

# **Knoxville Utilities Board**

**Consolidated Financial Statements and  
Supplemental Information**

**June 30, 2015 and 2014**

# Knoxville Utilities Board

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June 30, 2015 and 2014

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## Report of Independent Auditors

Board of Commissioners  
Knoxville Utilities Board  
Knoxville, Tennessee

We have audited the accompanying financial statements of the Knoxville Utilities Board (KUB), a component unit of the City of Knoxville, Tennessee, as of and for the year ended June 30, 2015, and the related notes to the financial statements, which collectively comprise KUB's basic financial statements as listed in the index.

### **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.

### **Auditor's Responsibility**

Our responsibility is to express an opinion 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 KUB'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 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 financial statements.

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

### **Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of KUB as of June 30, 2015, and the changes in its financial position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

### **Change in Accounting Principle**

As discussed in Note 10 to the financial statements, effective July 1, 2014, KUB adopted new accounting guidance, Governmental Accounting Standards Board Statement No. 68, *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27*. Our opinion is not modified with respect to that matter.

### **Other Matters**

#### *Prior Period Financial Statements*

The financial statements of KUB as of and for the year ended June 30, 2014, were audited by other auditors whose report dated October 24, 2014, expressed an unmodified opinion on those statements.

Board of Commissioners  
Knoxville Utilities Board  
Knoxville, Tennessee

**Other Matters (continued)**

*Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 26 and the required supplementary information on pages 62 through 64 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 an opinion on the financial statements that collectively comprise KUB's basic financial statements. The schedule of insurance in force is presented for purposes of additional analysis and is not a required part of the basic financial statements. The schedule of expenditures of federal awards and state financial assistance 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 the State of Tennessee Comptroller of the Treasury Office and is also not a required part of the basic financial statements.

The schedule of expenditures of federal awards and state financial assistance 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 schedule of expenditures of federal awards and state financial assistance is fairly stated in all material respects in relation to the basic financial statements as a whole.

The schedule of insurance in force has 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 it.

**Other Reporting Required by Government Auditing Standards**

In accordance with *Government Auditing Standards*, we have also issued our report dated October 16, 2015 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.

*Coulter & Justus, P. C.*

Knoxville, Tennessee  
October 16, 2015

# **Knoxville Utilities Board**

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

### **June 30, 2015 and 2014**

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Knoxville Utilities Board (KUB), comprised of the Electric Division, Gas Division, Water Division, and Wastewater Division (Divisions), is reported as a component unit enterprise fund in the financial statements of the City of Knoxville. KUB's responsibility is to oversee the purchase, production, distribution, and processing of electricity, natural gas, water, and wastewater services. A seven-member Board of Commissioners (Board) 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, 2015 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, 2015, KUB served 447,945 customers. KUB added 2,684 new customers in fiscal year 2015, representing growth of less than 1 percent.

Cold weather events resulted in new system peaks for the electric and natural gas systems. The natural gas system set a new daily peak in February 2015 at 136,356 dekatherms. The previous gas system peak was 133,366 dekatherms in January 2014. In February 2015, KUB's electric system also set a new hourly peak at 1,328 megawatt hours. The previous hourly peak was 1,313 megawatt hours, which occurred in January 2014.

KUB's electric system achieved record setting performance for electric reliability with only 1.67 hours of service interruption for the average electric system customer (excluding major storm events).

The first of three annual rate increases for each Division previously adopted by the KUB Board of Commissioners went into effect in fiscal year 2015. These rate increases will provide additional revenue to help fund each system's respective Century II infrastructure program.

The Board of Commissioners endorsed long-term funding plans for several key strategic initiatives including Century II Meter and Grid Modernization, Water System Redundancy, Workforce Planning, Downtown Electric Network upgrades, and several key Environment and Sustainability projects. These initiatives will help ensure KUB continues to meet its vision of providing safe, reliable and affordable services to its customers over the long-term. KUB's new ten-year financial plan included \$177 million for these initiatives.

In August 2014, KUB issued \$78 million of new revenue bonds to fund capital system improvements, including \$40 million for the electric system, \$8 million for the water system and \$30 million for the wastewater system.

# **Knoxville Utilities Board**

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

### **June 30, 2015 and 2014**

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In April 2015, KUB issued \$85 million of new revenue bonds to fund capital system improvements, including \$35 million for the electric system, \$20 million for the water system and \$30 million for the wastewater system.

As part of the August 2014 bond sale, the water system's bond rating from Standard & Poor's was upgraded to AAA from AA+. The AAA rating represents the highest rating from Standard & Poor's. All KUB bonds are highly-rated by the Standard and Poor's and Moody's Investment Service. Electric bonds are rated AA+/Aa2, gas bonds AA/Aa2, water bonds AAA/Aa2 and wastewater bonds AA+/Aa2.

In April 2015, KUB issued \$193.2 million of revenue refunding bonds to refinance debt, including \$28.6 million for the electric system, \$11.8 million for the gas system, \$23 million for the water system and \$129.8 million for the wastewater system. This refunding will provide debt service savings of \$19.2 million over the life of the bonds.

KUB's electric service territory was impacted by an ice storm event in February 2015 that resulted in a cost of \$2 million to the Electric Division. KUB anticipates reimbursements totaling \$1.6 million from the Federal Emergency Management Agency (FEMA) in future periods to offset the cost of the 2015 event.

Two historic storm events, with a combined cost of \$8.4 million, impacted the electric, water and wastewater systems during fiscal year 2011. To date, KUB has received \$4.4 million in reimbursements from the Federal Emergency Management Agency (FEMA). No reimbursements were received during fiscal year 2015. KUB anticipates an additional \$1.5 million in reimbursements from FEMA in fiscal year 2016.

KUB's treatment plants continue to meet high standards of operation. KUB's Eastbridge, Fourth Creek and Loves Creek wastewater treatment plants won Operational Excellence awards from the Tennessee Kentucky Water Environment Association for having no violations within the 2014 calendar year. The Kuwahee wastewater plant was awarded the National Association of Clean Water Agencies Peak Performance Silver award for outstanding compliance within the permitted limits for 2014 while the Eastbridge wastewater plant was awarded Platinum.

KUB continued to maintain certification with the National Biosolids Partnership following a rigorous review process and independent audit that was conducted in December 2014. (Biosolids are nutrient-rich organic matter produced by wastewater treatment that can be recycled as fertilizer).

## **Century II Infrastructure Program**

Century II is KUB's proactive long-range program to improve and maintain the electric, natural gas, water and wastewater systems for its customers. It includes maintenance and replacement strategies for each system and establishes sustainable replacement cycles. Century II moves KUB into its second century of service by improving each system through sound planning, resource allocation, and continued, but accelerated, investment.

KUB's Century II programs were resumed in 2011, after a break due to the economic recession. At that time, the KUB Board of Commissioners endorsed ten year funding plans for the electric and water systems, which include a combination of rate increases and debt issues to fully fund each Division's Century II program. The Board adopted three years of electric and water rate increases to help fund those plans. All three of those rate increases, adopted in 2011, have gone into effect.

In 2013, the Board extended the funding approach for Century II to include the natural gas and wastewater systems. The Board formally endorsed and adopted by resolution, ten year funding plans for the natural gas and wastewater systems, which include a combination of rate increases and debt issues to fully fund each Division's Century II program.

# **Knoxville Utilities Board**

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

### **June 30, 2015 and 2014**

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In April 2014, KUB management provided the Board an updated assessment of the overall condition of each utility system, including a recommendation for annual rate increases for each division for the next three fiscal years.

In June 2014, the Board approved the proposed three annual rate increases for all KUB Divisions. The electric rate increase will generate an additional \$5 million, while the gas rate increase will generate an additional \$1.8 million. The water rate increase will produce an additional \$2 million and wastewater will produce \$4.7 million of annual sales revenues.

For the fiscal year, KUB maintained its overall Century II capital budget. The electric system replaced 2,551 poles, exceeding the target level of 2,400 and 6.2 miles of underground electric cable. The natural gas system had 5.8 miles of cast iron/ductile iron gas main replaced. The water system replace 9.4 miles of galvanized water main and 6.1 miles of cast iron water main were replaced in the water system. The wastewater system rehabilitated or replaced 30.4 miles of wastewater system main, exceeding the target level of 25 miles. All systems remain on track to achieve long term infrastructure goals.

### **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. Through its PACE 10 program, KUB is addressing the terms of the Consent Decree. 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 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, 2015, the Wastewater Division had issued \$485 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, two 12 percent rate increases, which were effective in April 2011 and October 2012, and three 6 percent rate increases effective October 2014, October 2015 and October 2016, 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 306.9 miles of collection system pipe. KUB also

# **Knoxville Utilities Board**

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

### **June 30, 2015 and 2014**

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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 2015, the Wastewater Division incurred \$32 million in total expenditures related to Consent Decree requirements, including \$4 million for operating costs and \$28 million in capital improvements which included the rehabilitation or replacement of 30.4 miles of wastewater main. During the fiscal year, \$22.5 million was spent on sewer mini-basin rehab and replacement. Trunk line replacement and rehabilitation accounted for \$1.2 million of capital expenditures during the fiscal year, while pump station improvements accounted for \$2.8 million.

As of June 30, 2015, the Wastewater Division had completed its eleventh full year under the Consent Decree, spending \$495.5 million on capital investments to meet Consent Decree requirements. All collection system projects required under the federal Consent Decree were completed as of June 30, 2014.

## **Financial Highlights**

### ***Fiscal Year 2015 Compared to Fiscal Year 2014***

KUB's consolidated net position increased \$36 million. This increase was \$6.2 million greater than the prior year's change in net position. A restatement to the prior fiscal year's net position based on a change in method of accounting for the pension reduced the total net position by \$0.8 million during fiscal year 2015. This change resulted in a net increase of \$35.2 million or 3.9 percent in KUB's consolidated net position.

Operating revenue increased \$12 million or 1.6 percent, the result of additional revenue from electric, gas, water, and wastewater rate increases and modest increases in natural gas, water, and wastewater sales volumes. Purchased energy expense (power and natural gas) decreased \$4.9 million or 1 percent, the net effect of \$0.7 million increase in purchased power and a decrease of \$5.6 million in purchased gas. Margin from sales (operating revenue less purchased energy expense) was up \$16.9 million or 6.3 percent compared with the prior fiscal year.

Operating expenses (excluding purchased power and purchased gas expense) increased \$12 million, or 5.9 percent. Operating and maintenance (O&M) expenses were \$3.6 million or 3 percent higher than the previous year. Depreciation expense increased \$5.8 million or 10.4 percent. Taxes and tax equivalents increased \$2.6 million or 9.4 percent, reflecting higher plant in service levels and a property tax increase by the City of Knoxville.

Interest income was consistent with the prior fiscal year. Interest expense increased \$0.9 million or 2.5 percent, reflecting interest costs on \$163 million in revenue bonds issued during the fiscal year to fund system capital improvements.

Capital contributions decreased \$0.1 million, the result of less contributed assets from developers.

Total plant assets (net) increased \$102.3 million or 6.6 percent over the last fiscal year.

KUB sold six series of revenue bonds during fiscal year 2015 for the purpose of funding capital improvements totaling \$163 million. The \$85 million bond issue in April 2015 was accelerated to take advantage of the low interest rate environment which impacted the debt ratio and debt service coverage levels for fiscal year 2015. Long-term debt represented 52 percent of KUB's capital structure, compared to 49.2 percent last year. Capital structure equals long-term debt (including the current and long-term portion of revenue bonds and notes), plus net position.



# **Knoxville Utilities Board**

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

### **June 30, 2015 and 2014**

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#### ***Fiscal Year 2014 Compared to Fiscal Year 2013***

KUB's consolidated net position increased \$29.8 million in fiscal year 2014, compared to a \$28.3 million increase in fiscal year 2013.

Operating revenue increased \$8.5 million or 1.1 percent, the result of higher electric and natural gas sales volumes and additional revenue from electric, gas, and water rate increases. Purchased energy expense (power and natural gas) decreased \$5.2 million or 1.1 percent, the net effect of \$12.1 million decline in purchased power and an increase of \$6.9 million in purchased gas. Margin from sales (operating revenue less purchased energy expense) was up \$13.7 million or 5.4 percent compared with the prior fiscal year.

Operating expenses (excluding purchased power and purchased gas expense) increased \$10.4 million, or 5.4 percent. Operating and maintenance (O&M) expenses were \$5.8 million or 5.1 percent higher than the previous year. Depreciation expense increased \$3.5 million or 6.7 percent. Taxes and tax equivalents increased \$1.1 million or 4.1 percent.

Lower interest rates on investments resulted in a \$0.2 million decrease in interest income. Interest expense increased \$1.8 million or 5 percent, reflecting interest costs on \$50 million in gas and water revenue bonds sold during the fiscal year and a full year of interest on \$110 million of electric, gas and wastewater system bonds sold the previous fiscal year. Interest expense was reduced by lower interest rates from debt refunding in previous fiscal years. These items contributed to a net decrease in non-operating revenues (expenses) of \$2.3 million compared to the prior year.

Capital contributions increased \$0.4 million, the result of an increase in contributed assets from developers.

Total plant assets (net) increased \$83.2 million or 6 percent over the last fiscal year.

Long-term debt represented 49.2 percent of KUB's capital structure, compared to 49.3 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.

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**Knoxville Utilities Board  
Management's Discussion and Analysis  
June 30, 2015 and 2014**

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**Cash Budget Appropriations**

KUB's Board of Commissioners adopted a total cash budget of \$867.6 million for fiscal year 2015. In April 2015, additional appropriations were approved by the Board in the amount of \$30.5 million for higher than anticipated wholesale energy costs, increased capital costs and increased payments in lieu of taxes. Actual disbursements exceeded the original budget by \$10.8 million, with purchased energy exceeding the original budget by \$15.1 million. O&M and capital expenses were under the budget by a total of \$5.6 million, reflecting lower than anticipated staffing levels and savings in utilities and chemical costs. KUB's general fund balance was \$47.1 million more than expected primarily due to the acceleration of \$85 million in bonds sold in April and operating receipts greater than anticipated as a result of colder than normal winter weather. The chart below depicts KUB's original budget compared to actual results and is presented on a cash basis.

**KUB Consolidated Cash Report  
As of June 30, 2015**

<i>(in thousands of dollars)</i>	<b>FY 2015 Budget**</b>	<b>FY 2015 Actual FYTD</b>	<b>Dollar Variance*</b>	<b>Percent Variance</b>
Beginning Balance General Fund	\$113,079	\$113,079		
Operating Receipts	760,577	776,519	15,942	2.1%
Disbursements				
Purchased Energy Expense	473,423	488,480	(15,057)	-3.2%
Operation & Maintenance Expense	132,256	126,731	5,525	4.2%
Capital Expenditures	168,249	168,140	109	0.1%
Debt Service	63,825	64,862	(1,037)	-1.6%
Taxes & Tax Equivalents	29,840	30,158	(318)	-1.1%
Total Disbursements	867,593	878,371	(10,778)	-1.2%
Bond Proceeds	77,220	120,519	43,299	56.1%
Net Flow throughs and Transfers	(5,521)	(6,853)	(1,332)	-24.1%
Ending General Fund Balance	<u>\$ 77,762</u>	<u>124,893</u>	<u>\$ 47,131</u>	<u>60.6%</u>

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

\*\* *Excludes additional appropriations of \$30.5 million*

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**Knoxville Utilities Board  
Management's Discussion and Analysis  
June 30, 2015 and 2014**

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**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 how 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.

**Knoxville Utilities Board**  
**Management's Discussion and Analysis**  
**June 30, 2015 and 2014**

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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 and the year preceding the prior year.

**Statements of Net Position**  
**As of June 30**

<i>(in thousands of dollars)</i>	<b>2015</b>	<b>2014</b>	<b>2013</b>
Current, restricted and other assets	\$ 413,061	\$ 347,698	\$ 373,647
Capital assets, net	1,651,147	1,548,874	1,465,671
Deferred outflows of resources	<u>28,388</u>	<u>12,252</u>	<u>13,002</u>
Total assets and deferred outflows of resources	<u>2,092,596</u>	<u>1,908,824</u>	<u>1,852,320</u>
Current and other liabilities	152,535	161,523	173,335
Long-term debt outstanding	1,005,062	853,887	815,340
Deferred inflows of resources	<u>6,378</u>	<u>-</u>	<u>-</u>
Total liabilities and deferred inflows of resources	<u>1,163,975</u>	<u>1,015,410</u>	<u>988,675</u>
Net position			
Net investment in capital assets	650,464	688,374	630,793
Restricted	14,892	13,163	12,372
Unrestricted	<u>263,265</u>	<u>191,877</u>	<u>220,480</u>
Total net position	<u>\$ 928,621</u>	<u>\$ 893,414</u>	<u>\$ 863,645</u>

**Normal Impacts on Statement of Net Position**

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

- Change in net position (from Statement of Revenues, Expenses and Changes in Net Position): impacts (increase/decrease) current and other assets and/or capital assets and unrestricted net position.
- Issuing debt for capital: increases deferred 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.

# Knoxville Utilities Board

## Management's Discussion and Analysis

### June 30, 2015 and 2014

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## Impacts and Analysis

### Current, Restricted and Other Assets

#### *Fiscal Year 2015 Compared to Fiscal Year 2014*

Current, restricted and other assets increased \$65.4 million or 18.8 percent. The increase was primarily attributable to a \$45 million increase in unused bond proceeds. General fund cash (including cash and cash equivalents, short-term investments, and long-term investments) increased \$11.8 million. Operating contingency reserves increased \$7.8 million. Due to the adoption of a new accounting standard, GASB 68 (See Notes to the Financial Statements), the net pension asset increased \$6 million. These increases were partially offset by a \$3.5 million decline in other assets, \$1.1 million decrease in prepaid expenses, a \$0.8 million decrease in gas in storage, and a decrease in inventories of \$0.7 million.

#### *Fiscal Year 2014 Compared to Fiscal Year 2013*

Current, restricted and other assets decreased \$25.9 million or 6.9 percent. The decrease was primarily attributable to the use of general fund cash (including cash and cash equivalents, short-term investments, and long-term investments) to fund a portion of capital expenditures in fiscal year 2014. This was reflected by the \$40.1 million decrease in general fund cash. The decrease in general fund cash was offset by a \$4.3 million increase in operating contingency reserves, \$1.1 million increase in inventories, a \$0.9 million increase in gas in storage, and an increase in accounts receivable of \$0.5 million.

### Capital Assets

#### *Fiscal Year 2015 Compared to Fiscal Year 2014*

Capital assets (net) increased \$102.3 million or 6.6 percent. Major plant expenditures (reflected in both plant additions and work in progress) during fiscal year 2015 included \$28.7 million for various electric distribution system improvements, \$25.3 million for Century II projects for the wastewater collection system, \$12.5 million for water main replacement, \$8.4 million for information system upgrades, \$7.8 million for water plant and system improvements, \$6 million for gas main replacement and \$6 million for pole replacements for the electric system.

#### *Fiscal Year 2014 Compared to Fiscal Year 2013*

Capital assets (net) increased \$83.2 million or 5.7 percent. Major plant expenditures (reflected in both plant additions and work in progress) during fiscal year 2014 included \$34 million for PACE 10 projects for the wastewater collection system, \$31.8 million for electric distribution system improvements, \$9.8 million for gas main replacement, \$9.2 million for water plant and system improvements, \$8.7 million for pole replacements for the electric system and \$7.7 million for water main replacement.

### Deferred Outflows of Resources

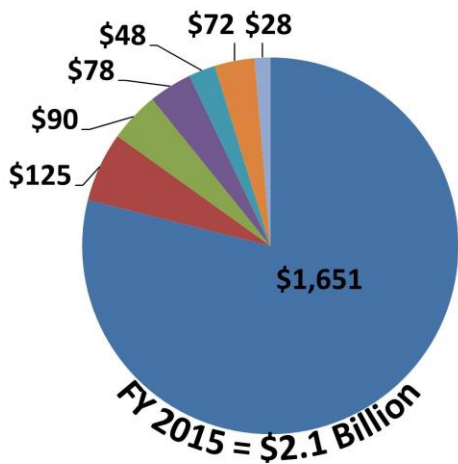
#### *Fiscal Year 2015 Compared to Fiscal Year 2014*

Deferred outflows of resources increased \$16.1 million compared to the prior year, reflecting amortization of deferred losses on bonds refunded during the fiscal year.

#### *Fiscal Year 2014 Compared to Fiscal Year 2013*

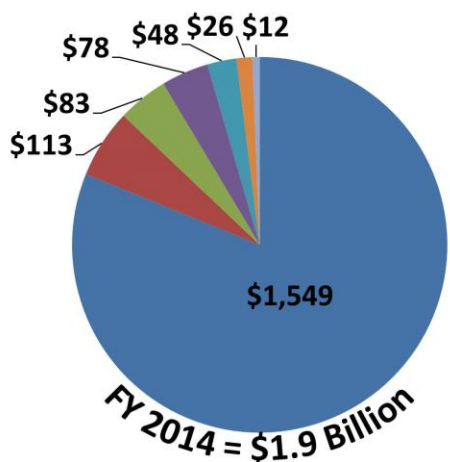
Deferred outflows of resources decreased \$0.8 million compared to the prior year, reflecting amortization of deferred losses on bonds refunded in prior periods.

**Knoxville Utilities Board  
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**Consolidated Total Assets and  
Deferred Outflows of Resources  
(in Millions)**

	<u>FY15</u>	<u>FY14</u>
Plant	79%	81%
General Fund	6%	6%
Contingency Fund	4%	4%
Accounts Receivable	4%	4%
Other Assets	2%	3%
Restricted Assets	4%	1%
Deferred Outflows of Resources	1%	1%



**Current and Other Liabilities**

***Fiscal Year 2015 Compared to Fiscal Year 2014***

Current and other liabilities decreased \$9 million or 5.6 percent. KUB over recovered \$1.1 million in wholesale gas costs from its customers in fiscal year 2015, as compared to a \$1.3 million over recovery in fiscal year 2014. Over recovery of purchased power expenses decreased \$3.9 million in fiscal year 2015. The over recovery of purchased power and gas costs will be refunded to KUB's electric and gas customers through future adjustments to electric and gas rates via the Purchased Power Adjustment and Purchased Gas Adjustment, respectively. Accrued expenses decreased \$7.5 million and accounts payable decreased \$2.5 million. This decrease was partially offset by an increase in the current portion of debt related to bonds of \$4.1 million.

***Fiscal Year 2014 Compared to Fiscal Year 2013***

Current and other liabilities decreased \$11.8 million or 6.8 percent. Accounts payable decreased \$6.4 million, primarily due to less contractor costs from Century II projects for June 2014 compared to the same month last year. KUB over recovered \$1.3 million in wholesale gas costs from its customers in fiscal year 2014, as compared to a \$0.8 million under recovery in fiscal year 2013. Over recovery of purchased power expenses decreased \$0.5 million in fiscal year 2014. The over recovery of purchased power and

# **Knoxville Utilities Board**

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### **June 30, 2015 and 2014**

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gas costs was refunded to KUB's electric and gas customers through adjustments to electric and gas rates via the Purchased Power Adjustment and Purchased Gas Adjustment, respectively. In addition, the liability for the current portion of debt related to bonds increased \$1.8 million compared to the prior year. Other bond related costs decreased \$7.4 million.

#### **Long-term Debt**

##### ***Fiscal Year 2015 Compared to Fiscal Year 2014***

Long-term debt increased \$151.2 million or 17.7 percent. During the fiscal year, \$26.2 million of bond debt was repaid. During the fiscal year, KUB issued \$163 million in revenue bonds to fund capital improvements for the electric, water and wastewater systems. The increase was partially offset by the scheduled repayment of bond debt.

##### ***Fiscal Year 2014 Compared to Fiscal Year 2013***

Long-term debt increased \$23.7 million or 2.9 percent. During the fiscal year, \$24.6 million of bond debt was repaid. In October 2014, KUB sold \$50 million in revenue bonds to fund capital improvements for the gas and water systems.

#### **Deferred Inflows of Resources**

##### ***Fiscal Year 2015 Compared to Fiscal Year 2014***

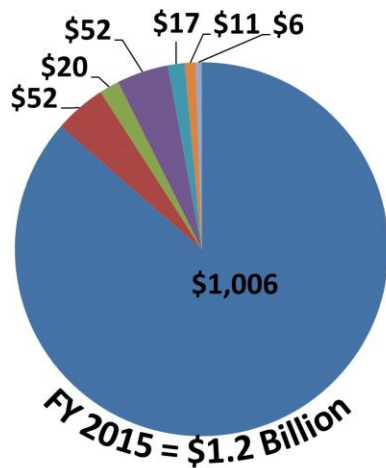
Deferred inflows increased \$6.4 million compared to the prior fiscal year due to the addition of pension inflow. For further explanation, see Notes to the Financial Statements.

##### ***Fiscal Year 2014 Compared to Fiscal Year 2013***

There were no deferred inflows of resources in either fiscal year 2014 or fiscal year 2013.

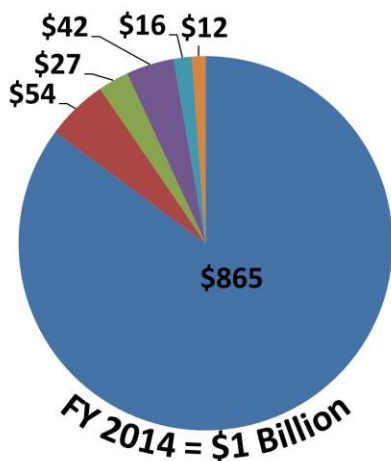
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**Knoxville Utilities Board  
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**Consolidated Total Liabilities and  
Deferred Inflows of Resources  
(in Millions)**

	<u>FY15</u>	<u>FY14</u>
■ Bond Debt	86%	85%
■ Payables	4%	5%
■ Misc Current	2%	3%
■ Other Liabilities	5%	4%
■ Customer Deposits	1%	2%
■ Interest Accrued	1%	1%
■ Deferred Inflows of Resources	1%	-



**Net Position**

***Fiscal Year 2015 Compared to Fiscal Year 2014***

Net position increased by \$35.2 million in fiscal year 2015. Net investment in capital assets decreased \$37.9 million or 5.5 percent, the net result of net capital assets increasing \$102.3 million offset by the \$137.4 million increase in long term debt from new bond issuances. Restricted net position increased \$1.7 million compared to the prior year. Unrestricted net position increased \$71.4 million or 37.2 percent compared to the previous fiscal year, reflecting increased unused bond proceeds and general fund cash.

***Fiscal Year 2014 Compared to Fiscal Year 2013***

Net position increased by \$29.8 million in fiscal year 2014. Net investment in capital assets increased \$57.6 million or 9.1 percent due to an increase in net capital assets as well as long term debt. Restricted net position increased \$0.8 million compared to the prior year. Unrestricted net position decreased \$28.6 million or 13 percent compared to the previous fiscal year, reflecting the use of general fund cash to fund capital assets.



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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 and the year preceding the prior year.

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

<i>(in thousands of dollars)</i>	<b>2015</b>	<b>2014</b>	<b>2013</b>
Operating revenues	\$ 763,704	\$ 751,710	\$ 743,249
Less: Purchased energy expense	<u>479,166</u>	<u>484,074</u>	<u>489,322</u>
Margin from sales	<u>284,538</u>	<u>267,636</u>	<u>253,927</u>
Operating expenses			
Treatment	15,319	14,038	13,280
Distribution and collection	62,319	60,100	57,052
Customer service	13,725	12,607	11,991
Administrative and general	30,741	31,747	30,402
Depreciation	61,708	55,885	52,364
Taxes and tax equivalents	<u>29,649</u>	<u>27,097</u>	<u>26,032</u>
Total operating expenses	<u>213,461</u>	<u>201,474</u>	<u>191,121</u>
Operating income	71,077	66,162	62,806
Interest income	917	852	1,032
Interest expense	(37,968)	(37,033)	(35,266)
Other income/(expense)	<u>1,340</u>	<u>(948)</u>	<u>(612)</u>
Change in net position before capital contributions	<u>35,366</u>	<u>29,033</u>	<u>27,960</u>
Capital contributions	606	736	378
Change in net position	<u>\$ 35,972</u>	<u>\$ 29,769</u>	<u>\$ 28,338</u>

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

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

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

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### **June 30, 2015 and 2014**

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- Interest income is impacted by level of interest rates and investments.
- Interest expense on debt is impacted by level of outstanding debt and the interest rate(s) on the outstanding debt.
- Other income/(expenses) is impacted by 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).

## **Impacts and Analysis**

### **Margin from Sales**

#### ***Fiscal Year 2015 Compared to Fiscal Year 2014***

KUB's consolidated net position increased \$36 million. This increase was \$6.2 million greater than the prior year's change in net position. A restatement to the prior fiscal year's net position based on a change in method of accounting for pension expense reduced the total net position by \$0.8 million during fiscal year 2015. This change resulted in a net increase of \$35.2 million or 3.9 percent in KUB's consolidated net position.

Operating revenue was \$12 million or 1.6 percent higher than the previous fiscal year. Electric Division operating revenue increased \$5.9 million, the net result of additional revenue from KUB's electric rate increases, the flow through of TVA rate adjustments and the flow through of prior year over recovered purchased power costs. Gas Division revenue decreased \$3 million for the fiscal year, the net result of additional revenue from rate increases effective October 2013 and October 2014 and the flow through of lower wholesale gas commodity costs. Water Division revenue increased \$4.8 million, the result of additional revenue from water rate increases and a 1.6 percent increase in water sales volumes. Wastewater Division revenue was \$4.3 million higher than the previous year due to additional revenue from the wastewater rate increase effective October 2014 and a 0.9 percent increase in wastewater billed sales volumes.

Wholesale energy expense decreased \$4.9 million or 1 percent. Purchased power expense increased \$0.7 million compared to last year, the net effect of a 1.5 percent increase to wholesale rate from TVA, coupled with decreased fuel costs. Purchased gas expense was \$5.6 million lower, due to lower commodity costs.

Margin from sales (operating revenue less purchased energy expense) increased \$16.9 million compared to the previous year. The increase reflects a higher level of gas sales volumes and additional revenue from the electric, gas, water, and wastewater rate increases.

#### ***Fiscal Year 2014 Compared to Fiscal Year 2013***

KUB's consolidated net position increased \$29.8 million, compared to a \$28.3 million increase last fiscal year.

Operating revenue was \$8.5 million or 1.1 percent higher than the previous fiscal year. Electric Division operating revenue decreased \$6.8 million, the net effect of the flow through of over recovered purchased power costs from the prior fiscal year, a 1.4 percent increase in billed sales volumes and additional revenue from electric rate increases effective October 2012 and 2013. Gas Division revenue increased

## **Knoxville Utilities Board Management's Discussion and Analysis June 30, 2015 and 2014**

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\$13.5 million or 13.1 percent for the fiscal year, the result of a 4.2 percent rise in natural gas billed sales volumes. Water Division revenue increased \$1.3 million or 3.5 percent, the net result of additional revenue from water rate increases and a 2.3 percent decline in water sales volumes. Wastewater Division revenue was \$0.5 million higher than the previous year, the net effect of a full year of revenue from a rate increase effective October 2012 and a 1.9 percent decline in wastewater billed sales volumes.

Wholesale energy expense decreased \$5.2 million or 1.1 percent. Purchased power expense decreased \$12.1 million compared to last year, the net result of higher sales volumes, and lower wholesale power rates from TVA. Purchased gas costs were \$6.9 million higher, reflecting increased wholesale gas purchases to meet higher customer demand from cold winter weather.

Margin from sales (operating revenue less purchased energy expense) increased \$13.7 million compared to the previous year. The increase reflects a higher level of energy sales volumes, a full year of revenue from the electric, water, and wastewater rate increases, as well as a partial year's revenue from the gas rate increase.

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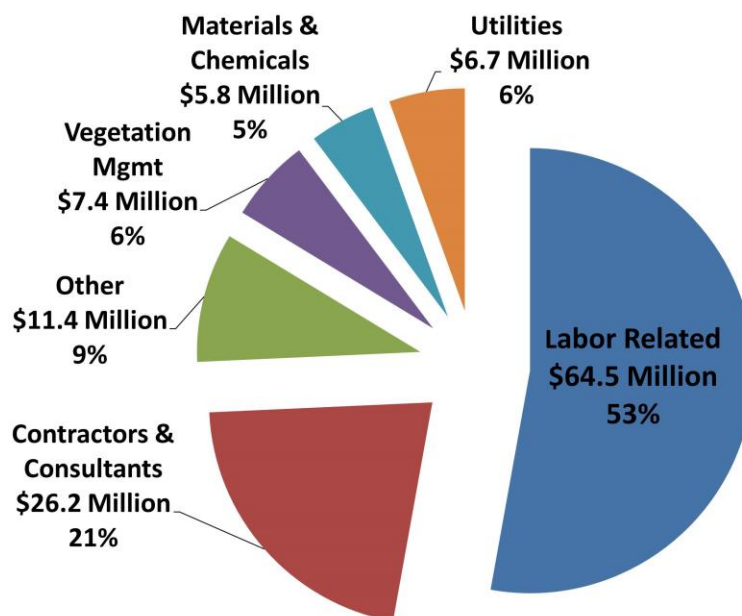
**Operating Expenses**

***Fiscal Year 2015 Compared to Fiscal Year 2014***

Operating expenses (excluding wholesale purchased energy expense) increased \$12 million or 5.9 percent compared to fiscal year 2014. Operating expenses include operations and maintenance (O&M) expense, depreciation, and taxes/tax equivalents. O&M expenses can be further classified as treatment, distribution and collection, customer service and administrative and general.

- Treatment expenses were \$1.3 million or 9.1 percent higher than the prior year, reflecting an increase in consultant and contractor expenses for the water and wastewater systems.
- Distribution and collection expenses increased \$2.2 million or 3.7 percent, primarily the result of restoration expenses related to the February 2015 ice storm, higher labor related expenses, vegetation management expenses, and outside consultant expenses.
- Customer service expenses rose \$1.1 million or 8.9 percent, due to an increase in computer software expenses and consultant expense during the fiscal year.
- Administrative and general expenses decreased \$1 million or 3.2 percent, primarily due to a decrease in pension expense.

**FY 2015 Consolidated O&M Expense = \$122.1 Million**



- Depreciation expense increased \$5.8 million or 10.4 percent. KUB added \$174 million in assets during fiscal year 2014. A full year of depreciation expense was recorded on these capital investments during fiscal year 2014 and a partial year of depreciation expense was incurred on \$94.5 million in assets placed in service during fiscal year 2015.
- Taxes and tax equivalents increased \$2.6 million or 9.4 percent. Tax equivalent payments to taxing jurisdictions in which KUB's utility systems are located are based on a combination of

# Knoxville Utilities Board

## Management's Discussion and Analysis

### June 30, 2015 and 2014

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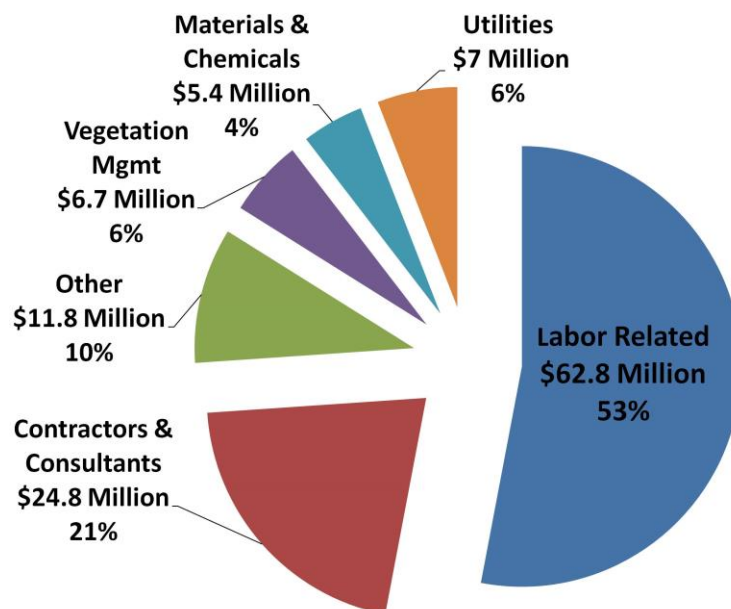
net plant values and margin from sales. The City of Knoxville's property tax rate increased this year and higher plant in service and margin levels both contributed to the growth in tax equivalent payments.

#### ***Fiscal Year 2014 Compared to Fiscal Year 2013***

Operating expenses (excluding wholesale purchased energy expense) increased \$10.4 million or 5.4 percent compared to fiscal year 2013. Operating expenses include operations and maintenance (O&M) expense, depreciation, and taxes/tax equivalents. O&M expenses can be further classified as treatment, distribution and collection, customer service and administrative and general.

- Treatment expenses were \$0.8 million or 5.7 percent higher than the prior year, reflecting an increase in labor related expenses for the water and wastewater systems.
- Distribution and collection expenses increased \$3 million or 5.3 percent, primarily the result of higher contractor expenses for electric substation breaker replacements and transformer testing, as well as higher labor related expenses.
- Customer service expenses rose \$0.6 million or 5.1 percent, partially due to a \$0.4 million increase in meter reading expenses, reflecting higher unit meter reading costs.
- Administrative and general expenses increased \$1.3 million or 4.4 percent, due to labor related expenses.

#### **FY 2014 Consolidated O&M Expense = \$118.5 Million**



- Depreciation expense increased \$3.5 million or 6.7 percent. KUB added \$146.1 million in assets during fiscal year 2013. A full year of depreciation expense was recorded on these capital investments during fiscal year 2014 and a partial year of depreciation expense was incurred on \$174 million in assets placed in service during fiscal year 2014.
- Taxes and tax equivalents increased \$1.1 million or 4.1 percent. Tax equivalent payments to taxing jurisdictions in which KUB's utility systems are located are based on a combination of

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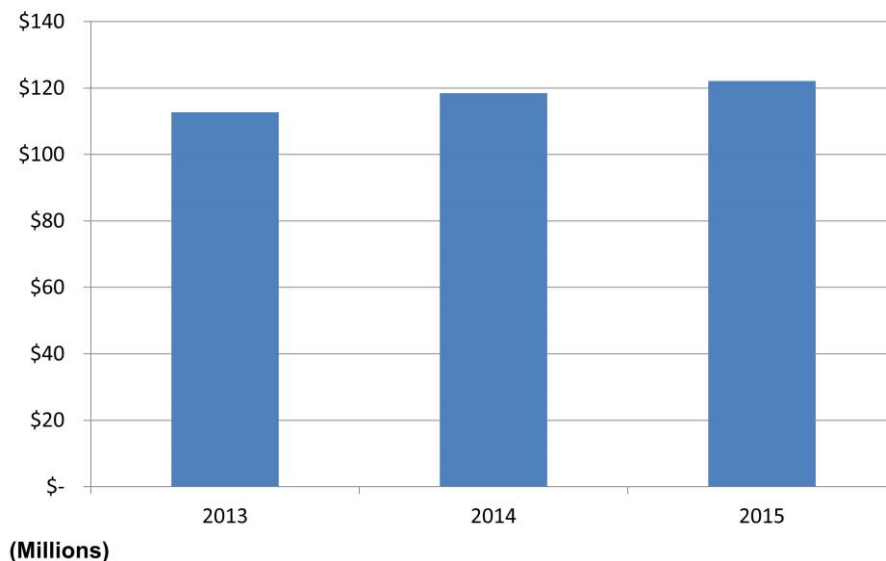
## Management's Discussion and Analysis

### June 30, 2015 and 2014

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net plant values and margin from sales. This increase was primarily due to the rise in KUB's plant values in fiscal year 2013.

#### Consolidated Operation & Maintenance Expense



#### Other Income and Expense

##### *Fiscal Year 2015 Compared to Fiscal Year 2014*

Contributions in aid of construction decreased \$4.6 million compared to the prior fiscal year. This was due to a \$3.9 million contribution from the University of Tennessee during the prior fiscal year, representing a portion of the University's contribution for the South Loop project, a new gas transmission main. The South Loop project will provide additional capacity to meet the University's increased natural gas demand in the future.

Interest income was consistent with the prior fiscal year.

Interest expense increased \$0.9 million or 2.5 percent, reflecting interest expense on \$78 million in bonds issued in August 2014, and \$85 million in bonds issued in April 2015.

Other income (net) increased \$2.3 million, primarily due to \$1.6 million in non-operating income from the accrual of the expected reimbursement of electric system restoration expenses related to the February 2015 ice storm. The loss on disposal of property decreased \$0.5 million compared to the prior fiscal year.

Capital contributions by developers were \$0.1 million lower than last fiscal year.

##### *Fiscal Year 2014 Compared to Fiscal Year 2013*

Contributions in aid of construction increased \$1.1 million compared to the prior fiscal year. This was primarily due to a \$3.9 million contribution from the University of Tennessee, representing a portion of the University's contribution for the South Loop project, a new gas transmission main. The South Loop project will provide additional capacity to meet the University's increased natural gas demand in the future.

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Interest income decreased \$0.2 million or 17.4 percent due to less interest earned on investments, the result of lower interest rates.

Interest expense increased \$1.8 million or 5 percent, reflecting interest expense on \$50 million in bonds sold in September 2013 and a full year of interest on bonds sold in December 2012.

Other income (net) decreased \$0.3 million. The market value of contingency fund investments decreased \$0.2 million compared to the prior fiscal year.

Capital contributions by developers were \$0.4 million higher than last fiscal year. Capital contributions for electric, water, and wastewater systems increased as a result of additional assets received from developers and other governmental entities.

**Capital Assets**

**Capital Assets  
As of June 30  
(Net of Depreciation)**

<i>(in thousands of dollars)</i>	<b>2015</b>	<b>2014</b>	<b>2013</b>
<b>Production Plant (Intakes)</b>	\$ 62	\$ 76	\$ 90
<b>Pumping and Treatment Plant</b>	174,660	177,256	154,157
<b>Distribution and Collection Plant</b>			
Mains and metering	685,480	670,953	612,433
Services and meters	89,086	85,654	83,278
Electric station equipment	34,643	32,797	30,227
Poles, towers and fixtures	93,780	84,332	72,274
Overhead conductors	79,199	73,663	67,449
Line transformers	56,774	55,600	52,503
Other	192,417	191,564	182,765
<b>Total Distribution &amp; Collection Plant</b>	<u>1,231,379</u>	<u>1,194,563</u>	<u>1,100,929</u>
<b>General Plant</b>	<u>51,234</u>	<u>52,149</u>	<u>50,398</u>
<b>Total Plant Assets</b>	<u>1,457,335</u>	<u>1,424,044</u>	<u>1,305,574</u>
Work In Progress	193,812	124,830	160,098
<b>Total Net Plant</b>	<u>\$ 1,651,147</u>	<u>\$ 1,548,874</u>	<u>\$ 1,465,672</u>

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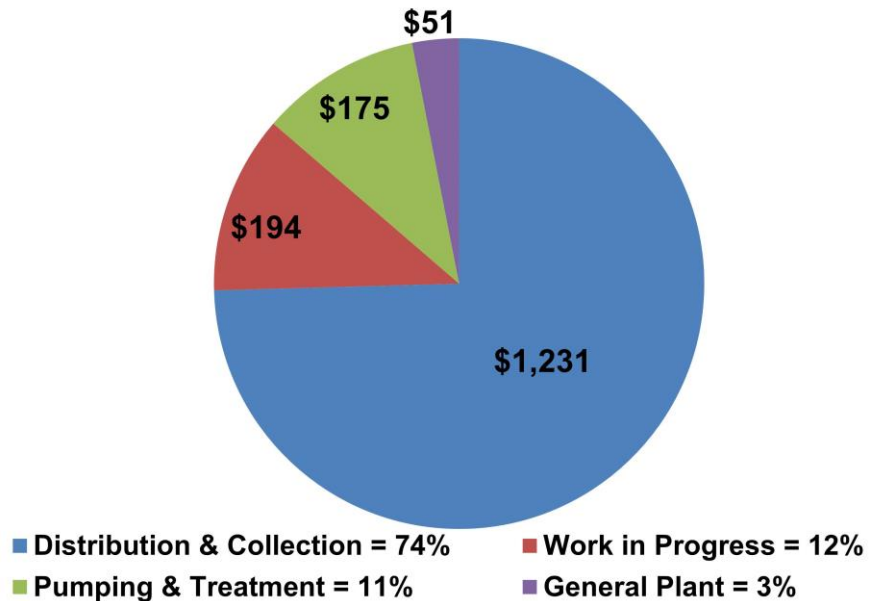
# Knoxville Utilities Board Management's Discussion and Analysis June 30, 2015 and 2014

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## *Fiscal Year 2015 Compared to Fiscal Year 2014*

As of June 30, 2015, KUB had \$1.7 billion invested in capital assets, as reflected in the schedule of Capital Assets, which represents a net increase (including additions, retirements, and depreciation) of \$102.3 million or 6.6 percent over the end of the last fiscal year.

### **FY 2015 Consolidated Capital Assets = \$1.7 Billion** (in Millions)



Major capital asset additions during the year were as follows:

- \$28.7 million for various electric distribution system improvements
- \$25.3 million related to wastewater Century II projects
  - \$20.4 million for sewer mini-basin rehab and replacement
  - \$2.6 million for pump station design and construction
  - \$1.3 million for wastewater treatment plant upgrades
  - \$1 million for sewer trunk line replacement and rehabilitation
- \$12.5 million for main replacement for the water system
- \$8.4 million for information system upgrades
- \$7.8 million for water plant and system improvements
- \$6 million for gas main replacement
- \$6 million for pole replacements for the electric system



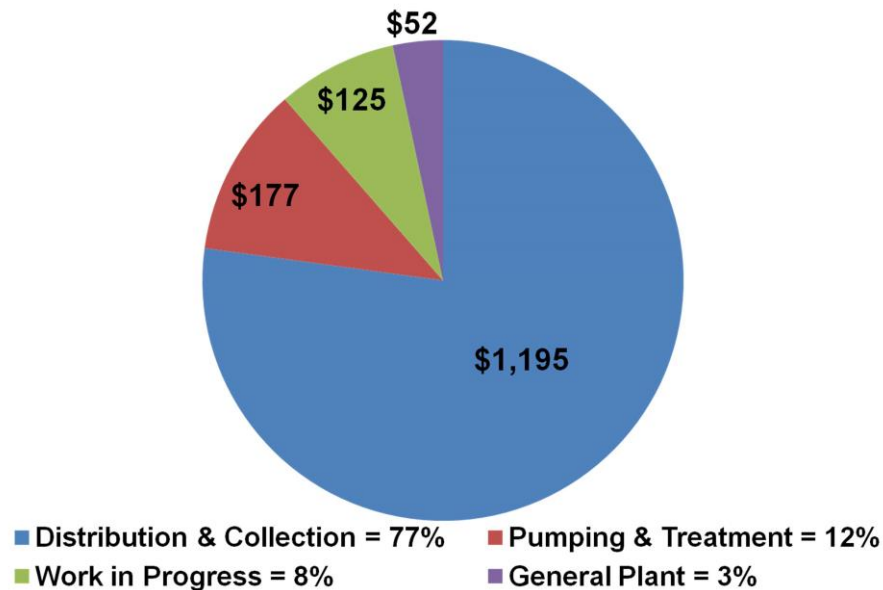
# Knoxville Utilities Board Management's Discussion and Analysis June 30, 2015 and 2014

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## *Fiscal Year 2014 Compared to Fiscal Year 2013*

As of June 30, 2014, KUB had \$1.5 billion invested in capital assets, as reflected in the schedule of Capital Assets, which represents a net increase (including additions, retirements, and depreciation) of \$83.2 million or 5.7 percent over the end of the last fiscal year.

### **FY 2014 Consolidated Capital Assets = \$1.5 Billion** (in Millions)



Major capital asset additions during the year were as follows:

- \$34 million related to PACE 10 projects
  - \$26 million for sewer mini-basin rehab and replacement
  - \$3.7 million for pump station design and construction
  - \$2.2 million for sewer trunk line replacement and rehabilitation
- \$31.8 million for various electric distribution system improvements
- \$9.8 million for gas main replacement
- \$9.2 million for water plant and system improvements
- \$8.7 million for pole replacements for the electric system
- \$7.7 million for main replacement for the water system

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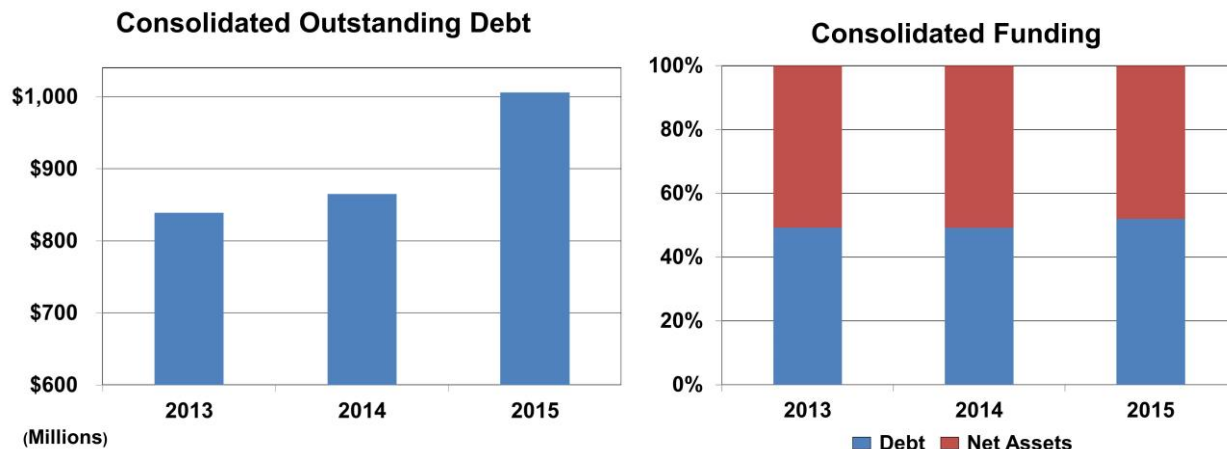
**Debt Administration**

KUB's outstanding debt has increased during the past three years from \$839.3 million to its current level of \$1 billion. 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. Debt as a percentage of capital structure was 52 percent in 2015, 49.2 percent in 2014 and 49.3 percent at the end of fiscal year 2013.

**Outstanding Debt  
As of June 30**

*(in thousands of dollars)*

	2015	2014	2013
Revenue bonds	\$ 1,006,260	\$ 864,740	\$ 839,305
Total outstanding debt	\$ <u>1,006,260</u>	\$ <u>864,740</u>	\$ <u>839,305</u>



KUB will pay \$356.7 million in principal payments over the next ten years, representing 35.5 percent of outstanding bonds.

**Fiscal Year 2015 Compared to Fiscal Year 2014**

As of June 30, 2015, KUB had \$1 billion in outstanding debt (including the current portion of revenue bonds) compared to \$864.7 million last year, an increase of \$141.5 million. KUB's weighted average cost of debt as of June 30, 2015 was 3.95 percent.

During fiscal year 2015, \$26.2 million in bonds were repaid.

In August 2014, KUB issued \$78 million of new revenue bonds to fund capital system improvements, including \$40 million for the electric system, \$8 million for the water system and \$30 million for the wastewater system.

In April 2015, KUB issued \$85 million of new revenue bonds to fund capital system improvements, including \$35 million for the electric system, \$20 million for the water system and \$30 million for the wastewater system.

In April 2015, KUB issued \$193.2 million in revenue refunding bonds to refinance certain outstanding bonds, including \$28.6 million for the electric system, \$11.8 million for the gas system, \$23 million for the

# **Knoxville Utilities Board**

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water system and \$129.8 million for the wastewater system. The refunding of certain bonds at lower interest rates will provide debt service savings of \$19.2 million over the life of the bonds

KUB's outstanding debt is rated by Standard & Poor's and Moody's Investors Service. As of June 30, 2015, Standard & Poor's rated the revenue bonds of the Water Division AAA, the Electric 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 Standard and Poor's water rating represented an upgrade for water system bonds and the highest credit rating available from Standard and Poor's. In the rating report on the water system bonds, Standard & Poor's stated "the upgrade is based on the water system's extremely strong financial risk profile, which we view as sustainable over time after reviewing management's long-term financial forecast."

#### ***Fiscal Year 2014 Compared to Fiscal Year 2013***

As of June 30, 2014, KUB had \$864.7 million in outstanding debt (including the current portion of revenue bonds) compared to \$839.3 million last year, an increase of \$25.4 million. KUB's weighted average cost of debt as of June 30, 2014 was 4.13 percent.

During fiscal year 2014, \$24.6 million in bonds were repaid.

During the fiscal year, \$50 million in long-term bonds were issued to finance capital improvements for the gas and water systems.

KUB's outstanding debt is rated by Standard & Poor's and Moody's Investors Service. As of June 30, 2014, 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.

### **Impacts on Future Financial Position**

KUB anticipates net customer growth of 2,050 customers during fiscal year 2016.

In June 2014, the KUB Board adopted three years of rate increases for all four Divisions to help fund the ongoing Century II infrastructure programs for each system.

The remaining two electric rate increases will be effective July 2015 and July 2016, respectively. Each rate increase will provide approximately \$5 million in additional Electric Division revenue.

The remaining two natural gas rate increases will be effective October 2015 and October 2016, respectively. Each rate increase will result in an additional \$1.8 million in Gas Division revenue.

The remaining two water rate increases will be effective July 2015 and July 2016, respectively. The July 2015 and July 2016 rate increases will result in annual Water Division revenue of \$2 million.

The remaining two wastewater rate increases will be effective October 2015 and October 2016, respectively. The wastewater rate increases will provide additional annual revenue of \$4.7 million.

This fiscal year KUB concluded the smart grid pilot project, of which a portion of the project was funded by a United States Department of Energy Smart Grid Investment Grant (SGIG). This grant was received by KUB in 2009 as part of the American Reinvestment and Recovery Act (ARRA). Based upon the success of that pilot, KUB formed a plan to move forward with a Century II Grid Modernization effort which includes advanced metering for all KUB customers, a telecommunication system linking critical

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KUB infrastructure, and an increased investment in automation technology to help operate KUB's energy and water distribution systems. Over the course of the next ten years KUB plans to spend \$102 million dollars in this effort. In April 2015, KUB management presented a modified long-term funding plan to the KUB Board of Commissioners that accommodates the projected level of capital investment.

KUB is in the process of implementing a new 15-year initiative to ensure KUB will continue to provide high-quality, reliable water service to its customers over the long-term. KUB maintains a single water treatment plant for its system. In lieu of building a second treatment facility to ensure capacity will be available to meet the needs of current and future water customers, KUB will invest approximately \$100 million in various redundant facilities at its existing Mark B. Whitaker Water Treatment Plant over the next 15 years. In April 2015, KUB management presented a modified long-term funding plan for the Water Division to the KUB Board of Commissioners that accommodates the projected level of capital investment.

In July 2015, KUB received the remaining reimbursement for storm restoration expenses associated with the 2011 storm events from the Federal Emergency Management Agency (FEMA) in the amount of \$1.5 million.

KUB long-term debt includes \$133 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 7.3 percent. Any future actions by Congress may also affect the anticipated rebates for future fiscal years.

KUB will continue work on the installation of a new gas transmission main extending from South Knoxville to the University of Tennessee, providing increased capacity to meet future natural gas requirements for the university. The \$38 million project is scheduled to be completed in November 2015. KUB anticipates a \$4 million contribution in aid of construction from the University of Tennessee during fiscal year 2016.

GASB Statement No. 72, *Fair Value Measurement and Application*, and GASB Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provision of GASB Statements 67 and 68*, are effective for periods beginning after June 15, 2015. GASB Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, and GASB No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, are effective for periods beginning after June 15, 2017. GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, is effective for periods beginning after June 15, 2015. 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 2015.

### **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, 2015 and 2014. 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, 2015 and 2014**

	<b>2015</b>	<b>2014</b>
<b>Assets and Deferred Outflows of Resources</b>		
Current assets:		
Cash and cash equivalents	\$ 124,892,534	\$ 106,078,842
Short-term investments	-	7,000,000
Short-term contingency fund investments	6,296,090	38,076,885
Other current assets	1,638,388	1,478,181
Accrued interest receivable	43,229	29,754
Accounts receivable, less allowance of uncollectible accounts of \$720,939 in 2015 and \$715,050 in 2014	77,844,543	78,140,323
Inventories	8,421,065	9,090,412
Prepaid expenses	809,844	1,931,869
Gas storage	9,447,403	10,281,088
Total current assets	<u>229,393,096</u>	<u>252,107,354</u>
Restricted assets:		
Bond funds	26,154,107	24,662,255
Other funds	43,897	43,872
Unused bond proceeds	46,053,950	1,055,410
Total restricted assets	<u>72,251,954</u>	<u>25,761,537</u>
Plant in service		
Plant in service	2,210,535,681	2,130,908,796
Less accumulated depreciation	<u>(753,200,620)</u>	<u>(706,864,663)</u>
	1,457,335,061	1,424,044,133
Retirement in progress	940,386	1,247,876
Construction in progress	192,871,763	123,581,867
Net plant in service	<u>1,651,147,210</u>	<u>1,548,873,876</u>
Other assets:		
Net pension asset	6,021,629	-
Long-term contingency fund investments	84,036,694	44,464,588
TVA conservation program receivable	10,109,135	10,632,815
Other	11,248,778	14,731,534
Total other assets	<u>111,416,236</u>	<u>69,828,937</u>
Total assets	<u>2,064,208,496</u>	<u>1,896,571,704</u>
Deferred outflows of resources:		
Pension outflow	3,157,199	-
Unamortized bond refunding costs	<u>25,230,799</u>	<u>12,251,803</u>
Total deferred outflows of resources	<u>28,387,998</u>	<u>12,251,803</u>
Total assets and deferred outflows of resources	<u>\$ 2,092,596,494</u>	<u>\$ 1,908,823,507</u>

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

**Knoxville Utilities Board**  
**Consolidated Statements of Net Position**  
**June 30, 2015 and 2014**

	<b>2015</b>	<b>2014</b>
<b>Liabilities, Deferred Inflows, and Net Position</b>		
Current liabilities:		
Current portion of revenue bonds	\$ 29,830,000	\$ 25,740,000
Sales tax collections payable	1,251,145	1,199,124
Accounts payable	50,651,280	53,144,305
Accrued expenses	19,729,155	27,247,849
Customer deposits plus accrued interest	16,465,292	15,732,652
Accrued interest on revenue bonds	11,306,248	11,543,105
Total current liabilities	<u>129,233,120</u>	<u>134,607,035</u>
Other liabilities:		
TVA conservation program	10,336,682	10,885,245
Accrued compensated absences	8,616,844	8,475,812
Customer advances for construction	2,305,058	1,607,364
Over recovered purchased power cost	500,522	4,412,769
Over recovered purchased gas cost	1,063,761	1,278,144
Other	478,797	256,124
Total other liabilities	<u>23,301,664</u>	<u>26,915,458</u>
Long-term debt:		
Revenue bonds	976,430,000	839,000,000
Unamortized premiums/discounts	28,631,810	14,887,211
Total long-term debt	<u>1,005,061,810</u>	<u>853,887,211</u>
Total liabilities	<u>1,157,596,594</u>	<u>1,015,409,704</u>
Deferred inflows of resources:		
Pension inflow	6,378,310	-
Total deferred inflows of resources	<u>6,378,310</u>	<u>-</u>
Total liabilities and deferred inflows of resources	<u>1,163,974,904</u>	<u>1,015,409,704</u>
Net position		
Net investment in capital assets	650,464,457	688,373,838
Restricted for:		
Debt service	14,847,859	13,119,150
Other	43,896	43,872
Unrestricted	263,265,378	191,876,943
Total net position	<u>928,621,590</u>	<u>893,413,803</u>
Total liabilities, deferred inflows, and net position	<u>\$ 2,092,596,494</u>	<u>\$ 1,908,823,507</u>

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

**Knoxville Utilities Board**  
**Consolidated Statements of Revenues, Expenses and Changes in Net Position**  
**June 30, 2015 and 2014**

	2015	2014
Operating revenues		
Electric	\$ 527,233,806	\$ 521,382,442
Gas	113,850,059	116,803,437
Water	43,777,160	38,934,984
Wastewater	78,842,964	74,589,237
Total operating revenues	<u>763,703,989</u>	<u>751,710,100</u>
Operating expenses		
Purchased power	415,610,969	414,928,209
Purchased gas	63,555,513	69,146,120
Treatment	15,318,610	14,038,067
Distribution and collection	62,318,632	60,099,715
Customer service	13,725,067	12,607,020
Administrative and general	30,741,405	31,746,959
Provision for depreciation	61,708,086	55,885,311
Taxes and tax equivalents	29,648,873	27,097,311
Total operating expenses	<u>692,627,155</u>	<u>685,548,712</u>
Operating income	<u>71,076,834</u>	<u>66,161,388</u>
Non-operating revenues (expenses)		
Contributions in aid of construction	2,871,465	7,489,259
Interest and dividend income	916,983	850,769
Interest expense	(37,967,821)	(37,032,613)
Amortization of debt costs	(225,173)	(218,802)
Write-down of plant for costs recovered through contributions	(2,871,465)	(7,489,259)
Other	1,565,032	(727,578)
Total non-operating revenues (expenses)	<u>(35,710,979)</u>	<u>(37,128,224)</u>
Change in net position before capital contributions	35,365,855	29,033,164
Capital contributions	605,907	735,759
Change in net position	35,971,762	29,768,923
Net position, beginning of year, as previously reported	893,413,803	863,644,880
Change in method of accounting for pension	(763,975)	-
Net position, beginning of year, as restated	<u>892,649,828</u>	<u>863,644,880</u>
Net position, end of year	<u>\$ 928,621,590</u>	<u>\$ 893,413,803</u>

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

# Knoxville Utilities Board

## Consolidated Statements of Cash Flows

### June 30, 2015 and 2014

	2015	2014
Cash flows from operating activities:		
Cash receipts from customers	\$ 761,548,382	\$ 748,864,302
Cash receipts from other operations	11,720,197	10,319,308
Cash payments to suppliers of goods or services	(569,272,217)	(569,365,252)
Cash payments to employees for services	(50,466,843)	(50,171,061)
Payment in lieu of taxes	(25,910,417)	(23,417,319)
Cash receipts from collections of TVA conservation loan program participants	3,046,131	2,803,444
Cash payments for TVA Conservation loan program	(3,071,013)	(2,811,356)
Net cash provided by operating activities	<u>127,594,220</u>	<u>116,222,066</u>
Cash flows from capital and related financing activities:		
Net proceeds from bond issuance	165,499,847	49,578,316
Principal paid on revenue bonds and notes payable	(26,240,000)	(24,565,000)
(Increase) decrease in unused bond proceeds	(44,998,540)	(1,055,204)
Interest paid on revenue bonds and notes payable	(37,130,082)	(35,346,487)
Acquisition and construction of plant	(168,110,486)	(148,917,816)
Changes in bond funds, restricted	(1,491,853)	(1,082,240)
Customer advances for construction	697,695	389,836
Proceeds received on disposal of plant	-	759,631
Cash received from developers and individuals for capital purposes	2,871,465	7,489,259
Net cash used in capital and related financing activities	<u>(108,901,954)</u>	<u>(152,749,705)</u>
Cash flows from investing activities:		
Purchase of investment securities	(20,286,901)	(8,308,246)
Maturities of investment securities	19,495,562	24,569,690
Interest received	903,509	873,941
Other property and investments	9,256	(252,490)
Net cash provided by (used in) investing activities	<u>121,426</u>	<u>16,882,895</u>
Net increase (decrease) in cash and cash equivalents	18,813,692	(19,644,744)
Cash and cash equivalents, beginning of year	<u>106,078,842</u>	<u>125,723,586</u>
Cash and cash equivalents, end of year	<u>\$ 124,892,534</u>	<u>\$ 106,078,842</u>
<b>Reconciliation of operating income to net cash provided by operating activities</b>		
Operating income	\$ 71,076,834	\$ 66,161,388
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization expenses	63,406,737	57,726,856
Changes in operating assets and liabilities:		
Accounts receivable	1,848,310	(524,331)
Inventories	669,347	(1,051,641)
Prepaid expenses	881,113	(952,607)
TVA conservation program receivable	523,680	(904,534)
Other assets	(2,942,632)	(888,086)
Sales tax collections payable	52,021	17,955
Accounts payable and accrued expenses	(4,201,309)	(5,877,846)
TVA conservation program payable	(548,563)	879,506
Overrecovered purchased power cost	(3,912,247)	(514,812)
Overrecovered gas costs	(214,383)	2,119,923
Customer deposits plus accrued interest	732,639	280,991
Other liabilities	222,673	(250,696)
Net cash provided by operating activities	<u>\$ 127,594,220</u>	<u>\$ 116,222,066</u>
Noncash capital activities:		
Acquisition of plant assets through developer contributions	\$ 605,907	\$ 735,759

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



# Knoxville Utilities Board

## Notes to Consolidated Financial Statements

### June 30, 2015 and 2014

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#### 1. Description of Business:

Knoxville Utilities Board (KUB), comprised of the Electric Division, Gas Division, Water Division, and Wastewater Division (Divisions), is reported as a component unit enterprise fund in the financial statements of the City of Knoxville. KUB's responsibility is to oversee the purchase, production, distribution, and processing of electricity, natural gas, water, and wastewater services. A seven-member Board of Commissioners (Board) 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**

In conformity with Generally Accepted Accounting Principles (GAAP), 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* as amended by GASB Statement No. 63 (Statement No. 63), *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position*. Statement No. 34 established standards for external financial reporting for all state and local governmental entities. Under Statement No. 63, 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. In addition, KUB follows GASB Statement No. 62 (Statement No. 62), *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* as it relates to certain items for regulatory accounting. Regulatory accounting allows a regulated utility to defer a cost (a regulatory asset) or recognize an obligation (a regulatory liability) if it is probable that through the rate making process, there will be a corresponding increase or decrease in future revenues. Accordingly, KUB has recognized certain regulatory assets and regulatory liabilities in the accompanying Statements of Net Position.

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) is segregated into net investment in capital assets, restricted for capital activity and debt service, and unrestricted components.

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

In June 2012, the Governmental Accounting Standards Board (GASB) issued Statement No. 68, *Accounting and Financial Reporting for Pensions – An Amendment of GASB Statement No. 27*, effective for fiscal years beginning after June 15, 2014. This Statement establishes new accounting and financial reporting requirements for governments that provide their employees with pensions. For defined benefit pensions, this Statement identifies the methods and assumptions that should be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service.

# **Knoxville Utilities Board**

## **Notes to Consolidated Financial Statements**

### **June 30, 2015 and 2014**

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In addition, during November 2013, GASB issued Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date*, effective concurrent with GASB 68 for fiscal years beginning after June 15, 2014. The objective of this Statement is to require a deferred outflow of resources to be recognized for any contributions made subsequent to the measurement date of the beginning net pension liability.

#### **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 \$1,698,650 in fiscal year 2015 and \$1,841,544 in fiscal year 2014. Under regulatory accounting, interest costs are expensed as incurred with construction of plant assets.

#### **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 \$2,504,785 in fiscal year 2015 and \$1,572,059 in fiscal year 2014.

#### **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.

#### **Net Position**

GASB 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

# Knoxville Utilities Board

## Notes to Consolidated Financial Statements

### June 30, 2015 and 2014

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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.

#### **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.

#### **Change in method of accounting for pension**

In June 2012, the Governmental Accounting Standards Board (GASB) issued Statement No. 68, *Accounting and Financial Reporting for Pensions – An Amendment of GASB Statement No. 27*, which revises existing standards of financial reporting for pensions. In addition, during November 2013, GASB issued Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date*, which requires deferred outflow of resources to be recognized for any contributions made subsequent to the measurement date of the beginning net pension liability. These standards were adopted by KUB in 2015 and resulted in a restatement of beginning net position of \$763,975 to increase the net pension liability by \$3,515,317 based on revised actuarial assumptions to conform with GASB 68 and to reclassify 2014 expenses of \$2,751,341 as deferred outflows in accordance with GASB 71.

#### **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 fully fund the annual actuarially determined contributions. As required by GASB Statement No. 68, KUB measures net pension liability as total pension liability less the amount of the Plan's fiduciary net position. The amounts reported as of June 30, 2015 must be based upon a plan measurement date within the

# **Knoxville Utilities Board**

## **Notes to Consolidated Financial Statements**

### **June 30, 2015 and 2014**

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prior twelve months. Therefore, KUB's measurements as of June 30, 2015 are based on December 31, 2014 measurement date.

#### **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, allowance for uncollectible 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. 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. Deferred outflows of resources also include employer pension contributions made subsequent to the measurement date of the net pension liability and before the end of the employer's reporting period in accordance with Statement No. 71. Deferred inflows also include the net difference between projected and actual earnings on pension plan investments in accordance with Statement No. 68.

#### **Debt Premium/Discount**

KUB records unamortized premium and discount on debt as a separate line item in the Long Term Debt section of the Financial Statements. Amortization of these amounts is recorded over the life of the applicable debt as amortization expense.

# **Knoxville Utilities Board**

## **Notes to Consolidated Financial Statements**

### **June 30, 2015 and 2014**

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#### **Debt Issuance Costs**

In accordance with regulatory accounting, KUB records debt issuance costs as an Other Asset. Amortization of these amounts is recorded over the life of the applicable debt as amortization expense.

#### **Deferred Gain/Loss on Refunding of Debt**

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. In accordance with FERC presentation, amortization of these amounts is recorded over the life of the applicable debt as amortization expense.

#### **Compensated Absences**

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

#### **TVA Conservation Program**

KUB serves as a fiscal intermediary for TVA whereby loans are made to KUB customers by TVA to be used in connection with TVA's Energy Right Residential Program.

#### **Subsequent Events**

KUB has evaluated events and transactions through October 16, 2015, 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 2014 balances to conform to fiscal year 2015 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 the Board. The rate-setting authority vested in the 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.

Under the PPA mechanism, KUB tracks the actual (under)/over recovered amount in the (Under)/Over Recovered Purchased Power Costs accounts. These accounts are rolled into the PPA rate adjustments thereby assuring that any (under)/over recovered amounts are promptly passed on to the KUB's electric customers. The amount of over recovered cost was \$500,522 at June 30, 2015 and \$4,412,769 at June 30, 2014.

# Knoxville Utilities Board

## Notes to Consolidated Financial Statements

### June 30, 2015 and 2014

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#### **Purchased Gas Adjustment**

In November 1990, the Board implemented a deferred Purchased Gas (Cost) Adjustment (PGA) mechanism, which allows KUB 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 the Board. The rate-setting authority vested in the 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, KUB 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 KUB's gas system customers. The amount of over/(under) recovered cost was \$1,063,761 at June 30, 2015 and \$1,278,144 at June 30, 2014.

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

In February 2015, the GASB issued Statement No. 72 (Statement No. 72), *Fair Value Measurement and Application*. Statement No. 72 is intended to provide guidance for determining a fair value measurement for financial reporting purposes and for applying fair value to certain investments and disclosures related to all fair value measurements. In June 2015, the GASB issued GASB Statement No. 73 (Statement No. 73), *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provision of GASB Statements 67 and 68*. The requirements of this Statement will improve financial reporting by establishing a single framework for the presentation of information about pensions and enhance comparability. Statements No. 72 and 73 are effective for fiscal years beginning after June 15, 2015.

In June 2015, the GASB issued two related Statements that affect accounting and financial reporting by state and local governments for postemployment benefits other than pensions (OPEB). GASB Statement No. 74 (Statement No. 74), *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, addresses reporting by OPEB plans that administer benefits on behalf of governments. GASB Statement No. 75 (Statement No. 75), *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, addresses reporting by governments that provide OPEB to their employees. Statement No. 74 is effective for fiscal years beginning after June 15, 2016, and Statement No. 75 is effective for fiscal years beginning after June 15, 2017.

In June 2015, the GASB issued GASB Statement No. 76 (Statement No. 76), *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. The objective of this Statement is to simplify the hierarchy of generally accepted accounting principles (GAAP) used to prepare financial statements of state and local governmental entities. This Statement supersedes Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, and amends Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, paragraphs 64, 74, and 82. Statement No. 76 is effective for fiscal years beginning after June 15, 2015.

# Knoxville Utilities Board

## Notes to Consolidated Financial Statements

### June 30, 2015 and 2014

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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

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.

KUB's investment policy provides the framework for the administration and investment of cash deposits. The investment policy follows State law and defines the parameters under which KUB funds should be invested. 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.

*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.

*Custodial Credit Risk.* KUB's investment policy limits exposure to custodial credit risk by restricting investments to a standard set forth by State law. All deposits in excess of federal depository insurance limits 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 are considered insured. A portion of KUB's investments are generally held in the State of Tennessee Local Government Investment Pool (LGIP). The LGIP is a part of the State Pooled Investment Fund and is sponsored by the State of Tennessee Treasury Department. Tennessee Code Annotated ¶9-4-701 *et seq.* authorizes local governments to invest in the LGIP. None of KUB's investments are exposed to custodial credit risk.

**Knoxville Utilities Board**  
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Classification of deposits and investments per Statement of Net Position:

	<b>2015</b>	<b>2014</b>
Current assets		
Cash and cash equivalents	\$ 124,892,534	\$ 106,078,842
Short-term investments	-	7,000,000
Short-term contingency fund investments	6,296,090	38,076,885
Other assets		
Long-term contingency fund investments	83,847,641	44,206,946
Restricted assets		
Unused bond proceeds	46,053,447	1,055,410
Bond fund	26,154,107	24,662,255
Other funds	43,897	43,872
	<u>\$ 287,287,716</u>	<u>\$ 221,124,210</u>

The above amounts do not include accrued interest of \$189,556 in fiscal year 2015 and \$257,642 in fiscal year 2014. Interest income is recorded on an accrual basis.

Investments and maturities of KUB's deposits and investments as held by financial institutions as of June 30, 2015:

	<b>Deposit and Investment Maturities (in Years)</b>		
	<b>Fair Value</b>	<b>Less Than 1</b>	<b>1-5</b>
Supersweep NOW and Other Deposits	\$ 116,511,291	\$ 116,511,291	\$ -
State Treasurer's Investment Pool	48,785,708	48,785,708	-
Agency Bonds	100,592,720	4,193,890	96,398,830
Certificates of Deposits	27,949,045	25,524,046	2,424,999
	<u>\$ 293,838,764</u>	<u>\$ 195,014,935</u>	<u>\$ 98,823,829</u>

**4. Accounts Receivable**

Accounts receivable consists of the following:

	<b>2015</b>	<b>2014</b>
Wholesale and retail customers		
Billed services	\$ 47,996,899	\$ 47,513,727
Unbilled services	25,602,160	27,270,344
Other	4,966,423	4,071,302
Allowance for uncollectible accounts	(720,939)	(715,050)
	<u>\$ 77,844,543</u>	<u>\$ 78,140,323</u>



**Knoxville Utilities Board**  
**Notes to Consolidated Financial Statements**  
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**5. Accounts Payable and Accruals**

Accounts payable and accruals consist of the following:

	<b>2015</b>	<b>2014</b>
Trade accounts	\$ 50,651,280	\$ 53,144,305
Salaries and wages	1,509,808	1,278,290
Advances on pole rental	1,147,346	1,156,634
Self-insurance liabilities	1,699,525	1,572,570
Other current liabilities	15,372,476	23,240,355
	<u>\$ 70,380,435</u>	<u>\$ 80,392,154</u>

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**Knoxville Utilities Board**  
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**6. Long-Term Obligations**

Long-term debt consists of the following:

	Balance June 30, 2014	Additions	Payments	Defeased	Balance June 30, 2015	Amounts Due Within One Year
<b>Electric</b>						
W-2005 - 3.0 - 4.5%	\$ 33,140,000	\$ -	\$ 1,790,000	\$ -	\$ 31,350,000	\$ 1,870,000
X-2006 - 4.0 - 5.0%	3,550,000	-	1,725,000	-	1,825,000	1,825,000
Y-2009 - 2.5 - 5.0%	35,900,000	-	1,525,000	27,500,000	6,875,000	1,600,000
Z-2010 - 1.45 - 6.35%	26,470,000	-	1,265,000	-	25,205,000	1,285,000
AA-2012 - 3.0 - 5.0%	35,795,000	-	955,000	-	34,840,000	990,000
BB-2012 - 3.0 - 4.0%	34,500,000	-	625,000	-	33,875,000	650,000
CC-2013 - 3.0 - 4.0%	9,585,000	-	50,000	-	9,535,000	50,000
DD-2014 - 2.0 - 4.0%	-	40,000,000	-	-	40,000,000	675,000
EE-2015 - 2.0 - 5.0%	-	28,550,000	-	-	28,550,000	125,000
FF-2015 - 2.0 - 5.0%	-	35,000,000	-	-	35,000,000	-
Total bonds	\$ 178,940,000	\$ 103,550,000	\$ 7,935,000	\$ 27,500,000	\$ 247,055,000	\$ 9,070,000
Unamortized premium	5,779,555	5,617,592	411,968	639,853	10,345,326	-
Total long term debt	\$ 184,719,555	\$ 109,167,592	\$ 8,346,968	\$ 28,139,853	\$ 257,400,326	\$ 9,070,000
<b>Gas</b>						
L-2005 - 3.0 - 4.75%	\$ 11,380,000	\$ -	\$ 665,000	\$ -	\$ 10,715,000	\$ 695,000
N-2007 - 4.0 - 5.0%	12,000,000	-	-	11,450,000	550,000	-
O-2010 - 2.0 - 3.0%	6,825,000	-	3,350,000	-	3,475,000	3,475,000
P-2010 - 3.3 - 6.2%	12,000,000	-	-	-	12,000,000	-
Q-2012 - 2.0 - 4.0%	24,030,000	-	685,000	-	23,345,000	700,000
R-2012 - 2.0 - 4.0%	9,800,000	-	200,000	-	9,600,000	200,000
S-2013 - 2.0 - 4.0%	11,530,000	-	50,000	-	11,480,000	50,000
T-2013 - 2.0 - 4.6%	24,800,000	-	200,000	-	24,600,000	200,000
U-2015 - 2.0 - 3.5%	-	11,780,000	-	-	11,780,000	100,000
Total bonds	\$ 112,365,000	\$ 11,780,000	\$ 5,150,000	\$ 11,450,000	\$ 107,545,000	\$ 5,420,000
Unamortized premium	3,434,514	701,501	296,934	44,677	3,794,404	-
Total long term debt	\$ 115,799,514	\$ 12,481,501	\$ 5,446,934	\$ 11,494,677	\$ 111,339,404	\$ 5,420,000
<b>Water</b>						
R-2005 - 3.5 - 5.0%	\$ 255,000	\$ -	\$ 255,000	\$ -	\$ -	\$ -
S-2005 - 3.5 - 5.0%	7,160,000	-	425,000	-	6,735,000	440,000
T-2007 - 4.0 - 5.5%	24,350,000	-	675,000	22,225,000	1,450,000	700,000
U-2009 - 3.0 - 4.5%	24,250,000	-	800,000	-	23,450,000	825,000
W-2011 - 2.0 - 4.0%	23,900,000	-	550,000	-	23,350,000	550,000
X-2012 - 3.0 - 5.0%	9,610,000	-	460,000	-	9,150,000	485,000
Y-2013 - 3.0 - 4.0%	9,260,000	-	25,000	-	9,235,000	265,000
Z-2013 - 2.0 - 5.0%	24,600,000	-	450,000	-	24,150,000	475,000
AA-2014 - 2.0 - 4.0%	-	8,000,000	125,000	-	7,875,000	150,000
BB-2015 - 2.0 - 5.0%	-	23,005,000	-	-	23,005,000	170,000
CC-2015 - 2.0 - 4.0%	-	20,000,000	-	-	20,000,000	350,000
Total bonds	\$ 123,385,000	\$ 51,005,000	\$ 3,765,000	\$ 22,225,000	\$ 148,400,000	\$ 4,410,000
Unamortized premium	1,518,734	1,493,612	102,471	42,985	2,866,890	-
Total long term debt	\$ 124,903,734	\$ 52,498,612	\$ 3,867,471	\$ 22,267,985	\$ 151,266,890	\$ 4,410,000
<b>Wastewater</b>						
2005 A - 4.0 - 5.0%	\$ 36,550,000	\$ -	\$ -	\$ 36,550,000	\$ -	\$ -
2005 B - 3.0 - 5.0%	17,395,000	-	1,350,000	-	16,045,000	1,410,000
2007 - 4.0 - 5.0%	75,000,000	-	-	75,000,000	-	-
2008 - 4.0 - 6.0%	30,975,000	-	4,300,000	15,675,000	11,000,000	4,450,000
2010 - 6.3 - 6.5%	30,000,000	-	-	-	30,000,000	-
2010C - 1.18 - 6.1%	66,850,000	-	1,100,000	-	65,750,000	1,250,000
2012A - 2.0 - 4.0%	16,215,000	-	800,000	-	15,415,000	820,000
2012B - 1.25 - 5.0%	64,150,000	-	875,000	-	63,275,000	925,000
2013A - 2.0 - 4.0%	112,915,000	-	590,000	-	112,325,000	610,000
2014A - 2.0 - 4.0%	-	30,000,000	375,000	-	29,625,000	425,000
2015A - 3.0 - 5.0%	-	129,825,000	-	-	129,825,000	465,000
2015B - 3.0 - 5.0%	-	30,000,000	-	-	30,000,000	575,000
Total bonds	\$ 450,050,000	\$ 189,825,000	\$ 9,390,000	\$ 127,225,000	\$ 503,260,000	\$ 10,930,000
Unamortized premium	4,154,409	8,539,211	312,636	755,794	11,625,190	-
Total long term debt	\$ 454,204,409	\$ 198,364,211	\$ 9,702,636	\$ 127,980,794	\$ 514,885,190	\$ 10,930,000
<b>Consolidated</b>						
Total Bonds	\$ 864,740,000	\$ 356,160,000	\$ 26,240,000	\$ 188,400,000	\$ 1,006,260,000	\$ 29,830,000
Total unamortized premium	14,887,211	16,351,916	1,124,009	1,483,309	28,631,810	-
Total long term debt	\$ 879,627,211	\$ 372,511,916	\$ 27,364,009	\$ 189,883,309	\$ 1,034,891,810	\$ 29,830,000

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	Balance June 30, 2013	Additions	Payments	Defeased	Balance June 30, 2014	Amounts Due Within One Year
<b>Electric</b>						
W-2005 - 3.0 - 4.5%	\$ 34,860,000	\$ -	\$ 1,720,000	\$ -	\$ 33,140,000	\$ 1,790,000
X-2006 - 4.0 - 5.0%	5,200,000	-	1,650,000	-	3,550,000	1,725,000
Y-2009 - 2.5 - 5.0%	37,350,000	-	1,450,000	-	35,900,000	1,525,000
Z-2010 - 1.45 - 6.35%	27,725,000	-	1,255,000	-	26,470,000	1,265,000
AA-2012 - 3.0 - 5.0%	36,715,000	-	920,000	-	35,795,000	955,000
BB-2012 - 3.0 - 4.0%	35,000,000	-	500,000	-	34,500,000	625,000
CC-2013 - 3.0 - 4.0%	9,660,000	-	75,000	-	9,585,000	50,000
Total bonds	<u>\$ 186,510,000</u>	<u>\$ -</u>	<u>\$ 7,570,000</u>	<u>\$ -</u>	<u>\$ 178,940,000</u>	<u>\$ 7,935,000</u>
<b>Gas</b>						
L-2005 - 3.0 - 4.75%	\$ 12,025,000	\$ -	\$ 645,000	\$ -	\$ 11,380,000	\$ 665,000
N-2007 - 4.0 - 5.0%	12,000,000	-	-	-	12,000,000	-
O-2010 - 2.0 - 3.0%	10,050,000	-	3,225,000	-	6,825,000	3,350,000
P-2010 - 3.3 - 6.2%	12,000,000	-	-	-	12,000,000	-
Q-2012 - 2.0 - 4.0%	24,695,000	-	665,000	-	24,030,000	685,000
R-2012 - 2.0 - 4.0%	10,000,000	-	200,000	-	9,800,000	200,000
S-2013 - 2.0 - 4.0%	11,580,000	-	50,000	-	11,530,000	50,000
T-2013 - 2.0 - 4.6%	-	25,000,000	200,000	-	24,800,000	200,000
Total bonds	<u>\$ 92,350,000</u>	<u>\$ 25,000,000</u>	<u>\$ 4,985,000</u>	<u>\$ -</u>	<u>\$ 112,365,000</u>	<u>\$ 5,150,000</u>
<b>Water</b>						
R-2005 - 3.5 - 5.0%	\$ 490,000	\$ -	\$ 235,000	\$ -	\$ 255,000	\$ 255,000
S-2005 - 3.5 - 5.0%	7,575,000	-	415,000	-	7,160,000	425,000
T-2007 - 4.0 - 5.5%	25,000,000	-	650,000	-	24,350,000	675,000
U-2009 - 3.0 - 4.5%	25,000,000	-	750,000	-	24,250,000	800,000
W-2011 - 2.0 - 4.0%	24,450,000	-	550,000	-	23,900,000	550,000
X-2012 - 3.0 - 5.0%	10,050,000	-	440,000	-	9,610,000	460,000
Y-2013 - 3.0 - 4.0%	9,285,000	-	25,000	-	9,260,000	25,000
Z-2013 - 2.0 - 5.0%	-	25,000,000	400,000	-	24,600,000	450,000
Total bonds	<u>\$ 101,850,000</u>	<u>\$ 25,000,000</u>	<u>\$ 3,465,000</u>	<u>\$ -</u>	<u>\$ 123,385,000</u>	<u>\$ 3,640,000</u>
<b>Wastewater</b>						
2005 A - 4.0 - 5.0%	\$ 36,550,000	\$ -	\$ -	\$ -	\$ 36,550,000	-
2005 B - 3.0 - 5.0%	18,680,000	-	1,285,000	-	17,395,000	1,350,000
2007 - 4.0 - 5.0%	75,000,000	-	-	-	75,000,000	-
2008 - 4.0 - 6.0%	35,100,000	-	4,125,000	-	30,975,000	4,300,000
2010 - 6.3 - 6.5%	30,000,000	-	-	-	30,000,000	-
2010C - 1.18 - 6.1%	67,925,000	-	1,075,000	-	66,850,000	1,100,000
2012A - 2.0 - 4.0%	17,000,000	-	785,000	-	16,215,000	800,000
2012B - 1.25 - 5.0%	65,000,000	-	850,000	-	64,150,000	875,000
2013A - 2.0 - 4.0%	113,340,000	-	425,000	-	112,915,000	590,000
Total bonds	<u>\$ 458,595,000</u>	<u>\$ -</u>	<u>\$ 8,545,000</u>	<u>\$ -</u>	<u>\$ 450,050,000</u>	<u>\$ 9,015,000</u>
<b>Consolidated</b>						
Total Bonds	<u>839,305,000</u>	<u>50,000,000</u>	<u>24,565,000</u>	<u>-</u>	<u>864,740,000</u>	<u>25,740,000</u>
Total Bonds	<u>\$ 839,305,000</u>	<u>\$ 50,000,000</u>	<u>\$ 24,565,000</u>	<u>\$ -</u>	<u>\$ 864,740,000</u>	<u>\$ 25,740,000</u>

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

Fiscal Year	Principal	Interest	Total
2016	\$ 29,830,000	\$ 37,687,614	\$ 67,517,614
2017	31,050,000	38,413,632	69,463,632
2018	32,195,000	37,216,662	69,411,662
2019	33,415,000	35,933,587	69,348,587
2020	34,810,000	34,573,291	69,383,291
2021-2025	195,415,000	149,795,486	345,210,486
2026-2030	195,195,000	111,755,498	306,950,498
2031-2035	156,405,000	78,166,981	234,571,981
2036-2040	150,365,000	49,577,542	199,942,542
2041-2045	125,080,000	20,061,169	145,141,169
2046-2050	22,500,000	1,850,275	24,350,275
Total	<u>\$ 1,006,260,000</u>	<u>\$ 595,031,737</u>	<u>\$ 1,601,291,737</u>

The Divisions have pledged sufficient revenue, after deduction of all current operating expenses (exclusive of tax equivalents), to meet bond principal and interest payments of revenue bonds when due. Such bond requirements are being met through monthly deposits to the bond funds as required by the bond covenants. As of June 30, 2015 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 October 1, 2014 these bonds became subject to a 7.3% reduction in rebate payment amounts due to the United States Government sequestration. The sequestration is effective until 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. During fiscal year 2015, KUB's Electric Division issued Series EE 2015 bonds to retire a portion of outstanding Series Y 2009 bonds as follows. On May 1, 2015 \$28.6 million in revenue refunding bonds with an average interest rate of 3.4 percent were issued to advance refund \$27.5 million of outstanding bonds with an average interest rate of 4.6 percent. The net proceeds of \$31 million (after payment of \$0.3 million in issuance costs plus premium of \$2.4 million and an additional issuer equity contribution of \$0.3 million) were used to purchase U.S. government securities. Those securities were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the bonds. 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 15 years by \$2.2 million resulting in an economic gain (difference between the present values of the debt service payments on the old and new debt) of \$1.6 million. KUB's Electric Division also issued Series DD 2014 and Series FF 2015 to fund electric system capital improvements. 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

# Knoxville Utilities Board

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service payments on the old bonds. Accordingly, the liability for the defeased bonds, \$37.6 million at June 30, 2015, 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 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. 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 October 1, 2014, these bonds became subject to a 7.3% reduction in rebate payment amounts due to the United States Government sequestration. The sequestration is effective until 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. During fiscal year 2014, KUB's Gas Division issued Series T 2013 to fund gas system capital improvements. During fiscal year 2015, KUB's Gas Division issued Series U 2015 bonds to retire Series N 2007 outstanding bonds as follows. On May 1, 2015, \$11.8 million in revenue refunding bonds with an average interest rate of 3.3 percent were issued to advance refund \$11.5 million of outstanding bonds with an average interest rate of 4.6 percent. The net proceeds of \$12.4 million (after payment of \$0.2 million in underwriting fees and other issuance costs plus premium of \$0.7 million and an additional issuer equity contribution of \$0.1 million) were used to purchase U.S. government securities. Those securities were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the bonds. 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 16 years 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 \$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, \$11.5 million at June 30, 2015, 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. 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. During fiscal year 2014, KUB's Water Division issued Series Z 2013 bonds to fund water system capital improvements. During fiscal year 2015, KUB's Water Division issued Series BB 2015 bonds to retire a portion of outstanding Series T 2007 bonds as follows. On May 1, 2015, \$23 million in revenue refunding bonds with an average interest rate of 3.3 percent were issued to advance refund \$22.2 million of outstanding bonds with an average interest rate of 4.5 percent. The net proceeds of \$24 million (after payment of \$0.2 million in underwriting fees and other issuance costs plus premium of \$1.1 million and an additional issuer equity contribution of \$0.1 million) were used to purchase U.S. government securities. Those securities were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the bonds. 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

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## **Notes to Consolidated Financial Statements**

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total debt service payments over the next 18 years by \$2.4 million resulting in an economic gain (difference between the present values of the debt service payments on the old and new debt) of \$1.8 million. KUB's Water Division also issued Series AA 2014 and Series CC 2015 bonds to fund water system capital improvements. 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, \$22.2 million at June 30, 2015, and the trust account assets are not included in the financial statements.

During fiscal year 2006, KUB's Wastewater Division 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 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 October 1, 2014, these bonds became subject to a 7.3% reduction in rebate payment amounts due to the United States Government sequestration. The sequestration is effective until 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 October 1, 2014, these bonds became subject to a 7.3% reduction in rebate payment amounts due to the United States Government sequestration. The sequestration is effective until 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. During fiscal year 2015, KUB's Wastewater Division issued Series 2015A bonds to retire a portion of outstanding Series 2005A, Series 2007, and Series 2008 bonds as follows. On May 1, 2015, \$129.8 million in revenue refunding bonds with an average interest rate of 3.8 percent were issued to refund \$127.2 million of outstanding bonds with an average interest rate of 4.5 percent. The net proceeds of \$135.5 million (after payment of \$1.5 million in underwriting fees and other issuance costs plus premium of \$7.2 million) were used to refund Series 2005A currently and to purchase U.S. government securities. Those securities were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the Series 2007 and Series 2008 bonds. 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 27 years by \$13.4 million resulting in an economic gain (difference between the present values of the debt service payments on the old and new debt) of \$9.3 million. KUB's Wastewater Division also issued Series 2014A and Series 2015B bonds to fund wastewater system capital improvements. 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, \$90.7 million at June 30, 2015, and the trust account assets are not included in the financial statements.

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Other liabilities consist of the following:

	<b>Balance June 30, 2014</b>		<b>Increase</b>		<b>Decrease</b>		<b>Balance June 30, 2015</b>
TVA conservation program	\$ 10,885,245	\$	2,629,945	\$	(3,178,508)	\$	10,336,682
Accrued compensated absences	8,475,812		14,845,854		(14,704,822)		8,616,844
Customer advances for construction	1,607,364		1,361,196		(663,502)		2,305,058
Other	256,124		739,871		(517,198)		478,797
	<u>\$ 21,224,545</u>	\$	<u>19,576,866</u>	\$	<u>(19,064,030)</u>	\$	<u>21,737,381</u>

**7. Lease Commitments**

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

2016	\$ 45,858
2017	27,456
2018	12,470
2019	8,189
2020	8,189
Total operating minimum lease payments	<u>\$ 102,162</u>

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**8. Capital Assets**

Capital asset activity was as follows:

	<b>Beginning</b>		<b>Increase</b>		<b>Decrease</b>		<b>Ending</b>
	<b>6/30/2014</b>						<b>6/30/2015</b>
<b>Production Plant (Intakes)</b>	\$ 742,503	\$	-	\$	-	\$	742,503
<b>Pumping and Treatment Plant</b>	268,416,043		4,348,531		(608,563)		272,156,011
<b>Distribution and Collection Plant</b>							
Mains and metering	827,485,705		32,368,532		(3,390,545)		856,463,692
Services and meters	150,206,800		7,460,515		(2,360,572)		155,306,743
Electric station equipment	120,964,151		6,556,645		(2,182,699)		125,338,097
Poles, towers and fixtures	124,328,627		12,739,496		(2,762,060)		134,306,063
Overhead conductors	120,168,100		9,163,450		(837,823)		128,493,727
Line transformers	90,103,801		3,298,379		(854,197)		92,547,983
Other	282,320,215		8,891,602		(837,956)		290,373,861
<b>Total Distribution &amp; Collection Plant</b>	\$ 1,715,577,399	\$	80,478,619	\$	(13,225,852)	\$	1,782,830,166
<b>General Plant</b>	146,172,851		10,527,779		(1,893,629)		154,807,001
<b>Total Plant Assets</b>	\$ 2,130,908,796	\$	95,354,929	\$	(15,728,044)	\$	2,210,535,681
Less Accumulated Depreciation	(706,864,663)		(63,051,875)		16,715,918		(753,200,620)
<b>Net Plant Assets</b>	\$ 1,424,044,133	\$	32,303,054	\$	987,874	\$	1,457,335,061
Work In Progress	124,829,743		164,644,375		(95,661,969)		193,812,149
<b>Total Net Plant</b>	\$ 1,548,873,876	\$	196,947,429	\$	(94,674,095)	\$	1,651,147,210

	<b>Beginning</b>		<b>Increase</b>		<b>Decrease</b>		<b>Ending</b>
	<b>6/30/2013</b>						<b>6/30/2014</b>
<b>Production Plant (Intakes)</b>	\$ 742,503	\$	-	\$	-	\$	742,503
<b>Pumping and Treatment Plant</b>	240,400,730		29,498,352		(1,483,039)		268,416,043
<b>Distribution and Collection Plant</b>							
Mains and metering	767,483,370		74,884,846		(14,882,511)		827,485,705
Services and meters	145,143,930		6,505,287		(1,442,417)		150,206,800
Electric station equipment	114,555,002		6,885,926		(476,777)		120,964,151
Poles, towers and fixtures	114,380,474		14,300,504		(4,352,351)		124,328,627
Overhead conductors	112,732,790		9,216,310		(1,781,000)		120,168,100
Line transformers	86,755,917		5,304,894		(1,957,010)		90,103,801
Other accounts	267,823,038		16,146,654		(1,649,477)		282,320,215
<b>Total Distribution &amp; Collection Plant</b>	\$ 1,608,874,521	\$	133,244,421	\$	(26,541,543)	\$	1,715,577,399
<b>General Plant</b>	137,331,993		11,294,651		(2,453,793)		146,172,851
<b>Total Plant Assets</b>	\$ 1,987,349,747	\$	174,037,424	\$	(30,478,375)	\$	2,130,908,796
Less Accumulated Depreciation	(681,775,954)		(55,192,036)		30,103,327		(706,864,663)
<b>Net Plant Assets</b>	\$ 1,305,573,793	\$	118,845,388	\$	(375,048)	\$	1,424,044,133
Work In Progress	160,097,345		135,673,684		(170,941,286)		124,829,743
<b>Total Net Plant</b>	\$ 1,465,671,138	\$	254,519,072	\$	(171,316,334)	\$	1,548,873,876



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**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, 2015, the amount of these liabilities was \$1,699,525 resulting from the following changes:

	<b>2015</b>	<b>2014</b>
Balance, beginning of year	\$ 1,572,570	\$ 1,733,984
Current year claims and changes in estimates	14,222,337	12,105,053
Claims payments	<u>(14,095,382)</u>	<u>(12,266,467)</u>
Balance, end of year	<u>\$ 1,699,525</u>	<u>\$ 1,572,570</u>

**10. Pension Plan**

**Description of Plan**

The Knoxville Utilities Board Pension Plan (the Plan) is a governmental plan as defined by the Employee Retirement Income Security Act of 1974 ("ERISA" or the "Act"), is not subject to any of the provisions of the Act, and was revised January 1, 2014 to include all prior approved amendments. The Plan is a single-employer contributory, defined benefit pension plan established by Knoxville Utilities Board ("KUB") 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 to KUB employees. KUB administers the Plan through an Administrative Committee consisting of seven KUB employees that are appointed by KUB's President and CEO. Any amendments to the Plan involving costs not approved in the operating budget must be adopted by KUB's Board of Commissioners, upon recommendation by KUB's President and CEO. All other amendments to the Plan may be approved by KUB's President and CEO upon 60 days notification to the KUB Audit and Finance Committee. 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 closed the Plan such that persons employed or re-employed by KUB on or after January 1, 2011, are not eligible to participate, but that eligible employees hired prior to January 1, 2011, who have not separated from service, shall continue as Participants and to accrue benefits under the Plan.

Participants in the Plan consisted of the following as of December 31:

	<b>2014</b>	<b>2013</b>
Inactive plan members:		
Terminated vested participants	40	49
Retirees and beneficiaries	627	639
Active plan members	<u>725</u>	<u>778</u>
Total	<u>1,392</u>	<u>1,466</u>

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#### **Retirement Benefits**

The Plan provides three benefit arrangements for KUB participants, retirees, and beneficiaries.

The Plan provides pension benefits through the Career Equity Program ("CEP") for eligible employees hired on or after January 1, 1999, and for eligible former "City System Plan A" participants who elected CEP coverage as of July 1, 1999. The guaranteed pension benefit payable to a participant who has completed five or more years of service (or reached the normal retirement date, if earlier) upon termination of KUB employment shall be a lump sum equal to the participant's average compensation times their benefit percentage, as defined in the Plan document, or an annuity may be chosen by the participant.

In addition, the Plan provided retirement benefits through "Plan A" for former City System Plan A participants who elected not to participate in the CEP. Plan A is a closed plan and is not available to KUB employees hired after July 1, 1999. Plan A provides for early retirement benefits with 25 years of service and normal retirement benefits at age 62 or later. Benefits provided to Plan A participants include several different forms of monthly annuity payments.

The Plan also provides retirement benefits through "Plan B" for former "City System Plan B" participants. Plan B is a closed plan providing benefits to participants not covered by Social Security. Benefits provided to Plan B participants include several different forms of monthly annuity payments available to participants.

Effective January 1, 2012, KUB began to provide for additional monthly supplements, which will not be subject to cost of living adjustments, to certain former employees and surviving dependents of former employees who are eligible for and have elected coverage under the KUB retiree medical plan and are eligible for Medicare. This was done to address the loss of drug coverage under the KUB retiree medical plan and to assist such individuals in obtaining prescription drug coverage under Medicare Part D.

#### **Contributions**

Participation in Plan A requires employee contributions of 3% of the first \$4,800 of annual earnings and 5% of annual earnings in excess of \$4,800. Plan B participants may not make contributions to the Plan. KUB contributions are determined by the enrolled actuary of the Plan and equal the amount necessary to provide the benefits under the Plan determined by the application of accepted actuarial methods and assumptions. The method of funding shall be consistent with Plan objectives.

#### **Plan Funding**

In 2014 the Tennessee General Assembly enacted "The Public Employee Defined Benefit Financial Security Act of 2014" that requires state and local governments that operate defined benefit pension plans to formally adopt a funding policy, and fully fund their annual actuarially determined contributions. On December 18, 2014 the KUB Board of Commissioners adopted Resolution No. 1320 approving a Funding Policy for the KUB Defined Benefit Pension Plan in accordance with Tennessee State Law. The primary goal of the Policy is to document the method KUB has adopted to provide assurance that future KUB and employee contributions and current Plan assets will be sufficient to fund all benefits expected to be paid to current active, inactive and retired Plan participants and their beneficiaries.

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**Investments**

The Plan's investments are held by State Street Bank and Trust Company (the "Trustee"). The Plan's policy in regard to the allocation of invested assets is established by the Investment Committee and approved by the KUB Board of Commissioners and may only be amended by the KUB Board of Commissioners. It is the policy of the Investment Committee to pursue an investment strategy that reduces risk through the prudent diversification of the portfolio across a broad selection of distinct asset classes. The following was the Plan's adopted asset allocation policy as of December 31, 2014:

Asset Class	Target Allocation
Domestic equity – large cap	20% - 50%
Domestic equity – mid cap	0% - 15%
Domestic equity – small cap	0% - 15%
Domestic equity - convertible securities	0% - 10%
Non-U.S. equity	0% - 20%
Real estate equity	0% - 10%
Fixed income – aggregate bonds	5% - 25%
Fixed income – long-term bonds	10% - 25%
Cash and deposits	0% - 5%

As of the actuarial report for the Plan year ended December 31, 2013, contributions of \$6,314,399 and \$5,502,677 for 2013 and 2012, respectively, were made during the Plan sponsor's fiscal years ending June 30, 2015 and 2014, respectively. The contribution was determined as part of the January 1, 2013 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. The actuarial valuation for the Plan year ending December 31, 2014 resulted in an actuarially determined contribution of \$5,669,380 for the fiscal year ending June 30, 2016, based on the Plan's current funding policy.

Subsequent to June 30, 2015, the actuarial valuation for the Plan year ending December 31, 2015 was completed. The actuarial valuation resulted in an actuarially determined contribution of \$4,813,913 for the fiscal year ending June 30, 2017, based on the Plan's current funding policy. For the Plan year ending December 31, 2015, the Plan's actuarial funded ratio was 99.5 percent.

The actuarial valuations for the Plan years ending December 31, 2014 and 2015, which determine the actuarially determined contribution for future fiscal years ending June 30, 2016 and 2017, have not been audited.

**Implementation of GASB 68**

In fiscal year 2015, KUB adopted GASB Statement No. 68, *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27* ("GASB 68"), which requires measurement of the net pension liability as total pension liability less the amount of the Plan's fiduciary net position. The amounts reported as of June 30, 2015, must be based upon a plan measurement date within the prior twelve months. Therefore, KUB's measurements as of June 30, 2015 will be based on the December 31, 2014 measurement date.

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GASB 68 requires certain disclosures related to the net pension liability of the Plan as disclosed below:

	<u>2014</u>	<u>2013</u>
Total Pension Liability	\$ 202,773,764	\$ 199,515,466
Plan Fiduciary Net Position	(208,795,394)	(196,000,149)
Plan's Net Pension Liability	<u>\$ (6,021,630)</u>	<u>\$ 3,515,317</u>

Plan fiduciary net position as a percentage of the total pension liability	102.97%	98.24%
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Changes in Net Pension Liability are as follows:

	Total Pension Liability (a)	Increase (Decrease) Plan Fiduciary Net Position (b)	Net Pension Liability (a) - (b)
Balances at December 31, 2013	\$ 199,515,466	\$ 196,000,149	\$ 3,515,317
Changes for the year:			
Service cost	4,092,808	-	4,092,808
Interest	14,698,657	-	14,698,657
Contributions - employer	-	5,908,541	(5,908,541)
Contributions - member	-	475,854	(475,854)
Net investment income	-	22,322,102	(22,322,102)
Benefit payments	(15,533,167)	(15,533,167)	-
Administrative expense	-	(378,085)	378,085
Net changes	<u>3,258,298</u>	<u>12,795,245</u>	<u>(9,536,947)</u>
Balances at December 31, 2014	<u>\$ 202,773,764</u>	<u>\$ 208,795,394</u>	<u>\$ (6,021,630)</u>

*Actuarial Assumptions*

The total pension surplus was determined by an actuarial valuation as of December 31, 2014, using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	2.8 percent
Salary increase	Service based rates
Investment rate of return	7.5 percent, net of pension plan investment expense, including inflation

Mortality rates were based on the RP2000 Combined Table projected to 2018 with no collar distinction, with separate tables for males and females.

The actuarial assumptions used in the December 31, 2014 valuation were based on the results of an actuarial experience study for the period January 1, 2009 through January 1, 2014.

The long-term expected rate of return on Plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of Plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by

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weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. Best estimates of arithmetic real rates of return for each major asset class included in the Plan's target asset allocation as of December 31, 2014 are summarized in the following table. The real rate of return reported for fixed income is for aggregate fixed income. The Plan has both aggregate and long duration fixed income.

<u>Asset Class</u>	<u>Long Term Expected Real Rate of Return</u>
Domestic equity	6.0%
Non-U.S. equity	7.0%
Real estate equity	5.7%
Fixed income	1.8%
Cash and deposits	0.5%

*Discount rate*

The discount rate used to measure the total pension liability was 7.5 percent as of January 1, 2014. Previous Plan years utilized a discount rate of 8.0 percent. The projection of cash flows used to determine the discount rate assumed that participant contributions will be made at the current contribution rate and that KUB contributions will be made at rates equal to the actuarially determined contribution rates. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

*Sensitivity of the net pension liability to changes in the discount rate*

The following presents the net pension liability of the Plan, calculated using the discount rate of 7.5 percent, as well as what the Plan's net pension liability would be if it were calculated using a discount rate that is 1 percent lower (6.5 percent) or 1 percent higher (8.5 percent) than the current rate:

	<b>1% Decrease (6.5%)</b>	<b>Current Discount Rate (7.5%)</b>	<b>1% Increase (8.5%)</b>
Plan's net pension liability	\$ 5,880,212	\$ (6,021,630)	\$ (16,861,943)

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**Pension Expense and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions**

For the year ended June 30, 2015, KUB recognized pension expense of \$2,749,905.

The impact of experience gains or losses and assumption changes on the Total Pension Liability are recognized in expense over the average expected remaining service life of all active and inactive members. As of the measurement date, this recognition period was 3.72 years. However, there were no experience gains or losses, and there were no assumption changes during the measurement year.

The impact of investment gains or losses is recognized over a period of five years. During the measurement year, there was an investment gain of \$7,972,887. \$1,594,577 of that gain was recognized in the current year and an identical amount will be recognized in each of the next four years, resulting in a deferred inflow of resources of \$6,378,310.

The table below summarizes the current balances of deferred outflows and deferred inflows of resources along with the net recognition over the next five years. In addition, KUB recorded a deferred outflow of resources of \$3,157,199 at June 30, 2015 for employer contributions made between December 31, 2014 and June 30, 2015.

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	\$ -	\$ -
Changes in assumptions	-	-
Net difference between projected and actual earnings on pension plan investments	-	6,378,310
Contributions subsequent to measurement date	3,157,199	-
Total	<u>\$ 3,157,199</u>	<u>\$ 6,378,310</u>

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

Year ended June 30:	
2016	\$ 1,562,620
2017	(1,594,577)
2018	(1,594,577)
2019	(1,594,577)
2020	-
Thereafter	-

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#### **11. Defined Contribution Plan**

The KUB Asset Accumulation 401(k) Plan is a defined contribution 401(k) employee retirement savings plan covering eligible KUB employees established by the KUB Board of Commissioners in accordance with the Charter of the City of Knoxville, Tennessee. The plan's assets are held in trust under an agreement between KUB and Fidelity Management and Research, LLC. 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. KUB funded 401(k) matching contributions and nonelective contributions of \$1,593,350 and \$1,463,184, respectively, for the years ended June 30, 2015 and 2014.

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

The Governmental Accounting Standards Board (GASB) established 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.

KUB currently provides post-employment health care benefits to 594 former employees and 619 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.

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, 2015, 375 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.

Knoxville Utilities Board Other Post-Employment Benefits Trust (the "Trust") is a single-employer Other Post-Employment Benefits Plan established by the Knoxville Utilities Board (KUB) Board of Commissioners through Resolution No. 1168, as amended, dated October 18, 2007. The applicable documentation was submitted to the State Funding Board and, in December 2007, the

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State Funding Board approved the Trust. The Trust was also approved by the Internal Revenue Service in June 2008. KUB administers the Trust through a Board of Trustees consisting of seven KUB employees that are appointed by KUB's President and CEO. Any amendments to the Trust involving costs not approved in the operating budget must be approved by KUB's Board of Commissioners, upon recommendation by KUB's President and CEO. All other amendments to the Trust may be approved by KUB's President and CEO upon 60 days notification to the KUB Audit and Finance Committee. 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.

KUB makes annual contributions to the Trust at an actuarially determined rate. Based on the date of retirement, certain retired plan members are required to contribute specified amounts monthly to maintain health insurance. Those who retired prior to July 1983 have no required monthly premiums for themselves or dependents. The retirees, or their surviving dependents, who retired between August 1983 and January 1998 are required to pay \$250 per month for pre-Medicare family health insurance. For individuals who retired after January 1998, the required monthly premium for pre-Medicare health insurance is \$250 for single coverage and \$500 for family coverage. There is currently no premium for Medicare eligible retirees or dependents.

An actuarial valuation of KUB's Postretirement Benefit Plan was performed for the Trust as of January 1, 2013. The following table presents the OPEB cost for the year, the amount contributed to the Trust, and changes in the net OPEB obligation for fiscal year ending June 30:

	2015	2014
a) Net OPEB Obligation/(Asset) at beginning of fiscal year	\$ (177,322)	\$ 560,756
b) Annual Required Contribution (ARC)	3,497,372	3,327,412
c) Interest on Net OPEB Obligation/(Asset)	(14,186)	44,860
d) Adjustment to ARC	(17,098)	53,259
e) Annual OPEB Cost (b+c-d)	<u>3,500,284</u>	<u>3,319,013</u>
f) Employer Contributions	3,497,372	4,057,091
g) Net OPEB Obligation/(Asset) at end of fiscal year (a+e-f)	<u>\$ (174,410)</u>	<u>\$ (177,322)</u>

KUB's annual OPEB cost, the percentage of annual OPEB cost contributed to the Trust, and the net OPEB obligation for fiscal year 2015 and the two preceding years were as follows:

<b>Schedule of Employer Contributions</b>					
Actuarial Valuation Date	Employer Fiscal Year	Annual Required Contribution	Fiscal Year Actual Contribution	Percentage Contributed	Net OPEB Obligation
1/1/2011	6/30/2013	3,252,635	4,394,445	135.10%	560,756
1/1/2012	6/30/2014	3,327,412	4,057,091	121.93%	(177,322)
1/1/2013	6/30/2015	3,497,372	3,497,372	100.00%	(174,410)

Total contributions to the OPEB Trust for the fiscal year ended June 30, 2015 were \$3,497,372. The contribution to the Trust was consistent with the annual required contribution, as determined by the Postretirement Benefit Plan's actuarial valuation as of January 1, 2013, which was \$3,497,372. As of June 30, 2015, the employer's OPEB obligation has been exceeded by \$174,410.



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The annual required contribution for the fiscal year ending June 30, 2016, as determined by the Plan's actuarial valuation as of January 1, 2014 is \$953,221.

The actuarial valuation for the Plan as of January 1, 2015 has been completed. The valuation determined that the Plan's actuarial accrued liability was \$47,745,640. The actuarial value of the Plan's assets was \$47,705,478. As a result, the Plan's unfunded actuarial accrued liability was \$40,162. The Plan's actuarial funded ratio was 100 percent. The valuation also determined that the employer's annual required contribution is \$620,015 for the fiscal year ending June 30, 2017. See Required Supplementary Information for OPEB Schedule of Funding Progress.

The actuarial valuations dated January 1, 2014 and 2015, which determine the annual required contribution for future fiscal years ending June 30, 2016 and 2017, have not been audited.

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future, and actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future.

The required schedule of funding progress immediately following the notes to the financial statements presents multi-year trend information about whether the actuarial value of Trust assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Calculations are based on the benefits provided under the terms of the substantive plan in effect at the time of each valuation and on the pattern of sharing of costs between the employer and plan members to that point.

Actuarial calculations reflect a long-term perspective. Consistent with that perspective, actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets.

Identification of actuarial methods and significant assumptions used to determine the annual required contribution:

I. Actuarial cost method	Projected unit credit cost method
II. Actuarial value of assets	Smoothed market value with phase-in method using a smoothing period of 5 years
III. Investment return	7.5%, based on the expected portfolio return
Projected salary increases	N/A
Healthcare cost Trend:	
Medicare	2014 - 2030+, ranging from 4.5% to 7.45%
Non-Medicare	2014 - 2030+, ranging from 4.5% to 8.75%
IV. Amortization method	Level dollar closed
Amortization period	Closed 30-year

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.

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**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, 2015 and 2014 are summarized as follows:

	<b>2015</b>	<b>2014</b>
City of Knoxville		
Amounts billed by KUB for utilities and related services	\$ 14,250,324	\$ 11,887,645
Payments by KUB in lieu of property tax	16,535,897	14,646,323
Payments by KUB for services provided	1,804,675	2,255,362

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

	<b>2015</b>	<b>2014</b>
Accounts receivable	\$ 869,815	\$ 632,000

**14. Natural Gas Supply Contract Commitments**

For fiscal year 2015, the Gas Division hedged 51 percent of its total gas purchases via gas supply contracts. As of June 30, 2015, the Gas Division had hedged the price on approximately 24 percent of its anticipated gas purchases for fiscal year 2016.

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

	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>
Transportation					
Tennessee Gas Pipeline	\$ 4,578,476	\$ 3,253,596	\$ 3,253,596	\$ 3,253,596	\$ 1,084,532
East Tennessee Natural Gas	10,066,388	10,066,388	10,066,388	10,066,388	2,748,496
Storage					
Tennessee Gas Pipeline	1,919,872	1,841,664	1,841,664	1,841,664	767,360
East Tennessee Natural Gas	757,460	757,460	757,460	757,460	-
Saltville Natural Gas	1,917,780	1,917,780	1,579,350	564,060	423,045
Demand Total	<u>\$ 19,239,976</u>	<u>\$ 17,836,888</u>	<u>\$ 17,498,458</u>	<u>\$ 16,483,168</u>	<u>\$ 5,023,433</u>

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Firm obligations related to purchased gas – commodity

	2016	2017	2018	2019	2020
Baseload					
Conoco	\$ 2,549,105	\$ -	\$ -	\$ -	\$ -
Shell Energy	2,518,300	-	-	-	-
BP	5,818,201	5,883,795	5,874,650	5,874,650	1,801,950
CNX	2,473,575	-	-	-	-
Commodity Total	<u>\$ 13,359,181</u>	<u>\$ 5,883,795</u>	<u>\$ 5,874,650</u>	<u>\$ 5,874,650</u>	<u>\$ 1,801,950</u>

The total commodity values presented here are based upon firm supply obligations with each individual natural gas supplier. The firm obligations value for Conoco, Shell Energy, and BP are based upon firm supply obligations and 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 June 30, 2015.

**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. Through its PACE 10 program, KUB is addressing the terms of the Consent Decree. 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 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, 2015, the Wastewater Division had issued \$485 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

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percent rate increase, which was effective in September 2008, two 12 percent rate increases, which were effective in April 2011 and October 2012, and three 6 percent rate increases effective October 2014, October 2015 and October 2016, respectively. KUB anticipates additional bond issues and rate increases over the next decade to help fund wastewater capital improvements.

KUB completed its eleventh full year of wastewater operations under the requirements of the federal Consent Decree. All collection system projects required under the federal Consent Decree were completed as of June 30, 2014.

**16. Segment Information**

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

**Condensed Statement of Net Position**

	<b>2015</b>			
	<b>Electric</b>	<b>Gas</b>	<b>Water</b>	<b>Wastewater</b>
<b>Assets and Deferred Outflows of Resources</b>				
Current assets	\$ 113,395,720	\$ 45,488,784	\$ 27,984,680	\$ 42,523,912
Restricted assets	33,517,297	3,119,403	12,903,096	22,712,158
Net capital assets	480,797,659	248,032,207	258,138,759	664,178,585
Other assets	43,446,286	14,911,384	14,195,562	38,863,004
<b>Total assets</b>	<b>\$ 671,156,962</b>	<b>\$ 311,551,778</b>	<b>\$ 313,222,097</b>	<b>\$ 768,277,659</b>
Deferred outflows of resources	5,410,730	1,925,346	2,459,219	18,592,703
<b>Total assets and deferred outflows of resources</b>	<b>\$ 676,567,692</b>	<b>\$ 313,477,124</b>	<b>\$ 315,681,316</b>	<b>\$ 786,870,362</b>
<b>Liabilities and Deferred Inflows of Resources</b>				
Current liabilities	\$ 85,227,269	\$ 16,716,438	\$ 9,361,281	\$ 17,928,132
Other liabilities	16,261,143	3,352,842	1,634,788	2,052,891
Long-term debt	248,330,326	105,919,404	146,856,890	503,955,190
<b>Total liabilities</b>	<b>\$ 349,818,738</b>	<b>\$ 125,988,684</b>	<b>\$ 157,852,959</b>	<b>\$ 523,936,213</b>
Deferred inflows of resources	3,061,589	1,148,096	\$ 829,180	\$ 1,339,445
<b>Total liabilities and deferred inflows of resources</b>	<b>\$ 352,880,327</b>	<b>\$ 127,136,780</b>	<b>\$ 158,682,139</b>	<b>\$ 525,275,658</b>
<b>Net position</b>				
Net investment in capital assets	\$ 228,768,196	\$ 138,973,111	\$ 110,579,425	\$ 172,143,725
Restricted	9,091,195	1,801,334	1,375,362	2,623,864
Unrestricted	85,827,974	45,565,899	45,044,390	86,827,115
<b>Total net position</b>	<b>\$ 323,687,365</b>	<b>\$ 186,340,344</b>	<b>\$ 156,999,177</b>	<b>\$ 261,594,704</b>

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**Knoxville Utilities Board**  
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**Condensed Statement of Net Position**

	2014			
	Electric	Gas	Water	Wastewater
Assets and Deferred Outflows of Resources				
Current assets	\$ 109,653,604	\$ 70,780,746	\$ 33,381,469	\$ 37,830,530
Restricted assets	11,604,449	4,244,640	2,888,739	7,023,709
Net capital assets	445,495,022	221,371,550	239,705,687	642,301,617
Other assets	28,818,241	8,549,839	6,589,557	17,849,571
Total assets	<u>\$ 595,571,316</u>	<u>\$ 304,946,775</u>	<u>\$ 282,565,452</u>	<u>\$ 705,005,427</u>
Deferred outflows of resources	1,415,368	511,898	\$ 260,151	\$ 10,064,386
Total assets and deferred outflows of resources	<u>\$ 596,986,684</u>	<u>\$ 305,458,673</u>	<u>\$ 282,825,603</u>	<u>\$ 715,069,813</u>
Liabilities and Deferred Inflows of Resources				
Current liabilities	\$ 88,779,761	\$ 18,827,048	\$ 9,060,170	\$ 17,940,056
Other liabilities	19,997,416	3,354,987	1,524,137	2,038,918
Long-term debt	171,005,000	107,215,000	119,745,000	441,035,000
Total liabilities	<u>\$ 279,782,177</u>	<u>\$ 129,397,035</u>	<u>\$ 130,329,307</u>	<u>\$ 461,013,974</u>
Deferred inflows of resources	4,220,243	1,744,056	\$ 383,669	\$ 56,509
Total liabilities and deferred inflows of resources	<u>\$ 284,002,420</u>	<u>\$ 131,141,091</u>	<u>\$ 130,712,976</u>	<u>\$ 461,070,483</u>
Net position				
Net investment in capital assets	\$ 262,994,767	\$ 107,234,408	\$ 116,197,169	\$ 201,947,494
Restricted	7,955,720	1,725,103	1,219,136	2,263,063
Unrestricted	42,033,777	65,358,071	34,696,322	49,788,773
Total net position	<u>\$ 312,984,264</u>	<u>\$ 174,317,582</u>	<u>\$ 152,112,627</u>	<u>\$ 253,999,330</u>

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**Knoxville Utilities Board**  
**Notes to Consolidated Financial Statements**  
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**Condensed Statement of Revenues, Expenses  
and Changes in Net Position**

	2015			
	Electric	Gas	Water	Wastewater
Operating revenues	\$ 533,205,845	\$ 114,168,784	\$ 44,173,190	\$ 79,206,028
Operating expenses	489,617,790	86,845,366	26,315,917	35,189,854
Provision for depreciation	25,887,777	10,894,826	7,794,763	17,130,721
Total operating expenses	<u>515,505,567</u>	<u>97,740,192</u>	<u>34,110,680</u>	<u>52,320,575</u>
Operating income	17,700,278	16,428,592	10,062,510	26,885,453
Non-operating expense	<u>(6,642,081)</u>	<u>(4,272,667)</u>	<u>(5,309,339)</u>	<u>(19,486,890)</u>
Change in net position before capital contributions	11,058,197	12,155,925	4,753,171	7,398,563
Capital contributions	11,611	4,353	232,696	357,246
Change in net position	<u>11,069,808</u>	<u>12,160,278</u>	<u>4,985,867</u>	<u>7,755,809</u>
Net position				
Beginning of year, as previously reported	312,984,264	174,317,582	152,112,627	253,999,330
Change in method of accounting for pension	<u>(366,707)</u>	<u>(137,516)</u>	<u>(99,317)</u>	<u>(160,435)</u>
Net position, beginning of year, as restated	<u>312,617,557</u>	<u>174,180,066</u>	<u>152,013,310</u>	<u>253,838,895</u>
End of year	<u>\$ 323,687,365</u>	<u>\$ 186,340,344</u>	<u>\$ 156,999,177</u>	<u>\$ 261,594,704</u>

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

	2014			
	Electric	Gas	Water	Wastewater
Operating revenues	\$ 527,832,791	\$ 117,145,734	\$ 39,373,714	\$ 75,041,645
Operating expenses	485,298,618	92,390,649	25,913,424	33,744,494
Provision for depreciation	23,190,530	9,674,685	6,933,752	16,086,344
Total operating expenses	<u>508,489,148</u>	<u>102,065,334</u>	<u>32,847,176</u>	<u>49,830,838</u>
Operating income	19,343,643	15,080,400	6,526,538	25,210,807
Non-operating expense	<u>(7,662,103)</u>	<u>(4,452,600)</u>	<u>(5,205,074)</u>	<u>(19,808,447)</u>
Change in net position before capital contributions	11,681,540	10,627,800	1,321,464	5,402,360
Capital contributions	306,250	-	157,859	271,650
Change in net position	<u>11,987,790</u>	<u>10,627,800</u>	<u>1,479,323</u>	<u>5,674,010</u>
Net position				
Beginning of year	300,996,474	163,689,782	150,633,304	248,325,320
End of year	<u>\$ 312,984,264</u>	<u>\$ 174,317,582</u>	<u>\$ 152,112,627</u>	<u>\$ 253,999,330</u>

**Knoxville Utilities Board**  
**Notes to Consolidated Financial Statements**  
**June 30, 2015 and 2014**

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**Condensed Statement of Cash Flows**

	2015			
	Electric	Gas	Water	Wastewater
Net cash provided by operating activities	\$ 38,410,104	\$ 28,984,668	\$ 17,603,576	\$ 42,595,872
Net cash used in capital and related financing activities	(22,524,068)	(46,023,953)	(17,392,294)	(22,961,641)
Net cash provided by (used in) investing activities	<u>(2,886,436)</u>	<u>(712,007)</u>	<u>5,914,751</u>	<u>(2,194,880)</u>
Net increase (decrease) in cash and cash equivalents	12,999,600	(17,751,292)	6,126,033	17,439,351
Cash and cash equivalents, beginning of year	<u>31,472,251</u>	<u>44,014,211</u>	<u>15,178,461</u>	<u>15,413,919</u>
Cash and cash equivalents, end of year	<u>\$ 44,471,851</u>	<u>\$ 26,262,919</u>	<u>\$ 21,304,494</u>	<u>\$ 32,853,270</u>

**Condensed Statement of Cash Flows**

	2014			
	Electric	Gas	Water	Wastewater
Net cash provided by operating activities	\$ 42,266,527	\$ 26,236,760	\$ 10,882,313	\$ 36,836,466
Net cash used in capital and related financing activities	(78,746,408)	(1,141,280)	(4,463,650)	(68,398,367)
Net cash provided by (used in) investing activities	<u>7,366,073</u>	<u>(1,184,190)</u>	<u>(3,363,442)</u>	<u>14,064,454</u>
Net increase (decrease) in cash and cash equivalents	(29,113,808)	23,911,290	3,055,221	(17,497,447)
Cash and cash equivalents, beginning of year	<u>60,586,059</u>	<u>20,102,921</u>	<u>12,123,240</u>	<u>32,911,366</u>
Cash and cash equivalents, end of year	<u>\$ 31,472,251</u>	<u>\$ 44,014,211</u>	<u>\$ 15,178,461</u>	<u>\$ 15,413,919</u>

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**Knoxville Utilities Board**  
**Required Supplementary Information - Schedule of Funding Progress**  
**June 30, 2015**  
**(Unaudited)**

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

<b>Valuation Date</b>	<b>Actuarial Value of Assets (a)</b>	<b>Actuarial Accrued Liability (AAL) (b)</b>	<b>Unfunded Actuarial Accrued Liability (UAAL) (b-a)</b>	<b>Funded Ratio (a)/(b)</b>	<b>Covered Payroll (c)</b>	<b>UAAL as a Percentage of Covered Payroll [(b)-(a)]/(c)</b>
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%
* January 1, 2014	43,409,955	46,889,808	3,479,853	93%	26,724,154	13.0%
* January 1, 2015	47,705,478	47,745,640	40,162	100%	25,816,884	0.2%

\* The actuarial valuations dated January 1, 2014 and 2015, which determine the annual required contribution for future fiscal years ending June 30, 2016 and 2017, have not been audited.

See accompanying Report of Independent Auditors on Supplemental Information.



**Knoxville Utilities Board**  
**Required Supplementary Information - Schedule of Changes in Net Pension**  
**Liability and Related Ratios**  
**June 30, 2015**  
**(Unaudited)**

	<u>2014</u>
<b>Total pension liability</b>	
Service cost	\$ 4,092,808
Interest	14,698,657
Benefit payments, including refunds of member contributions	<u>(15,533,167)</u>
<b>Net change in total pension liability</b>	3,258,298
<b>Total pension liability - beginning</b>	<u>199,515,466</u>
<b>Total pension liability - ending (a)</b>	<u>\$ 202,773,764</u>
<b>Plan fiduciary net position</b>	
Contributions - employer	\$ 5,908,541
Contributions - participants	475,854
Net investment income	22,292,369
Other additions	29,733
Benefit payments, including refunds of member contributions	(15,405,167)
Administrative expense	(378,085)
Death benefits	<u>(128,000)</u>
<b>Net change in plan fiduciary net position**</b>	12,795,245
<b>Plan fiduciary net position - beginning**</b>	<u>196,000,149</u>
<b>Plan fiduciary net position - ending (b)**</b>	<u>\$ 208,795,394</u>
<b>Plan's net pension liability - ending (a) - (b)</b>	<u>\$ (6,021,630)</u>
Plan fiduciary net position as a percentage of the total pension liability	102.97%
Covered-employee payroll	\$ 50,246,074
Plan's net pension liability as a percentage of covered-employee payroll	(11.98%)

**Notes to Schedule:**

\* Information not reflected prior to 2014 due to changes in actuary methodologies required under GASB 67, which was implemented in 2014.

\*\* Excludes amounts related to 401(k) matching contributions.

See accompanying Report of Independent Auditors on Supplemental Information.

**Knoxville Utilities Board**  
**Required Supplementary Information - Schedule of Employer Pension**  
**Contributions**  
**June 30, 2015**  
**(Unaudited)**

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	<u>2014</u>
Annual required contribution	\$ 5,908,541
Contribution in relation to the annual required contribution	<u>5,908,541</u>
Contribution deficiency	<u>\$ -</u>
Covered-employee payroll	\$ 50,246,074
Contributions as a percentage of covered-employee payroll	11.76%

**Notes to Schedule:**

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Valuation Dates: January 1, 2012 and January 1, 2013  
Timing: Annual required contributions for a plan year are based upon 50% of the amounts determined at the actuarial valuations for each of the two prior plan years.

**Key methods and assumptions used to determine contribution rates:**

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Actuarial cost method: Entry Age Normal  
Asset valuation method: 5-year smoothed market  
Amortization method: Level dollar closed period with 29 years remaining as of January 1, 2012 and 28 years remaining as of January 1, 2013.  
Discount rate: 8.0%  
Salary increases: From 2.58% to 7.92% based on years of service  
Mortality: Sex distinct RP-2000 Combined Mortality projected to 2018 using Scale AA.

\* Schedule of Employer Contribution information is not reflected prior to 2013 due to changes in actuary methodologies required under GASB 67, which was implemented 2014.

See accompanying Report of Independent Auditors on Supplemental Information.

**Knoxville Utilities Board Electric Division**  
**Supplemental Information –**  
**Schedule of Expenditures of Federal Awards and State Financial Assistance**  
**June 30, 2015**

**Schedule 1**

KUB was awarded a grant from Tennessee Emergency Management Agency (as a flow through from FEMA) for reimbursement for costs related to storms in 2015. The schedule below shows the expenditures for the current fiscal year.

<u>Program Name</u>	<u>Federal/State Agency</u>	<u>CFDA Number</u>	<u>Contract Number</u>	<u>Expenditures</u>
U.S. Department of Homeland Security	Tennessee Emergency Management	97.036	37101-06616	<u>\$ 227,006</u>
		Total Program 97.036		<u>\$ 227,006</u>
		<b>Total Federal Awards</b>		<b><u>\$ 227,006</u></b>

**NOTE 1 - BASIS OF PRESENTATION**

The accompanying Schedule of Expenditures of Federal Awards and State Financial Assistance 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.

**NOTE 2 - EXPENDITURES**

The accompanying Schedule of Expenditures of Federal Awards and State Financial Assistance does not include the expenditures related to a project worksheet awarded to Knoxville Utilities Board in July 2015 totaling \$1,325,524. 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*. Since the project worksheet was signed after fiscal year end, the Single Audit is not required until fiscal year 2016 in accordance with guidance for CFDA Number 97.036 of OMB Circular A-133.

See accompanying Report of Independent Auditors on Supplemental Information.

**Knoxville Utilities Board**  
**Supplemental Information - Schedule of Insurance in Force**  
**June 30, 2015**  
**(Unaudited)**

**Schedule 2**

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**Crime**

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

**Directors' and Officers' Liability Insurance**

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

**Employment Practices Liability**

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

**Fiduciary**

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

**Pollution Legal Liability**

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

**Property Insurance**

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

**Travel Accident**

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

**Excess Insurance for General Liability**

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

**Excess Insurance for Workers' Compensation**

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

**Employee Health Plan Stop Loss Coverage**

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

See accompanying Report of Independent Auditors on Supplemental Information.



## Report of Independent Auditors 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*

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), a component unit of the City of Knoxville, Tennessee, as of and for the year ended June 30, 2015, and the related notes to the financial statements, which collectively comprise KUB's basic financial statements, and have issued our report thereon dated October 16, 2015.

### **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 opinion 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 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.

Board of Commissioners  
Knoxville Utilities Board  
Knoxville, Tennessee

### **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 and grant agreements, 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 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.

*Coulter & Justus, P.C.*

Knoxville, Tennessee  
October 16, 2015