,246
	$ 84,315,878	$ 85,494,792

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Classification of deposits and investments:

Depository Account	**Bank Balance**
Insured	$ 382,827
Collateralized:	
Collateral held by pledging bank's trust department in KUB's name	17,298,246
Collateral held by pledging bank's trust department not in KUB's name*	67,813,719
Total deposits and investments	$ 85,494,792

* - Deposits 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. KUB deposits with First Tennessee Bank are collateralized at 115 percent of their total value.

Classification of deposits and investments per statement of net position:

	2013	**2012**
Current assets		
Cash and cash equivalents	$ 32,911,366	$ 14,997,191
Short-term investments	15,000,000	10,000,000
Short-term contingency fund investments	12,955,337	11,079,030
Other assets		
Long-term contingency fund investments	16,307,425	15,220,256
Restricted assets		
Unused bond proceeds	206	-
Wastewater bond fund	7,130,242	6,484,629
Other funds	11,302	718
	$ 84,315,878	$ 57,781,824

The above amounts do not include accrued interest of $72,901 in fiscal year 2013 and $79,509 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.

	Deposit and Investment Maturities (in Years)		
	Fair Value	**Less Than 1**	**1-5**
Supersweep NOW and Other Deposits	$ 34,101,295	$ 34,101,295	$ -
State Treasurer's Investment Pool	1,617,378	1,617,378	-
Agency Bonds	17,298,246	8,149,482	9,148,764
Certificates of deposits	32,477,873	25,324,644	7,153,229
	$ 85,494,792	$ 69,192,799	$ 16,301,993

Interest Rate Risk. KUB's primary investment objectives 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 limiting investments to those types described above and limiting maturity horizons. 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.

4. Accounts Receivable

Accounts receivable consists of the following:

	2013	2012
Wholesale and retail customers		
Billed services	$ 5,061,661	$ 4,344,993
Unbilled services	3,311,565	3,114,882
Other	717,571	1,240,455
Allowance for uncollectible accounts	(113,372)	(105,622)
	$ 8,977,425	$ 8,594,708

5. Accounts Payable and Accruals

Accounts payable and accruals were composed of the following:

	2013	2012
Trade accounts	$ 6,898,846	$ 3,571,664
Salaries and wages	160,257	134,724
Self-insurance liabilities	360,281	341,126
Other current liabilities	1,308,796	1,004,328
	$ 8,728,180	$ 5,051,842

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
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	$ 390,745,000	$ 178,340,000	$ 110,490,000	$ 458,595,000	$ 8,545,000

Other liabilities consist of the following:

	Balance June 30, 2012	Increase	Decrease	Balance June 30, 2013	Amounts Due Within One Year
Accrued compensated absences	$ 1,447,257	$ 2,765,925	$ (2,827,231)	$ 1,385,951	$ 350,000
Customer advances for construction	342,000	-	(21,000)	321,000	20,000
Other	75,317	194,856	(244,842)	25,331	10,000
	$ 1,864,574	$ 2,960,781	$ (3,093,073)	$ 1,732,282	$ 380,000

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

Fiscal Year	Principal	Total Interest	Grand Total
2014	$ 8,545,000	$ 19,496,968	$ 28,041,968
2015	9,015,000	19,042,584	28,057,584
2016	9,465,000	18,635,744	28,100,744
2017	9,905,000	18,266,269	28,171,269
2018	10,320,000	17,879,661	28,199,661
2019-2023	58,365,000	82,767,045	141,132,045
2024-2028	64,525,000	69,394,794	133,919,794
2029-2033	73,340,000	56,384,782	129,724,782
2034-2038	89,290,000	41,112,206	130,402,206
2039-2043	92,325,000	20,731,900	113,056,900
2044-2047	33,500,000	2,925,000	36,425,000
Total	$ 458,595,000	$ 366,636,953	$ 825,231,953

The Division has pledged sufficient revenue, after deduction of all current operating expenses (exclusive of tax equivalents), to meet bond principal and interest payments when due. The bond covenants relating to the Wastewater Revenue Bonds require the establishment of a Wastewater Bond Fund for the payment of principal and interest requirements. As of June 30, 2013, those bond covenants had been satisfied.

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 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 wastewater system 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 current and prior years, certain wastewater 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	$	14,835
2015		11,961
2016		4,314
2017		450
Total operating minimum lease payments	$	31,560

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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
Pumping & Treatment Plant	$ 165,017,018	$ 13,752,928	$ (2,743,679)	$ 176,026,267
Collection Plant				
Mains and Metering	389,329,642	40,300,709	(5,179,650)	424,450,701
Other Accounts	71,883,127	5,151,900	-	77,035,027
Total Collection Plant	$ 461,212,769	$ 45,452,609	$ (5,179,650)	$ 501,485,728
Total General Plant	21,114,093	1,789,414	(281,697)	22,621,810
Total Wastewater Plant	$ 647,343,880	$ 60,994,951	$ (8,205,026)	$ 700,133,805
Less accumulated depreciation	(139,274,178)	(15,532,960)	4,987,179	(149,819,959)
Net Plant Assets	$ 508,069,702	$ 45,461,991	$ (3,217,847)	$ 550,313,846
Work In Progress	66,314,738	58,408,730	(56,903,695)	67,819,773
Total Net Plant	$ 574,384,440	$ 103,870,721	$ (60,121,542)	$ 618,133,619

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.

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 $360,281 resulting from the following changes:

	2013	2012
Balance, beginning of year	$ 341,126	$ 369,796
Current year claims and changes in estimates	2,612,176	3,626,016
Claims payments	(2,593,021)	(3,654,686)
Balance, end of year	$ 360,281	$ 341,126

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 Division 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 Division Plan A active employees, vested terminated employees, retirees, and beneficiaries. Plan A is a closed plan.

All employees participating in the City Division 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 1999. Participation in Plan A requires employee contributions of 3 percent of the first $4,800 of annual 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 Division Plan B active employees, vested terminated employees, retirees, and beneficiaries. Plan B is a closed plan.

All employees participating in the City Division 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 Wastewater Division’s portion of this contribution is $1,155,562. 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. Of these amounts, $1,155,562 and $754,589 are attributable to the Wastewater Division.

Subsequent to June 30, 2013, the actuarial valuation for the Plan year ending December 31, 2013 was completed. Based on the actuarial valuation, a contribution of $6,314,399 is recommended for the plan sponsor's fiscal year ending June 30, 2015 based on the plan's current funding policy. The Wastewater Division's portion of this recommended contribution is $1,326,024. 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 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.

Total contributions to the OPEB Trust for the fiscal year ended June 30, 2013 were $4.4 million (Division's share $0.9 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 (Division's share $0.7 million). As of June 30, 2013, the employer's net OPEB obligation was $0.6 million (Division's share $0.1 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 (Division's share $0.7 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 (Division's share $13.3 million). The actuarial value of the Plan's assets was $38.6 million (Division's share $8.1 million). As a result, the Plan's unfunded actuarial accrued liability was $24.8 million (Division's share $5.2 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 (Division's share $0.7 million). See Required Supplementary Information for OPEB Schedule of Funding Progress.

13. Related Party Transactions

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

	2013	**2012**
City of Knoxville		
Amounts billed by the Division for utilities and related services	$ 799,852	$ 704,749
Payments by the Division in lieu of property tax	3,182,147	3,002,025
Payments by the Division for services provided	216,857	421,662
Other divisions of KUB		
Amounts billed to other divisions for utilities and related services provided	318,800	312,212
Interdivisional rental expense	166,589	164,829
Interdivisional rental income	110,666	90,385
Amounts billed to the Division by other divisions for utilities services provided	3,173,199	2,860,227

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

	2013	**2012**
Accounts receivable	$ 64,001	$ 16,444

14. 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 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.

Knoxville Utilities Board Wastewater Division

Required Supplementary Information – Schedule of Funding Progress

June 30, 2013

(Unaudited)

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%

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

Schedule 1

KUB was 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.

Program Name	Federal/State Agency	CFDA Number	Contract Number	Beginning Receivable	Cash Receipts	Expenditures	Adjustments	Ending Receivable
U.S. Department of Homeland Security	Tennessee Emergency Management	97.036	34101-0000009205	$ 285,111	$ 191,276	$ -	$ (22,557)	$ 71,278
U.S. Department of Homeland Security	Tennessee Emergency Management	97.036	34101-0000009832	$ 2,167	$ -	$ -	$ -	$ 2,167
		Total Program 97.036		$ 287,278	$ 191,276	$ -	$ (22,557)	$ 73,445
		Total Federal Awards		$ 287,278	$ 191,276	$ -	$ (22,557)	$ 73,445

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.

Knoxville Utilities Board Wastewater Division

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:

CFDA Number	Name of Federal Program
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? ___Yes ✓___ No

Findings – Financial Statements Audit

None

Findings and Questioned Costs – Major Federal Award Programs Audit

None

Insurance coverage is for KUB as a consolidated entity.

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.

Knoxville Utilities Board Wastewater Division
Supplemental Information – Schedule of Debt Maturities by Fiscal Year
June 30, 2013
Schedule 4

Continued on Next Page

	2005A		2005B		2007		2008		2010		
FY	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Rebate*
13-14	$	$ 1,462,000	$ 1,285,000	$ 808,335	$	$ 3,463,013	$ 4,125,000	$ 1,802,937	$	$ 1,910,000	$ 639,420
14-15		1,462,000	1,350,000	744,085		3,463,013	4,300,000	1,637,938		1,910,000	668,500
15-16		1,462,000	1,410,000	676,585		3,463,013	4,450,000	1,379,938		1,910,000	668,500
16-17		1,462,000	1,470,000	620,185		3,463,013	4,600,000	1,157,438		1,910,000	668,500
17-18		1,462,000	1,525,000	561,385	2,725,000	3,463,013	1,950,000	927,438		1,910,000	668,500
18-19		1,462,000	1,595,000	498,860	2,900,000	3,354,012	2,025,000	829,938		1,910,000	668,500
19-20		1,462,000	1,655,000	433,066	3,125,000	3,234,387	2,075,000	723,625		1,910,000	668,500
20-21		1,462,000	1,725,000	363,556	3,175,000	3,101,575	2,150,000	619,875		1,910,000	668,500
21-22		1,462,000	1,800,000	290,244	3,300,000	2,962,669	2,225,000	507,000		1,910,000	668,500
22-23		1,462,000	1,880,000	212,844	3,525,000	2,817,469	2,300,000	395,750		1,910,000	668,500
23-24		1,462,000	695,000	130,594	1,125,000	2,658,843	2,400,000	269,250		1,910,000	668,500
24-25		1,462,000	730,000	100,188	1,175,000	2,608,219	2,500,000	131,250		1,910,000	668,500
25-26		1,462,000	765,000	68,250	1,225,000	2,555,344				1,910,000	668,500
26-27		1,462,000	795,000	34,781	1,300,000	2,498,688				1,910,000	668,500
27-28		1,462,000			1,225,000	2,438,562				1,910,000	668,500
28-29		1,462,000			1,275,000	2,381,906				1,910,000	668,500
29-30		1,462,000			1,300,000	2,322,938				1,910,000	668,500
30-31		1,462,000			1,375,000	2,262,812				1,910,000	668,500
31-32		1,462,000			1,400,000	2,200,938				1,910,000	668,500
32-33		1,462,000			1,475,000	2,137,938				1,910,000	668,500
33-34		1,462,000			1,550,000	2,067,875				1,910,000	668,500
34-35		1,462,000			1,625,000	1,998,125				1,910,000	668,500
35-36		1,462,000			1,700,000	1,925,000				1,910,000	668,500
36-37		1,462,000			1,800,000	1,848,500				1,910,000	668,500
37-38	11,600,000	1,462,000			1,850,000	1,767,500				1,910,000	668,500
38-39	12,175,000	998,000			1,825,000	1,684,250				1,910,000	668,500
39-40	12,775,000	511,000			1,825,000	1,602,125				1,910,000	668,500
40-41					15,200,000	1,520,000				1,910,000	668,500
41-42					16,000,000	760,000				1,910,000	668,500
42-43									10,000,000	1,910,000	668,500
43-44									10,000,000	1,260,000	441,000
44-45									10,000,000	630,000	220,500
45-46											
46-47											
Total	$ 36,550,000	$ 38,059,000	$ 18,680,000	$ 5,542,958	$ 75,000,000	$ 72,024,740	$ 35,100,000	$ 10,382,377	$ 30,000,000	$ 59,190,000	$ 20,687,420

*Series 2010 and 2010c bonds were issued as federally taxable Build America Bonds. KUB will receive a 35 percent interest rebate payment from the United States Government for each interest payment. Effective March 1, 201 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. The series 2010 rebate payments are scheduled to total $22,787,624 over the life of the bonds. The net cost of issuing the series 2010 bonds is $42,373,879. The series 2010c rebate payments are scheduled to total $26,747,884 over the life of the bonds. The net cost of issuing the series 2010c bonds is $49,780,063.

Knoxville Utilities Board Wastewater Division
Supplemental Information – Schedule of Debt Maturities by Fiscal Year
June 30, 2013
Schedule 4

Continued from Previous Page

	2010C			2012A		2012B		2013A		TOTALS		Grand Total (P + I)	Grand Total (Less Rebates)
FY	Principal	Interest	Rebate*	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest		
13-14	$ 1,075,000	$ 3,728,463	$ 1,248,196	$ 785,000	$ 603,625	$ 850,000	$ 1,969,563	$ 425,000	$ 3,749,032	$ 8,545,000	$ 19,496,968	$ 28,041,968	$ 26,154,352
14-15	1,100,000	3,704,060	1,296,422	800,000	587,925	875,000	1,952,563	590,000	3,581,000	9,015,000	19,042,584	28,057,584	26,092,662
15-16	1,250,000	3,673,920	1,285,872	820,000	571,925	925,000	1,935,063	610,000	3,563,300	9,465,000	18,635,744	28,100,744	26,146,372
16-17	1,400,000	3,634,545	1,272,090	840,000	551,425	975,000	1,916,563	620,000	3,551,100	9,905,000	18,266,269	28,171,269	26,230,679
17-18	1,500,000	3,584,425	1,254,548	985,000	528,325	1,000,000	1,904,375	635,000	3,538,700	10,320,000	17,879,661	28,199,661	26,276,613
18-19	1,550,000	3,525,625	1,233,968	970,000	498,775	1,050,000	1,891,875	660,000	3,513,300	10,750,000	17,484,385	28,234,385	26,331,917
19-20	1,600,000	3,460,990	1,211,346	950,000	467,250	1,100,000	1,878,750	685,000	3,486,900	11,190,000	17,056,968	28,246,968	26,367,122
20-21	1,650,000	3,394,270	1,187,994	1,085,000	434,000	1,150,000	1,862,250	710,000	3,459,500	11,645,000	16,607,026	28,252,026	26,395,532
21-22	1,700,000	3,325,465	1,163,912	1,175,000	390,600	1,200,000	1,804,750	740,000	3,431,100	12,140,000	16,083,828	28,223,828	26,391,416
22-23	1,750,000	3,246,925	1,136,424	1,165,000	343,600	1,250,000	1,744,750	770,000	3,401,500	12,640,000	15,534,838	28,174,838	26,369,914
23-24	1,850,000	3,162,575	1,106,902	1,250,000	297,000	1,300,000	1,694,750	4,600,000	3,370,699	13,220,000	14,955,711	28,175,711	26,400,309
24-25	1,950,000	3,065,450	1,072,908	1,140,000	247,000	1,375,000	1,642,750	4,900,000	3,232,700	13,770,000	14,399,557	28,169,557	26,428,149
25-26	2,375,000	2,961,125	1,036,394	1,190,000	201,400	1,425,000	1,587,750	5,040,000	3,085,700	12,020,000	13,831,569	25,851,569	24,146,675
26-27	2,500,000	2,830,738	990,758	1,235,000	153,800	1,500,000	1,530,750	5,200,000	2,934,500	12,530,000	13,355,257	25,885,257	24,225,999
27-28	2,600,000	2,688,488	940,970	1,280,000	104,400	1,575,000	1,470,750	6,305,000	2,778,500	12,985,000	12,852,700	25,837,700	24,228,230
28-29	2,725,000	2,536,388	887,736	1,330,000	53,200	1,625,000	1,423,500	6,535,000	2,573,587	13,490,000	12,340,581	25,830,581	24,274,345
29-30	2,850,000	2,376,975	831,942			1,700,000	1,374,750	8,315,000	2,377,537	14,165,000	11,824,200	25,989,200	24,488,758
30-31	2,975,000	2,210,250	773,588			1,775,000	1,323,750	8,550,000	2,128,087	14,675,000	11,296,899	25,971,899	24,529,811
31-32	3,100,000	2,031,750	711,112			1,875,000	1,270,500	8,840,000	1,871,588	15,215,000	10,746,776	25,961,776	24,582,164
32-33	3,250,000	1,845,750	646,012			1,950,000	1,214,250	9,120,000	1,606,388	15,795,000	10,176,326	25,971,326	24,656,814
33-34	3,375,000	1,650,750	577,762			2,025,000	1,155,750	9,390,000	1,332,787	16,340,000	9,579,162	25,919,162	24,672,900
34-35	3,550,000	1,448,250	506,882			2,125,000	1,095,000	9,705,000	1,015,875	17,005,000	8,929,250	25,934,250	24,758,868
35-36	3,700,000	1,235,250	432,338			2,225,000	1,031,250	10,025,000	688,331	17,650,000	8,251,831	25,901,831	24,800,993
36-37	3,875,000	1,009,550	353,342			2,325,000	964,500	10,370,000	349,988	18,370,000	7,544,538	25,914,538	24,892,696
37-38	4,050,000	773,175	270,612			2,425,000	894,750			19,925,000	6,807,425	26,732,425	25,793,313
38-39	4,225,000	526,125	184,144			2,550,000	822,000			20,775,000	5,940,375	26,715,375	25,862,731
39-40	4,400,000	268,400	93,940			2,650,000	745,500			21,650,000	5,037,025	26,687,025	25,924,585
40-41						2,775,000	666,000			17,975,000	4,096,000	22,071,000	21,402,500
41-42						2,900,000	582,750			18,900,000	3,252,750	22,152,750	21,484,250
42-43						3,025,000	495,750			13,025,000	2,405,750	15,430,750	14,762,250
43-44						3,150,000	405,000			13,150,000	1,665,000	14,815,000	14,374,000
44-45						3,300,000	310,500			13,300,000	940,500	14,240,500	14,020,000
45-46						3,450,000	211,500			3,450,000	211,500	3,661,500	3,661,500
46-47						3,600,000	108,000			3,600,000	108,000	3,708,000	3,708,000
Total	$ 67,925,000	$ 67,899,677	$ 23,708,114	$ 17,000,000	$ 6,034,250	$ 65,000,000	$ 42,882,252	$ 113,340,000	$ 64,621,699	$ 458,595,000	$ 366,636,953	$ 825,231,953	$ 780,836,419

*Series 2010 and 2010c bonds were issued as federally taxable Build America Bonds. KUB will receive a 35 percent interest rebate payment 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. The series 2010 rebate payments are scheduled to total $22,787,624 over the life of the bonds. The net cost of issuing the series 2010 bonds is $42,373,879. The series 2010c rebate payments are scheduled to total $26,747,884 over the life of the bonds. The net cost of issuing the series 2010c bonds is $49,780,063.

Knoxville Utilities Board Wastewater Division
Supplemental Information – Schedule of Current Rates in Force
June 30, 2013
(Unaudited)

Schedule 5

Rate Class	Base Charge	Number of Customers
Residential Inside City rate	For wastewater service furnished to premises entirely within the corporate limits of the City of Knoxville:	53,021

Commodity Charge

First	0 to 2	100 Cubic Feet Per Month at $0.85 Per 100 Cubic Feet
Over	2	100 Cubic Feet Per Month at $9.30 Per 100 Cubic Feet

Additional Monthly Customer Charge

5/8" meter	$ 20.00
1" meter	35.00
1 1/2" meter	47.00
2" meter	67.00

Rate Class	Base Charge	Number of Customers
Non-Residential Inside City rate	For wastewater service furnished to premises entirely within the corporate limits of the City of Knoxville:	6,292

Commodity Charge

First	0 to 2	100 Cubic Feet Per Month at $0.70 Per 100 Cubic Feet
Next	8	100 Cubic Feet Per Month at $9.30 Per 100 Cubic Feet
Next	90	100 Cubic Feet Per Month at $8.30 Per 100 Cubic Feet
Next	300	100 Cubic Feet Per Month at $7.10 Per 100 Cubic Feet
Next	4,600	100 Cubic Feet Per Month at $5.80 Per 100 Cubic Feet
Next	5,000	100 Cubic Feet Per Month at $4.30 Per 100 Cubic Feet

Knoxville Utilities Board Wastewater Division

Supplemental Information – Schedule of Current Rates in Force

June 30, 2013

(Unaudited)

Schedule 5

Additional Monthly Customer Charge

5/8" meter	$ 20.00
1" meter	35.00
1 1/2" meter	47.00
2" meter	67.00
3" meter	116.00
4" meter	189.00
6" meter	403.00
8" meter	700.00
10" meter	1,061.00
12" meter	1,564.00

Knoxville Utilities Board Wastewater Division
Supplemental Information – Schedule of Current Rates in Force
June 30, 2013
(Unaudited)

Schedule 5

Rate Class	Base Charge	Number of Customers
Residential Outside City rate	For wastewater service furnished to premises entirely or partly outside the corporate limits of the City of Knoxville:	7,240

Commodity Charge

First	0 to 2	100 Cubic Feet Per Month at $0.70 Per 100 Cubic Feet
Over	2	100 Cubic Feet Per Month at $8.70 Per 100 Cubic Feet

Additional Monthly Customer Charge

5/8" meter	$ 24.00
1" meter	38.00
1 1/2" meter	55.00
2" meter	75.00

Rate Class	Base Charge	Number of Customers
Non-Residential Outside City rate	For wastewater service furnished to premises entirely or partly outside the corporate limits of the City of Knoxville:	286

Commodity Charge

First	0 to 2	100 Cubic Feet Per Month at $0.85 Per 100 Cubic Feet
Next	8	100 Cubic Feet Per Month at $10.30 Per 100 Cubic Feet
Next	90	100 Cubic Feet Per Month at $9.10 Per 100 Cubic Feet
Next	300	100 Cubic Feet Per Month at $7.80 Per 100 Cubic Feet
Next	4,600	100 Cubic Feet Per Month at $6.50 Per 100 Cubic Feet
Next	5,000	100 Cubic Feet Per Month at $4.80 Per 100 Cubic Feet

Knoxville Utilities Board Wastewater Division

Supplemental Information – Schedule of Current Rates in Force

June 30, 2013

(Unaudited)

Schedule 5

Additional Monthly Customer Charge

5/8" meter	$ 24.00
1" meter	38.00
1 1/2" meter	55.00
2" meter	75.00
3" meter	131.00
4" meter	209.00
6" meter	442.00
8" meter	771.00
10" meter	1,164.00
12" meter	1,718.00

• Certified Public Accountants
• Business Advisors

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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.

Rodefer Moss & Co, PLLC

Knoxville, Tennessee
October 22, 2013

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• Business Advisors

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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.

Rodefer Moss & Co, PLLC

Knoxville, Tennessee
October 22, 2013