

Knoxville Utilities Board

**Consolidated Financial Statements and
Supplemental Information**

June 30, 2015 and 2014

Knoxville Utilities Board

Index

June 30, 2015 and 2014

	Page(s)
Independent Auditors' Report	1-2
Management's Discussion and Analysis	3-26
Financial Statements	
Consolidated Statements of Net Position	27-28
Consolidated Statements of Revenues, Expenses and Changes in Net Position	29
Consolidated Statements of Cash Flows.....	30
Notes to Consolidated Financial Statements.....	31-61
Required Supplementary Information – Schedule of Funding Progress	62
Required Supplementary Information – Schedule of Changes in Net Pension Liability and Related Ratios	63
Required Supplementary Information – Schedule of Employer Pension Contributions	64
Supplemental Information	
Schedule 1 – Schedule of Expenditures of Federal Awards and State Financial Assistance	65
Schedule 2 – Schedule of Insurance in Force	66
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 <i>Government Auditing Standards</i>	67-68



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

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

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

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

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

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

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

(in thousands of dollars)

	FY 2015 Budget**	FY 2015 Actual FYTD	Dollar Variance*	Percent Variance
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

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

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>	2015	2014	2013
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	28,388	12,252	13,002
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	6,378	-	-
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	263,265	191,877	220,480
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

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

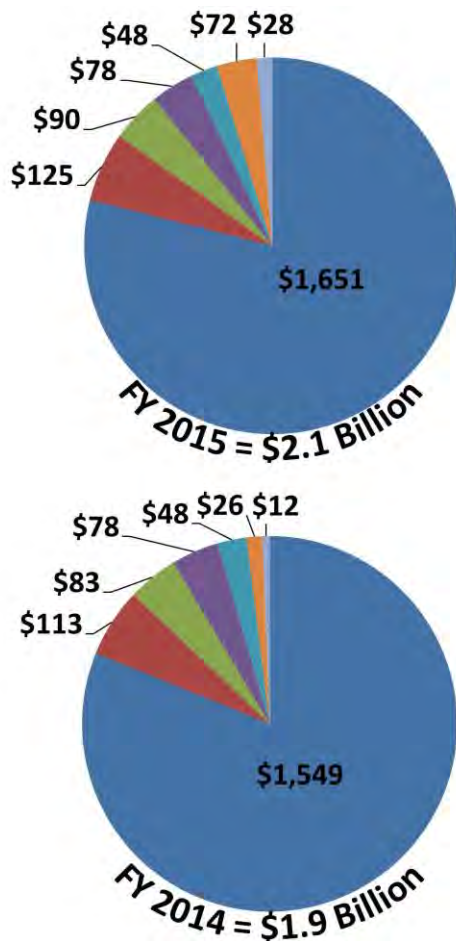
Fiscal Year 2015 Compared to Fiscal Year 2014

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
Management's Discussion and Analysis
June 30, 2015 and 2014



**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

Management's Discussion and Analysis

June 30, 2015 and 2014

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

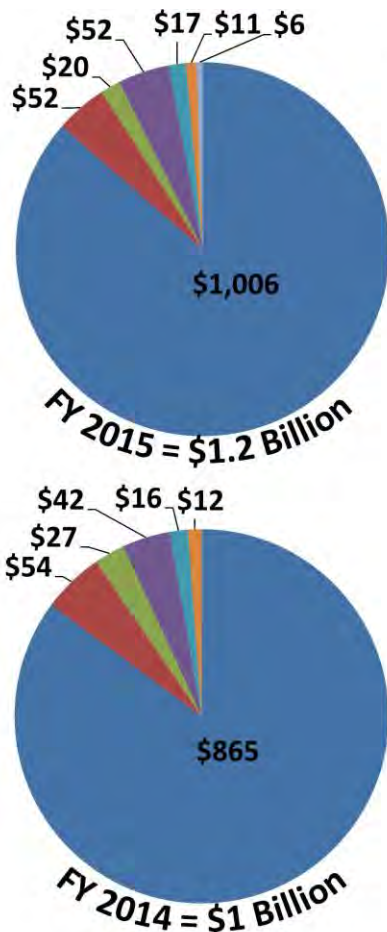
Deferred inflows increased \$6.4 million compared to the prior fiscal year due to the addition of pension inflow. For further explanation, see Notes to the Financial Statements.

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
Management's Discussion and Analysis
June 30, 2015 and 2014



**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.

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

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>	2015	2014	2013
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	<u>606</u>	<u>736</u>	<u>378</u>
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.

Knoxville Utilities Board

Management's Discussion and Analysis

June 30, 2015 and 2014

- 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

\$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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Knoxville Utilities Board

Management's Discussion and Analysis

June 30, 2015 and 2014

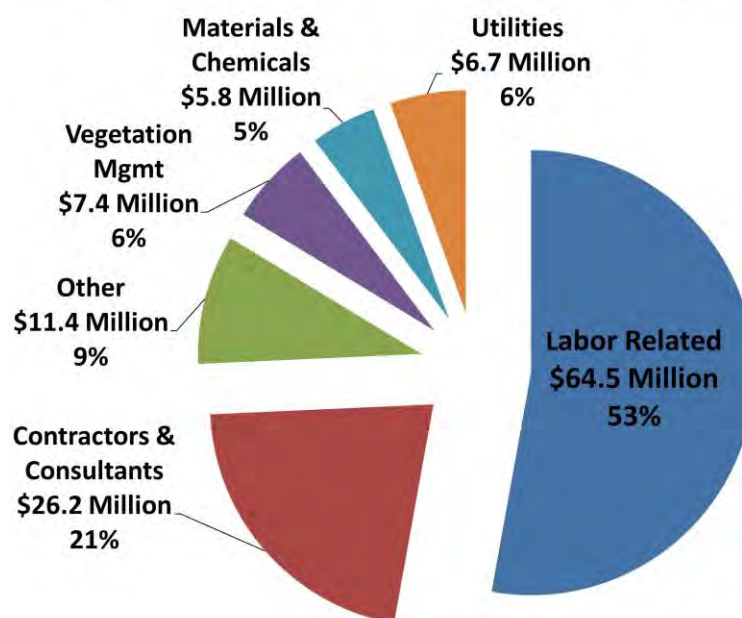
Operating Expenses

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

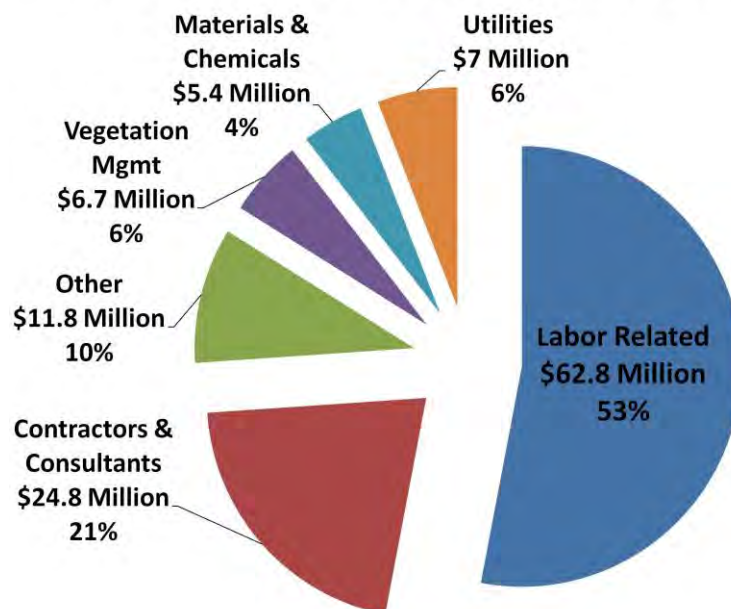
net plant values and margin from sales. The City of Knoxville's property tax rate increased this year and higher plant in service and margin levels both contributed to the growth in tax equivalent payments.

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

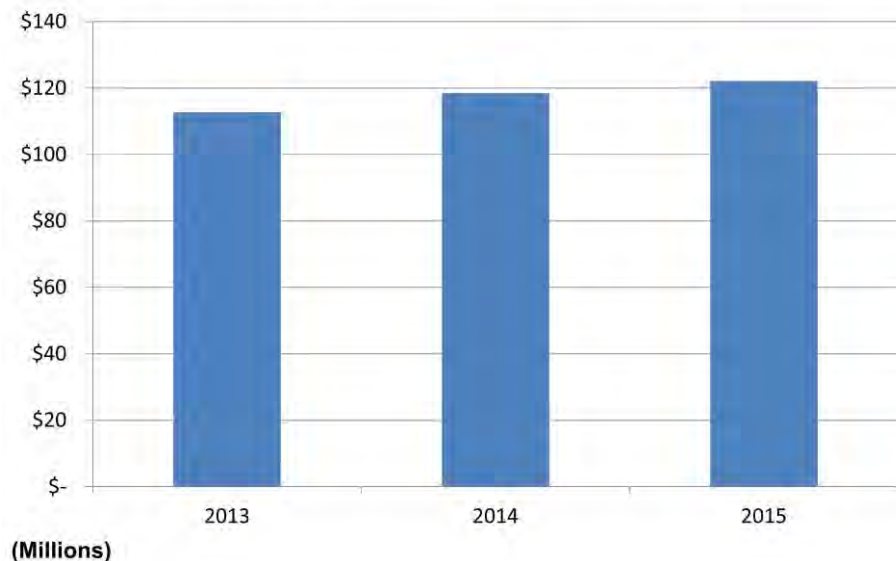
Knoxville Utilities Board

Management's Discussion and Analysis

June 30, 2015 and 2014

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.

Knoxville Utilities Board

Management's Discussion and Analysis

June 30, 2015 and 2014

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>	2015	2014	2013
Production Plant (Intakes)	\$ 62	\$ 76	\$ 90
Pumping and Treatment Plant	174,660	177,256	154,157
Distribution and Collection Plant			
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
Total Distribution & Collection Plant	1,231,379	1,194,563	1,100,929
General Plant	51,234	52,149	50,398
Total Plant Assets	1,457,335	1,424,044	1,305,574
Work In Progress	193,812	124,830	160,098
Total Net Plant	\$ 1,651,147	\$ 1,548,874	\$ 1,465,672

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Knoxville Utilities Board

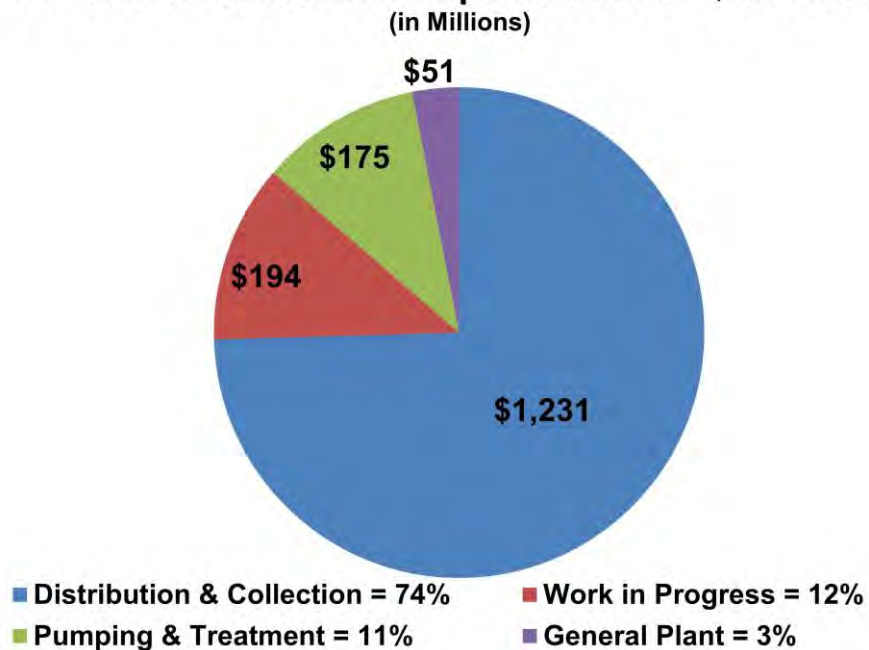
Management's Discussion and Analysis

June 30, 2015 and 2014

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



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

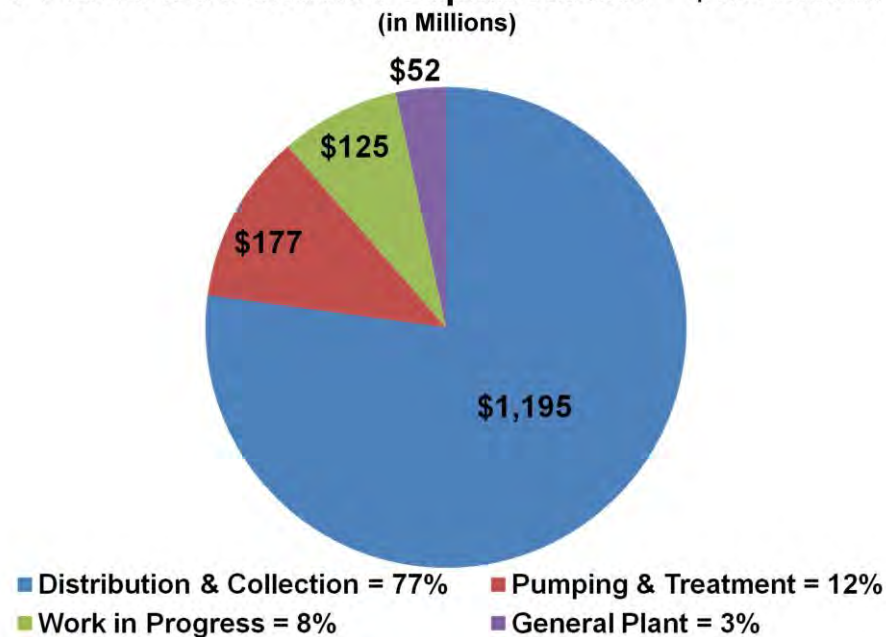
Management's Discussion and Analysis

June 30, 2015 and 2014

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



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

Knoxville Utilities Board

Management's Discussion and Analysis

June 30, 2015 and 2014

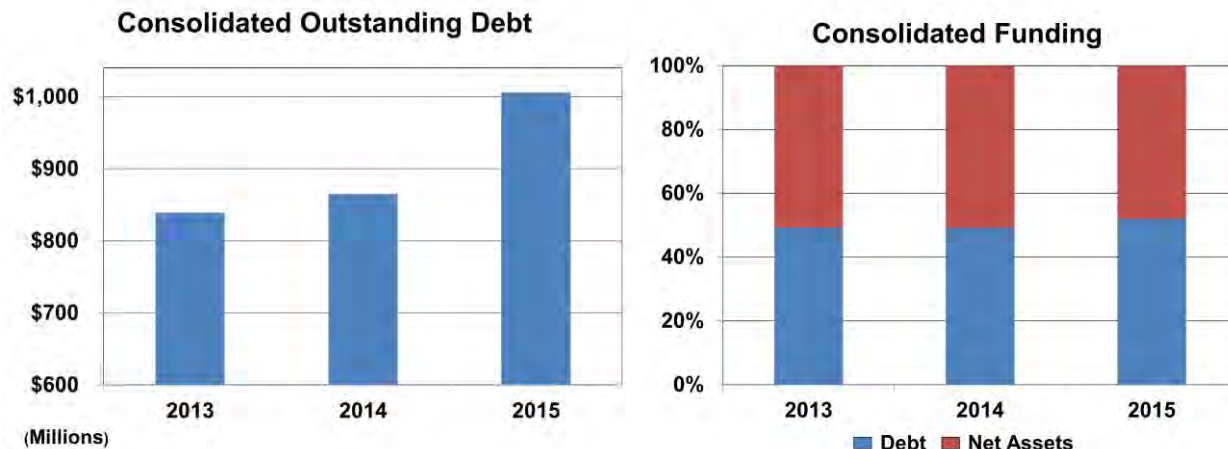
Debt Administration

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	\$ 1,006,260	\$ 864,740	\$ 839,305



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

Management's Discussion and Analysis

June 30, 2015 and 2014

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

Knoxville Utilities Board

Management's Discussion and Analysis

June 30, 2015 and 2014

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

	2015	2014
Assets and Deferred Outflows of Resources		
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	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	25,230,799	12,251,803
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

	2015	2014
Liabilities, Deferred Inflows, and Net Position		
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>
Reconciliation of operating income to net cash provided by operating activities		
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

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

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

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

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

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

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

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
Notes to Consolidated Financial Statements
June 30, 2015 and 2014

Classification of deposits and investments per Statement of Net Position:

	2015	2014
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:

	Deposit and Investment Maturities (in Years)		
	Fair Value	Less Than 1	1-5
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:

	2015	2014
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
June 30, 2015 and 2014

5. Accounts Payable and Accruals

Accounts payable and accruals consist of the following:

	2015	2014
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

Notes to Consolidated Financial Statements

June 30, 2015 and 2014

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
Electric						
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
Gas						
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
Water						
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
Wastewater						
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
Consolidated						
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

Knoxville Utilities Board

Notes to Consolidated Financial Statements

June 30, 2015 and 2014

	Balance June 30, 2013	Additions	Payments	Defeased	Balance June 30, 2014	Amounts Due Within One Year
Electric						
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>
Gas						
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>
Water						
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>
Wastewater						
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>
Consolidated						
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>

Knoxville Utilities Board

Notes to Consolidated Financial Statements

June 30, 2015 and 2014

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

Notes to Consolidated Financial Statements

June 30, 2015 and 2014

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

Knoxville Utilities Board

Notes to Consolidated Financial Statements

June 30, 2015 and 2014

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.

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

Other liabilities consist of the following:

	Balance June 30, 2014	Increase	Decrease	Balance June 30, 2015
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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Knoxville Utilities Board
Notes to Consolidated Financial Statements
June 30, 2015 and 2014

8. Capital Assets

Capital asset activity was as follows:

	Beginning 6/30/2014	Increase	Decrease	Ending 6/30/2015
Production Plant (Intakes)	\$ 742,503	\$ -	\$ -	\$ 742,503
Pumping and Treatment Plant	268,416,043	4,348,531	(608,563)	272,156,011
Distribution and Collection Plant				
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
Total Distribution & Collection Plant	\$ 1,715,577,399	\$ 80,478,619	\$ (13,225,852)	\$ 1,782,830,166
General Plant	146,172,851	10,527,779	(1,893,629)	154,807,001
Total Plant Assets	\$ 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)
Net Plant Assets	\$ 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
Total Net Plant	\$ 1,548,873,876	\$ 196,947,429	\$ (94,674,095)	\$ 1,651,147,210

	Beginning 6/30/2013	Increase	Decrease	Ending 6/30/2014
Production Plant (Intakes)	\$ 742,503	\$ -	\$ -	\$ 742,503
Pumping and Treatment Plant	240,400,730	29,498,352	(1,483,039)	268,416,043
Distribution and Collection Plant				
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
Total Distribution & Collection Plant	\$ 1,608,874,521	\$ 133,244,421	\$ (26,541,543)	\$ 1,715,577,399
General Plant	137,331,993	11,294,651	(2,453,793)	146,172,851
Total Plant Assets	\$ 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)
Net Plant Assets	\$ 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
Total Net Plant	\$ 1,465,671,138	\$ 254,519,072	\$ (171,316,334)	\$ 1,548,873,876

Knoxville Utilities Board

Notes to Consolidated Financial Statements

June 30, 2015 and 2014

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:

	2015	2014
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	(14,095,382)	(12,266,467)
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:

	2014	2013
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>

Knoxville Utilities Board

Notes to Consolidated Financial Statements

June 30, 2015 and 2014

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.

Knoxville Utilities Board

Notes to Consolidated Financial Statements

June 30, 2015 and 2014

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.

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

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

	2014	2013
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

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

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:

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

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

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	-

Knoxville Utilities Board

Notes to Consolidated Financial Statements

June 30, 2015 and 2014

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

Knoxville Utilities Board

Notes to Consolidated Financial Statements

June 30, 2015 and 2014

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)	3,500,284	3,319,013
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:

Schedule of Employer Contributions					
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.

Knoxville Utilities Board

Notes to Consolidated Financial Statements

June 30, 2015 and 2014

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.

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

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:

	2015	2014
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:

	2015	2014
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

	2016	2017	2018	2019	2020
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>

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

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

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

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

	2015			
	Electric	Gas	Water	Wastewater
Assets and Deferred Outflows of Resources				
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
Total assets	<u>\$ 671,156,962</u>	<u>\$ 311,551,778</u>	<u>\$ 313,222,097</u>	<u>\$ 768,277,659</u>
Deferred outflows of resources	5,410,730	1,925,346	2,459,219	18,592,703
Total assets and deferred outflows of resources	<u>\$ 676,567,692</u>	<u>\$ 313,477,124</u>	<u>\$ 315,681,316</u>	<u>\$ 786,870,362</u>
Liabilities and Deferred Inflows of Resources				
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
Total liabilities	<u>\$ 349,818,738</u>	<u>\$ 125,988,684</u>	<u>\$ 157,852,959</u>	<u>\$ 523,936,213</u>
Deferred inflows of resources	3,061,589	1,148,096	\$ 829,180	\$ 1,339,445
Total liabilities and deferred inflows of resources	<u>\$ 352,880,327</u>	<u>\$ 127,136,780</u>	<u>\$ 158,682,139</u>	<u>\$ 525,275,658</u>
Net position				
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
Total net position	<u>\$ 323,687,365</u>	<u>\$ 186,340,344</u>	<u>\$ 156,999,177</u>	<u>\$ 261,594,704</u>

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

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
June 30, 2015 and 2014

**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	(6,642,081)	(4,272,667)	(5,309,339)	(19,486,890)
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	(366,707)	(137,516)	(99,317)	(160,435)
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	(7,662,103)	(4,452,600)	(5,205,074)	(19,808,447)
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	<u>300,996,474</u>	<u>163,689,782</u>	<u>150,633,304</u>	<u>248,325,320</u>
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

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><u>\$ 44,471,851</u></u>	<u><u>\$ 26,262,919</u></u>	<u><u>\$ 21,304,494</u></u>	<u><u>\$ 32,853,270</u></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><u>\$ 31,472,251</u></u>	<u><u>\$ 44,014,211</u></u>	<u><u>\$ 15,178,461</u></u>	<u><u>\$ 15,413,919</u></u>

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

Other Post-Employment Benefits (OPEB)

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

	2014
Total pension liability	
Service cost	\$ 4,092,808
Interest	14,698,657
Benefit payments, including refunds of member contributions	(15,533,167)
Net change in total pension liability	3,258,298
Total pension liability - beginning	199,515,466
Total pension liability - ending (a)	\$ 202,773,764
Plan fiduciary net position	
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	(128,000)
Net change in plan fiduciary net position**	12,795,245
Plan fiduciary net position - beginning**	196,000,149
Plan fiduciary net position - ending (b)**	\$ 208,795,394
Plan's net pension liability - ending (a) - (b)	\$ (6,021,630)
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)

	<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:

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:

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	\$ 227,006
		Total Program 97.036		\$ 227,006
		Total Federal Awards		\$ 227,006

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

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

Knoxville Utilities Board Electric Division

**Financial Statements and Supplemental
Information**

June 30, 2015 and 2014

Knoxville Utilities Board Electric Division

Index

June 30, 2015 and 2014

	Page(s)
Independent Auditors' Report	1-2
Management's Discussion and Analysis	3-24
Basic Financial Statements	
Statements of Net Position.....	25-26
Statements of Revenues, Expenses and Changes in Net Position.....	27
Statements of Cash Flows	28
Notes to Financial Statements	29-50
Required Supplementary Information – Schedule of Funding Progress	51
Required Supplementary Information – Schedule of Changes in Net Pension Liability and Related Ratios	52
Required Supplementary Information – Schedule of Employer Pension Contributions	53
Supplemental Information	
Schedule 1 – Schedule of Expenditures of Federal Awards and State Financial Assistance	54
Schedule 2 – Schedule of Insurance in Force	55
Schedule 3 – Schedule of Debt Maturities by Fiscal Year	56-57
Schedule 4 – Schedule of Current Rates in Force.....	58-83
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 <i>Government Auditing Standards</i>	84-85



Report of Independent Auditors

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

We have audited the accompanying financial statements of the Electric Division (the Division) 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 the Division'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 Division's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Division's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Electric Division of the Knoxville Utilities Board 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, the Division 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.

Board of Commissioners
The Electric Division of the Knoxville Utilities Board
Knoxville, Tennessee

Other Matters

Prior Period Financial Statements

The financial statements of the Division 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.

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 24 and the required supplementary information on pages 51 through 53 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 Division's basic financial statements. The supplemental information on schedules 2 through 4, as listed on the index, are presented for purposes of additional analysis and are 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 supplemental information on schedules 2 through 4 have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on 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 the Division's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Division's internal control over financial reporting and compliance.

Coulter & Justus, P.C.

Knoxville, Tennessee
October 16, 2015

Knoxville Utilities Board Electric Division

Management's Discussion and Analysis

June 30, 2015 and 2014

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. The Electric Division (Division) provides services to certain customers in Knox County and in seven surrounding counties in East Tennessee. The Division's accounts are maintained in conformity with the Uniform System of Accounts of the Federal Energy Regulatory Commission and the Governmental Accounting Standards Board, as applicable. The financial statements present only the Electric Division and do not purport to, and do not, present fairly the consolidated financial position of Knoxville Utilities Board at June 30, 2015 and 2014, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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

The Division's Management Discussion and Analysis ("MD&A") focuses on the fiscal year ending June 30, 2015 activities, resulting changes and current known facts, and should be read in conjunction with the Division's financial statements.

Electric Division Highlights

System Highlights

KUB serves 200,852 electric customers over a 688 square mile service area and maintains 5,300 miles of service lines and 61 electric substations to provide 5.7 million megawatt hours to its customers annually.

KUB's electric system experienced a record peak in demand of 1,328 megawatt hours in February 2015. The previous peak before this fiscal year 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).

KUB added 1,470 customers to its electric system in fiscal year 2015, which is up from the addition of 1,026 customers in fiscal year 2014.

The typical residential customer's monthly electric bill was \$101.29 as of June 30, 2015, representing an increase of \$1.77 or 1.8 percent compared to June 30, 2014. The increase in the monthly bill during fiscal year 2015 was the net result of the flow through of TVA wholesale rate adjustments including the 1.5 percent wholesale base rate increase effective October 2014, previously over recovered wholesale power costs and KUB's one percent rate increase.

In August 2014, KUB sold \$40 million in electric system revenue bonds. In April 2015, KUB sold \$35 million in electric system revenue bonds. These two issuances were to fund electric system capital improvements. KUB also sold \$28.6 million in electric system revenue refunding bonds in April 2015. This refunding will provide debt service savings of \$2.2 million over the life of the bonds.

KUB's electric system was impacted by an ice storm event in February 2015 that resulted in a cost of \$2 million to the system. 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.

Knoxville Utilities Board Electric Division

Management's Discussion and Analysis

June 30, 2015 and 2014

Century II Infrastructure Program

Century II is KUB's proactive long-range program to improve and maintain its electric, natural gas, water and wastewater systems for its customers. It includes the maintenance and replacement strategies for each utility 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 a ten year funding plan for the Electric Division, which includes a combination of rate increases and debt issues to fully fund the electric system's Century II program.

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 the Electric Division. The first rate increase went into effect in July 2014. Each electric rate increase will generate an additional \$5 million in Electric Division revenue.

KUB replaced 2,551 poles, exceeding the target level of 2,400, and replaced 6.17 miles of underground electric cable while staying within the Electric Division's total capital budget during fiscal year 2015.

Financial Highlights

Fiscal Year 2015 Compared to Fiscal Year 2014

The Division's net position during the year increased \$11.1 million compared to a \$12 million increase last fiscal year. 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 \$0.4 million during fiscal year 2015. This change resulted in a net increase of \$10.7 million in the Division's net position.

Operating revenue increased \$5.4 million or 1 percent over the prior fiscal year. The increase in operating revenue was the net result of additional revenue from KUB's one percent electric rate increase, the flow through of TVA rate adjustments and the flow through of prior year over recovered purchase power costs to electric customers. KUB flows changes to wholesale power rates directly through to its retail electric rates via its Purchased Power Adjustment.

Eighty-one percent of Electric Division sales revenue was used to purchase electric power from TVA for the fiscal year ended June 30, 2015. Purchased power expense increased \$0.2 million compared to last year, due to a 1.5 percent wholesale power rate increase from TVA effective October 2014.

Margin on electric sales (operating revenue less purchased power expense) increased \$5.2 million or 4.8 percent, reflecting additional revenue from the KUB electric rate increase.

Operating expenses (excluding purchased power expense) increased \$6.8 million or 7.6 percent. Operating and maintenance ("O&M") expenditures increased \$2.7 million or 5.1 percent. Depreciation expense increased \$2.7 million or 11.6 percent. Taxes and tax equivalents were \$1.4 million, or 10.6 percent, higher than the prior fiscal year.

Interest income was consistent with the prior fiscal year. Interest expense increased \$0.8 million or 10.5 percent, primarily due to the additional interest accrued on long-term bonds issued in August 2014 and April 2015.

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

Capital contributions decreased \$0.3 million, reflecting fewer electric system assets provided to KUB during the fiscal year.

Total plant assets (net) increased \$35.3 million or 7.9 percent over the end of the last fiscal year reflecting pole replacements and other distribution system improvements as part of KUB's Century II electric program.

KUB sold two series of electric system revenue bonds during fiscal year 2015 for the purpose of funding electric system capital improvements totaling \$75 million. The \$35 million bond issue in April 2015 was accelerated to take advantage of the low interest rate environment which impacted the Division's debt rate and debt service coverage levels for fiscal year 2015. Long-term debt represented 43.3 percent of the Division's capital structure as of June 30, 2015, compared to 36.4 percent last year. Capital structure equals long-term debt (including the current and long-term portion of any revenue bonds and notes) plus net position.

The Division's bond covenants require a debt service coverage ratio of at least 1.2 times the maximum principal and interest payments over the life of the Division's outstanding bonds. Current year debt coverage for the fiscal year was 3.8. Maximum debt service coverage was 3.06.

Fiscal Year 2014 Compared to Fiscal Year 2013

The Division's net position increased \$12 million or 4 percent, compared to an \$11.2 million increase in fiscal year 2013.

Operating revenue decreased \$7.1 million or 1.3 percent. The decline in operating revenue was the net result of additional revenue from KUB electric rate increases, increased sales volumes, the flow through of TVA rate adjustments and the flow through of prior year over recovered purchase power costs to electric customers. KUB flows changes to wholesale power rates directly through to its retail electric rates via its Purchased Power Adjustment.

KUB expended 81 percent of Electric Division sales revenue to TVA for wholesale power purchases for the fiscal year ended June 30, 2014. Purchased power expense decreased \$12.5 million compared to last year, reflecting lower wholesale power rates from TVA during fiscal year 2014.

Margin on electric sales (operating revenue less purchased power expense) increased \$5.4 million or 5.3 percent.

Operating expenses (excluding purchased power expense) increased \$4.1 million or 4.8 percent. Operating and maintenance ("O&M") expenditures increased \$2.6 million or 5.2 percent. Depreciation expense increased \$0.8 million or 3.6 percent. Taxes and tax equivalents were \$0.7 million higher than the prior fiscal year.

Lower interest rates on investments resulted in a \$0.1 million decrease in interest income. Interest expense increased \$0.5 million or 6.3 percent, primarily due to the additional interest expense from revenue bonds issued in December 2012.

Capital contributions increased \$0.1 million, reflecting additional street lighting assets provided to KUB.

Total plant assets (net) increased \$39.5 million or 9.7 percent over the end of the last fiscal year reflecting pole replacements and other distribution system improvements as part of KUB's Century II electric program.

Knoxville Utilities Board Electric Division

Management's Discussion and Analysis

June 30, 2015 and 2014

Long-term debt represented 36.4 percent of the Division's capital structure as of June 30, 2014, compared to 38.3 percent last year. Capital structure equals long-term debt (including the current portion of any revenue bonds and notes, as applicable, due to be retired the next fiscal year) plus net position.

The Division's bond covenants require a debt service coverage ratio of at least 1.2 times the maximum principal and interest payments over the life of the Division's outstanding bonds. Fiscal year 2014 debt coverage was 3.66. Maximum debt service coverage was 3.63.

Division Cash Budget Appropriations

KUB's Board of Commissioners adopted an Electric Division budget of \$570.3 million for fiscal year 2015. In April 2015, additional appropriations were approved by the Board in the amount of \$15 million for increased wholesale energy costs associated with customer demand due to the colder than normal winter. Actual disbursements exceeded the original budget by \$5.5 million, with purchased power from TVA exceeding the original budget by \$11.5 million and O&M and capital expenses under budget by a total of \$6.8 million. The Electric Division's general fund balance was \$18.5 million higher than originally budgeted, primarily due to the acceleration of a planned bond issue from fiscal year 2016 to April 2015 to take advantage of the low interest rate environment. The chart below depicts KUB's original budget compared to actual results and is presented on a cash basis.

Electric Division Cash Report As of June 30, 2015

<i>(in thousands of dollars)</i>	FY 2015 Budget**	FY 2015 Actual FYTD	Dollar Variance*	Percent Variance
Beginning Balance General Fund	\$ 31,472	\$ 31,472		
Operating Receipts	526,886	534,737	7,851	1.5%
Disbursements				
Purchased Power Expense	412,429	423,896	(11,467)	-2.8%
Operation & Maintenance Expense	56,965	54,803	2,162	3.8%
Capital Expenditures	69,150	64,498	4,652	6.7%
Debt Service	16,455	17,177	(722)	-4.4%
Taxes & Tax Equivalents	15,253	15,413	(160)	-1.0%
Total Disbursements	570,252	575,787	(5,535)	-1.0%
Bond Proceeds	39,600	56,500	16,900	42.7%
Net Flow-throughs and Transfers	(1,759)	(2,450)	(691)	-39.3%
Ending General Fund Balance	\$ 25,947	\$ 44,472	\$ 18,525	71.4%

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

** *Excludes additional appropriations of \$15 million*

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Knoxville Utilities Board Electric Division

Management's Discussion and Analysis

June 30, 2015 and 2014

Knoxville Utilities Board Electric Division - Financial Statements

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

Statement of Net Position

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

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

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

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

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

Statement of Revenues, Expenses and Changes in Net Position

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

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

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

Statement of Cash Flows

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

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

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

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

Condensed Financial Statements

Statement of Net Position

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

Statements of Net Position
As of June 30

<i>(in thousands of dollars)</i>	2015	2014	2013
Current, restricted and other assets	\$ 190,359	\$ 151,636	\$ 183,847
Capital assets, net	480,798	445,495	406,026
Deferred outflows of resources	5,411	1,415	1,605
Total assets and deferred outflows of resources	<u>676,568</u>	<u>598,546</u>	<u>591,478</u>
Current and other liabilities	101,489	108,777	111,542
Long-term debt outstanding	248,330	176,785	178,940
Deferred inflows of resources	3,062	-	-
Total liabilities and deferred inflows of resources	<u>352,881</u>	<u>285,562</u>	<u>290,482</u>
Net position			
Net investment in capital assets	228,768	262,995	216,052
Restricted	9,091	7,956	7,595
Unrestricted	85,828	42,033	77,349
Total net position	<u>\$ 323,687</u>	<u>\$ 312,984</u>	<u>\$ 300,996</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 Electric Division

Management's Discussion and Analysis

June 30, 2015 and 2014

Impacts and Analysis

Current, Restricted and Other Assets

Fiscal Year 2015 Compared to Fiscal Year 2014

Current, restricted and other assets increased \$38.7 million or 25.5 percent. The increase in current assets reflects \$20.5 million more in unused bond proceeds, an increase in general fund cash of \$13 million, and a \$3.2 million rise in operating contingency reserves.

Fiscal Year 2014 Compared to Fiscal Year 2013

Current, restricted and other assets decreased \$32.2 million or 17.5 percent. The decrease is attributable to the reduction in general fund cash of \$38.1 million primarily for funding capital projects in fiscal year 2014. This decrease was partially offset by a \$1.9 million increase in operating contingency reserves.

Capital Assets

Fiscal Year 2015 Compared to Fiscal Year 2014

Capital assets, net of depreciation, increased \$35.3 million or 7.9 percent. Major capital expenditures included \$28.7 million for distribution system improvements, \$6 million for pole replacements, \$5.9 million for installation or replacement of electric services, \$4 million for a new substation and \$4 million for information systems upgrades.

Fiscal Year 2014 Compared to Fiscal Year 2013

Capital assets, net of depreciation, increased \$39.5 million or 9.7 percent. Major capital expenditures included \$31.8 million for distribution system improvements, \$8.7 million for pole replacements, \$5.5 million for growth-related expenditures and \$2.7 million for fleet and heavy equipment.

Deferred Outflows of Resources

Fiscal Year 2015 Compared to Fiscal Year 2014

Deferred outflows of resources increased \$4 million compared to the prior fiscal year, reflecting a \$2.5 million increase in the amortization of deferred losses on bonds primarily attributable to bonds refunded in April 2015. Pension outflow increased \$1.5 million. For further explanation, see Notes to the Financial Statements.

Fiscal Year 2014 Compared to Fiscal Year 2013

Deferred outflows of resources decreased \$0.2 million or 11.8 percent compared to the prior fiscal year, reflecting amortization of deferred losses on bonds refunded in prior periods.

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



**Electric Division Total Assets and
Deferred Outflows of Resources
(in Millions)**

	<u>FY15</u>	<u>FY14</u>
Plant	71%	74%
General Fund	7%	5%
Contingency Fund	4%	5%
Accounts Receivable	9%	10%
Other Assets	3%	4%
Restricted Assets	5%	2%
Deferred Outflows of Resources	1%	<1%



Current and Other Liabilities

Fiscal Year 2015 Compared to Fiscal Year 2014

Current and other liabilities decreased \$7.3 million or 6.7 percent, due in part to a \$4.1 million decrease in accrued expenses from recognizing a \$2.9 million net pension asset during the fiscal year compared to a \$3 million pension contribution liability in the prior year. Accounts payable declined \$1.4 million. The outstanding balance on TVA conservation loans fell \$0.5 million. KUB over recovered \$0.5 million in purchased power costs from its customers in fiscal year 2015, which was \$3.9 million less than last fiscal year. The \$0.5 million over recovery in fiscal year 2015 will be flowed back to KUB's electric customers next fiscal year through adjustments to electric rates via the Purchased Power Adjustment. Those decreases were offset by a \$1.1 million increase in the current portion of revenue bonds payable.

Fiscal Year 2014 Compared to Fiscal Year 2013

Current and other liabilities decreased \$2.8 million or 2.5 percent, due in part to a \$5.3 million decrease in other bond related costs. Over recovery of purchased power cost was \$0.5 million less in fiscal year 2014. The \$4.4 million over recovery in fiscal year 2014 will be flowed back to KUB's electric customers next fiscal year through adjustments to electric rates via the Purchased Power Adjustment. The overall decline was offset by an increase in accounts payables of \$1.4 million from higher contractor costs for June 2014 compared to June 2013 and an increase in TVA conservation loans of \$0.9 million.

Knoxville Utilities Board Electric Division

Management's Discussion and Analysis

June 30, 2015 and 2014

Long-Term Debt

Fiscal Year 2015 Compared to Fiscal Year 2014

Long-term debt increased \$71.5 million or 40.5 percent due to new debt issuances of \$40 million in August 2014 and \$35 million in April 2015 for the purpose of funding electric system capital improvements. The increase was partially offset by the scheduled repayment of bond debt.

Fiscal Year 2014 Compared to Fiscal Year 2013

Long-term debt decreased \$2.2 million or 1.2 percent from the scheduled repayment of debt.

Deferred Inflows of Resources

Fiscal Year 2015 Compared to Fiscal Year 2014

Deferred inflows increased \$3.1 million compared to the prior fiscal year due to the change in valuation of pension liability creating a deferred 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 Electric Division
Management's Discussion and Analysis
June 30, 2015 and 2014



**Electric Division Total Liabilities
and Deferred Inflows of Resources
(in Millions)**

	<u>FY15</u>	<u>FY14</u>
Bond Debt	70%	63%
Payables	12%	16%
Misc Current	5%	7%
Other Liabilities	8%	9%
Customer Deposits	3%	4%
Interest Accrued	1%	1%
Deferred Inflows of Resources	1%	-



Net Position

Fiscal Year 2015 Compared to Fiscal Year 2014

Unrestricted net position increased \$43.8 million, primarily due to the \$38.7 million increase in current and other assets. Restricted net position increased \$1.1 million, due to the net increase of the electric bond fund and the associated interest payable. Net investment in capital assets decreased by \$34.2 million or 13 percent. The decrease was primarily the result of an increase of \$35.3 million of net electric plant additions offset by an increase of \$68.1 million in long-term debt from new bond issuances.

Fiscal Year 2014 Compared to Fiscal Year 2013

Net investment in capital assets increased by \$46.9 million or 21.7 percent. The increase was primarily the result of \$39.5 million of net electric plant additions. Unrestricted net position decreased \$35.3 million, due to the \$32.2 million decrease in current and other assets. Restricted net position increased \$0.4 million, due to the net increase of the electric bond fund and the associated interest payable.

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

Statement of Revenues, Expenses and Changes in Net Position

The following table reflects the condensed Statement of Revenues, Expenses and Changes in Net Position for the Electric Division compared to the prior year 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>	2015	2014	2013
Operating revenues	\$ 533,206	\$ 527,833	\$ 534,888
Less: Purchased power expense	419,773	419,558	432,024
Margin from sales	<u>113,433</u>	<u>108,275</u>	<u>102,864</u>
Operating expenses			
Distribution	34,408	32,905	30,914
Customer service	6,546	5,858	5,588
Administrative and general	13,822	13,351	13,021
Depreciation	25,888	23,190	22,377
Taxes and tax equivalents	15,069	13,627	12,940
Total operating expenses	<u>95,733</u>	<u>88,931</u>	<u>84,840</u>
Operating income	<u>17,700</u>	<u>19,344</u>	<u>18,024</u>
Interest income	322	290	371
Interest expense	(8,549)	(7,739)	(7,281)
Other income/(expense)	1,585	(213)	(85)
Change in net position before capital contributions	<u>11,058</u>	<u>11,682</u>	<u>11,029</u>
Capital contributions	12	306	177
Change in net position	<u>\$ 11,070</u>	<u>\$ 11,988</u>	<u>\$ 11,206</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 the volume of electric power sales for the fiscal year. Any change (increase/decrease) in retail electric rates would also be a cause of change in operating revenue.
- Purchased power expense is determined by volume of power purchases from TVA for the fiscal year. Also, any change (increase/decrease) in TVA wholesale power rates would result in a change in purchased power expense.
- Operating expenses (distribution, customer service, administrative and general) are normally impacted by changes in areas including, but not limited to, labor costs (staffing, wage rates), active employee and retiree medical costs, and overhead line maintenance (tree trimming, pole inspection, etc.).
- Depreciation expense is impacted by plant additions and retirements during the fiscal year.
- Taxes and tax equivalents are impacted by plant additions/retirements, changes in property tax rates, and margin (operating revenue less purchased power expense) levels.

Knoxville Utilities Board Electric Division

Management's Discussion and Analysis

June 30, 2015 and 2014

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

Impacts and Analysis

Margin from Sales

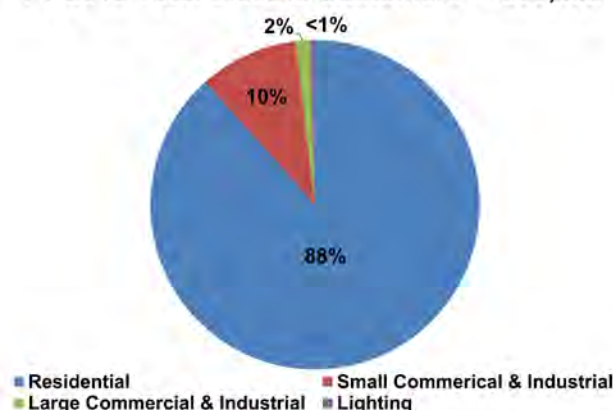
Fiscal Year 2015 Compared to Fiscal Year 2014

The Division's net position increased \$11.1 million, which was \$0.9 million less than last year's \$12 million increase. 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 \$0.4 million during fiscal year 2015 to \$10.7 million. The lower earnings were attributable to the net effect of a \$5.2 million increase in margin on sales, a \$6.8 million rise in operating expenses, a \$0.8 million increase in interest expense, a \$1.8 million increase in other income and a \$0.3 million decrease in capital contributions.

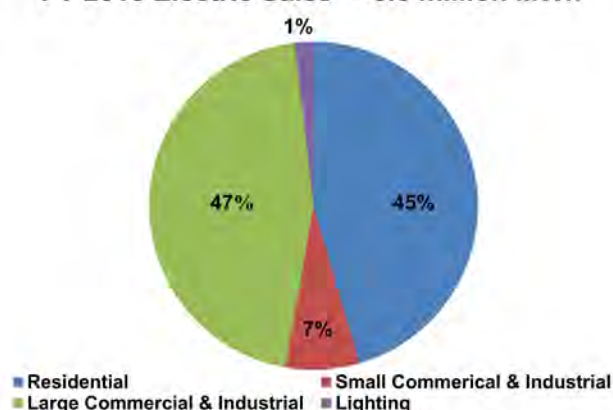
Margin on electric sales grew \$5.2 million, reflecting higher revenues due to the October 2013 and July 2014 rate increases.

Operating revenue increased \$5.4 million or 1 percent, reflecting the net result of additional revenue from KUB's one percent electric rate increase effective July 2014, and the flow through of TVA rate adjustments. Purchased power expense increased \$0.2 million over last year. Power sales of 5.5 million MWh were consistent with the prior fiscal year.

FY 2015 Total Electric Customers = 200,852



FY 2015 Electric Sales = 5.5 million MWh



Residential customers represented 88 percent of total electric system customers and accounted for 45 percent of electric sales volumes for the year. Large commercial and industrial customers accounted for the largest portion of total sales volumes for the year, which was consistent with the prior year due to a steady customer base. KUB's ten largest electric customers accounted for 15.6 percent of KUB's billed volumes. Those ten customers represent five industrial and five commercial customers, including two governmental customers. Sales to Gerdau Ameristeel, KUB's largest industrial customer, were 295 MWh or 5.3 percent of total electric system sales.

Knoxville Utilities Board Electric Division

Management's Discussion and Analysis

June 30, 2015 and 2014

Electric sales volumes in fiscal year 2015 were consistent with the previous fiscal year.

KUB has added 3,194 electric system customers over the past three years, representing annual growth of less than 1 percent.

Electric sales volumes have increased 1.5 percent since fiscal year 2013. Large commercial and industrial sales have increased 0.2 percent over the same period of time.

Fiscal Year 2014 Compared to Fiscal Year 2013

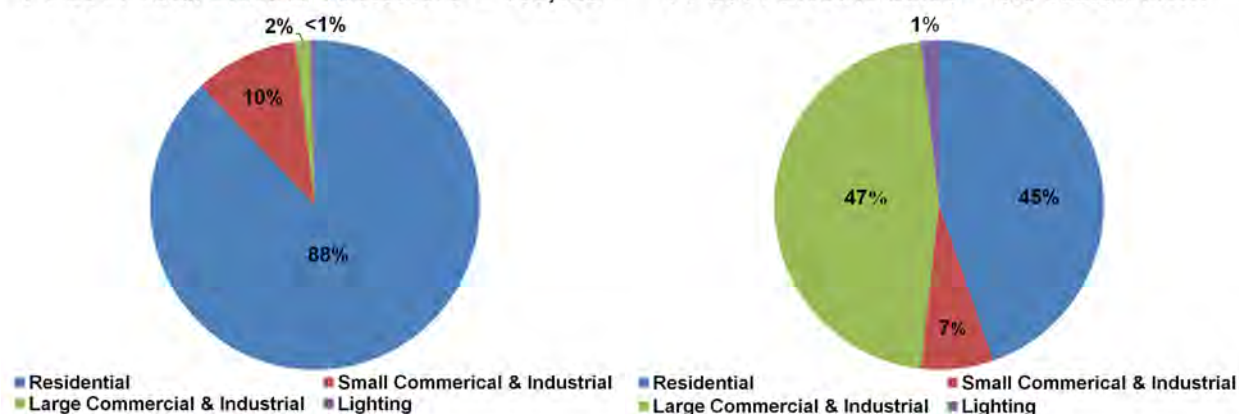
The Division's net position increased \$12 million, which was \$0.8 million more than last year's \$11.2 million increase. The higher earnings were due to the net effect of a \$5.4 million increase in margin on sales, a \$4.1 million rise in operating expenses, a \$0.5 million increase in interest expense, and a \$0.1 million rise in capital contributions.

Margin on electric sales grew \$5.4 million, which was the combined result of an increase in sales volumes and additional revenue from the one percent October 2012 and 2013 rate increases.

Operating revenue decreased \$7.1 million or 1.3 percent, reflecting the flow through of over recovered purchased power 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. Purchased power expense decreased \$12.5 million over last year the net result of higher sales volumes and wholesale purchase power rates from TVA. Power sales of 5.5 million MWh were 1.4 percent higher than the prior year.

FY 2014 Total Electric Customers = 199,382

FY 2014 Electric Sales = 5.5 million MWh



Residential customers represented 88 percent of total electric system customers and accounted for 45 percent of electric sales volumes for the year. Large commercial and industrial customers accounted for the largest portion of total sales volumes for fiscal year 2014, which was consistent with the prior year due to a steady customer base. KUB's ten largest electric customers accounted for 15.8 percent of KUB's billed volumes. Those ten customers represent five industrial and five commercial customers, including two governmental customers. Sales to Gerdau Ameristeel, KUB's largest industrial customer, were 305.2 MWh or 5.5 percent of total electric system sales for fiscal year 2014.

Electric sales volumes were 1.1 percent lower during the first six months of fiscal year 2014 compared to the previous fiscal year. However, sales over the course of the winter heating season were significantly higher, reflecting colder temperatures than the prior fiscal year.

Knoxville Utilities Board Electric Division

Management's Discussion and Analysis

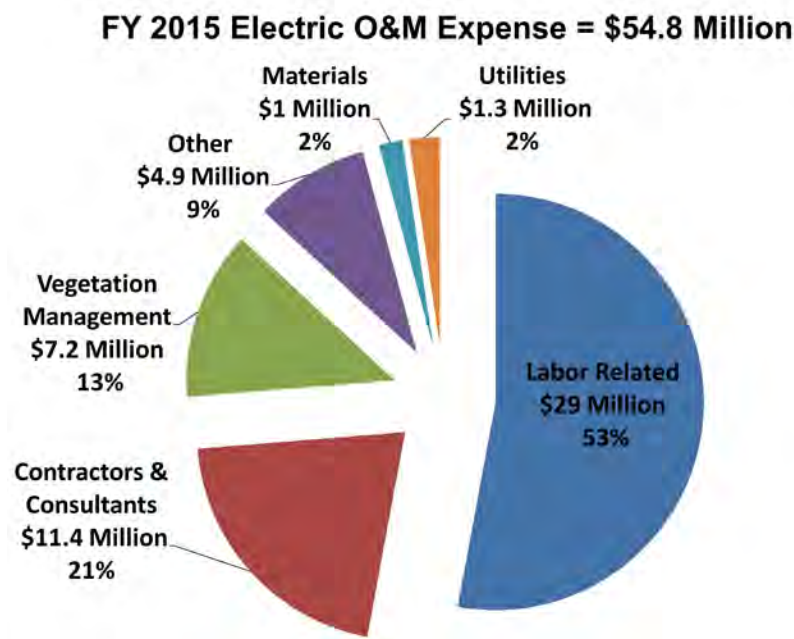
June 30, 2015 and 2014

Operating Expenses

Fiscal Year 2015 Compared to Fiscal Year 2014

Operating expenses (excluding purchased power expense) increased \$6.8 million, or 7.6 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 distribution, customer service and administrative and general.

- Distribution expenses increased \$1.5 million or 4.6 percent, primarily from electric system restoration expenses related to the February 2015 ice storm.
- Customer service expenses were up \$0.7 million compared with the prior year, primarily due to increased computer software expenses and outside consultant expenses.
- Administrative and general expenses increased \$0.5 million or 3.5 percent, primarily due to an increase in the Division's portion of shared costs.



- Depreciation expense for fiscal year 2015 increased \$2.7 million or 11.6 percent. This increase was primarily attributable to Grid Modernization related software, meters and meter testing equipment and substation improvements.
- Taxes and tax equivalents were \$1.4 million higher than the prior fiscal year due to an increase in tax equivalent payments to the City of Knoxville, Knox County, and other taxing jurisdictions. The City of Knoxville's property tax rate increased this year and higher plant in service levels contributed to the growth in tax equivalent payments.

Knoxville Utilities Board Electric Division

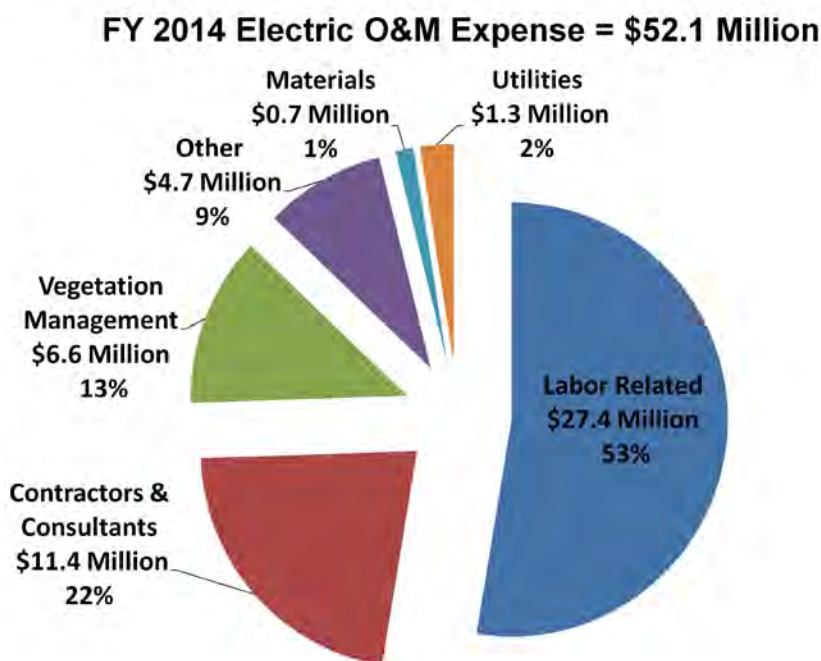
Management's Discussion and Analysis

June 30, 2015 and 2014

Fiscal Year 2014 Compared to Fiscal Year 2013

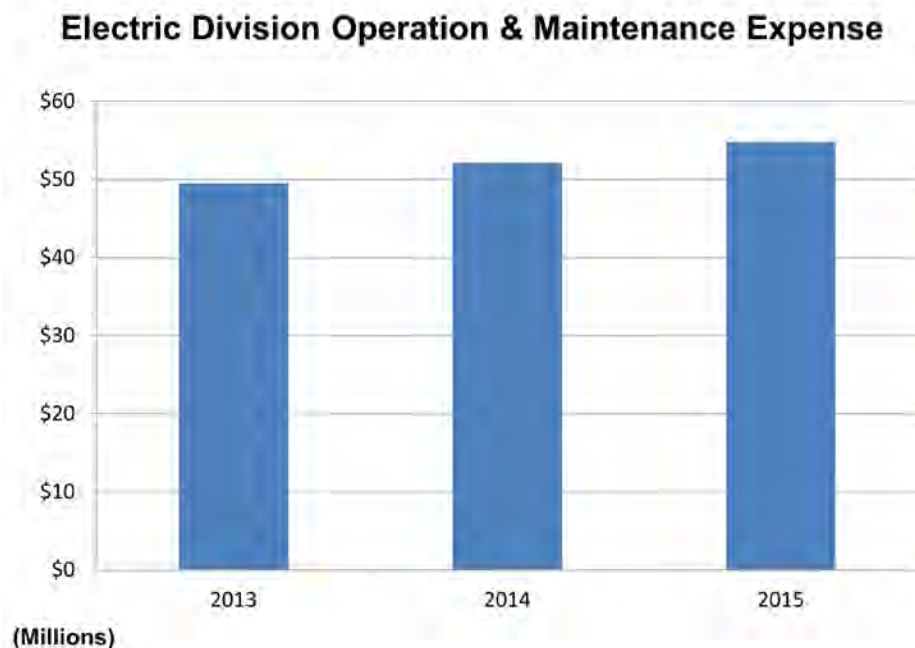
Operating expenses (excluding purchased power expense) increased \$4.1 million, or 4.8 percent, compared to fiscal year 2013. Operating expenses include operations and maintenance (O&M) expense, depreciation, and taxes/tax equivalents. O&M expenses can be further classified as distribution, customer service, and administrative and general.

- Distribution expenses increased \$2 million or 6.4 percent, primarily from an increase in substation breaker replacements and outside contractor expenses.
- Customer service expenses were up \$0.3 million compared with the prior year, primarily due to the Division's share of increased meter reading expenses.
- Administrative and general expenses increased \$0.3 million or 2.5 percent, primarily due to an increase in the Division's portion of shared costs.



- Depreciation expense for fiscal year 2014 increased \$0.8 million or 3.6 percent. This increase was primarily attributable to station equipment, poles and overhead conductors.
- Taxes and tax equivalents were \$0.7 million higher than the prior fiscal year due to an increase in tax equivalent payments to the City of Knoxville, Knox County, and other taxing jurisdictions as a result of capital asset and margin growth.

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



Other Income and Expense

Fiscal Year 2015 Compared to Fiscal Year 2014

Interest income was consistent with the prior fiscal year.

Interest expense increased \$0.8 million or 10.5 percent, primarily due to the additional interest accrued on long-term revenue bonds issued in August 2014 and April 2015.

Other income (net) increased \$1.8 million, primarily due to an accrual of \$1.6 million in non-operating income for future reimbursement of restoration expenses related to the February 2015 ice storm.

The Division's capital contributions decreased \$0.3 million due to less donated assets compared to the prior fiscal year.

Fiscal Year 2014 Compared to Fiscal Year 2013

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

Interest expense increased \$0.5 million or 6.3 percent, primarily due to the additional interest from revenue bonds issued December 2012.

Other income (net) decreased \$0.1 million.

The Division recorded \$0.3 million in capital contributions from donated street lighting assets during the fiscal year.

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

Capital Assets

	Capital Assets As of June 30 (Net of Depreciation)		
<i>(in thousands of dollars)</i>	2015	2014	2013
Distribution Plant			
Services and Meters	\$ 17,964	\$ 16,851	\$ 16,968
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	67,448
Line Transformers	56,774	55,600	52,503
Other	108,888	106,894	100,458
Total Distribution Plant	<u>391,248</u>	<u>370,137</u>	<u>339,878</u>
General Plant	<u>27,312</u>	<u>27,288</u>	<u>25,959</u>
Total Plant Assets	<u>418,560</u>	<u>397,425</u>	<u>365,837</u>
Work In Progress	62,238	48,070	40,189
Total Net Plant	<u>\$ 480,798</u>	<u>\$ 445,495</u>	<u>\$ 406,026</u>

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Knoxville Utilities Board Electric Division

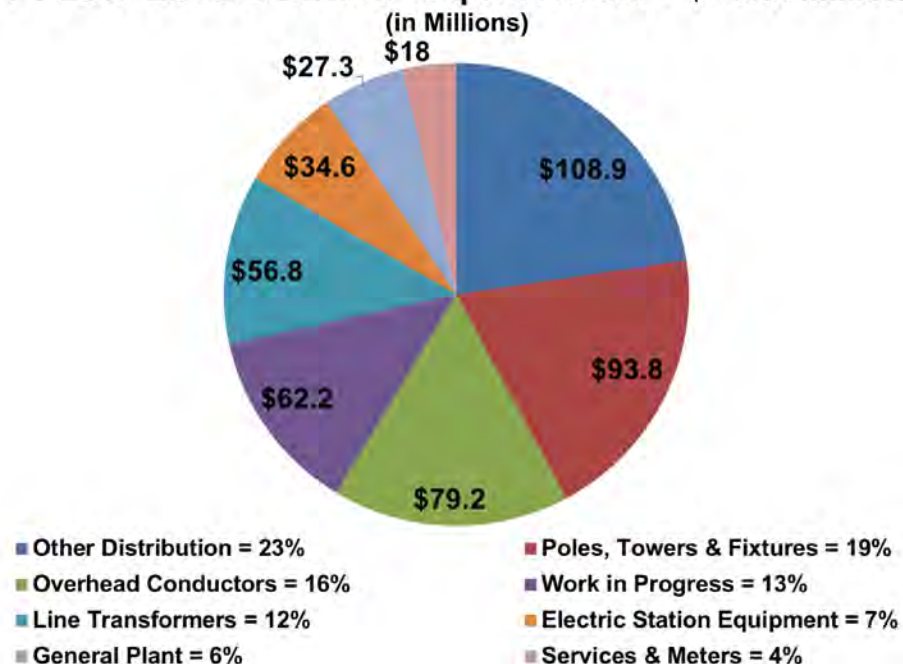
Management's Discussion and Analysis

June 30, 2015 and 2014

Fiscal Year 2015 Compared to Fiscal Year 2014

As of June 30, 2015, the Division had \$480.8 million invested in a variety of capital assets, as reflected in the schedule of capital assets, which represents a net increase (including additions, retirements, and depreciation) of \$35.3 million or 7.9 percent over the end of the last fiscal year.

FY 2015 Electric Division Capital Assets = \$480.8 Million



Major capital asset expenditures during the year were as follows:

- \$28.7 million for various electric distribution improvements
- \$6 million for pole replacements
- \$5.9 million for installation of new electric services and the upgrade or replacement of existing services
- \$4.5 million for new Cherokee Trail substation
- \$4 million for information systems upgrades

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Knoxville Utilities Board Electric Division

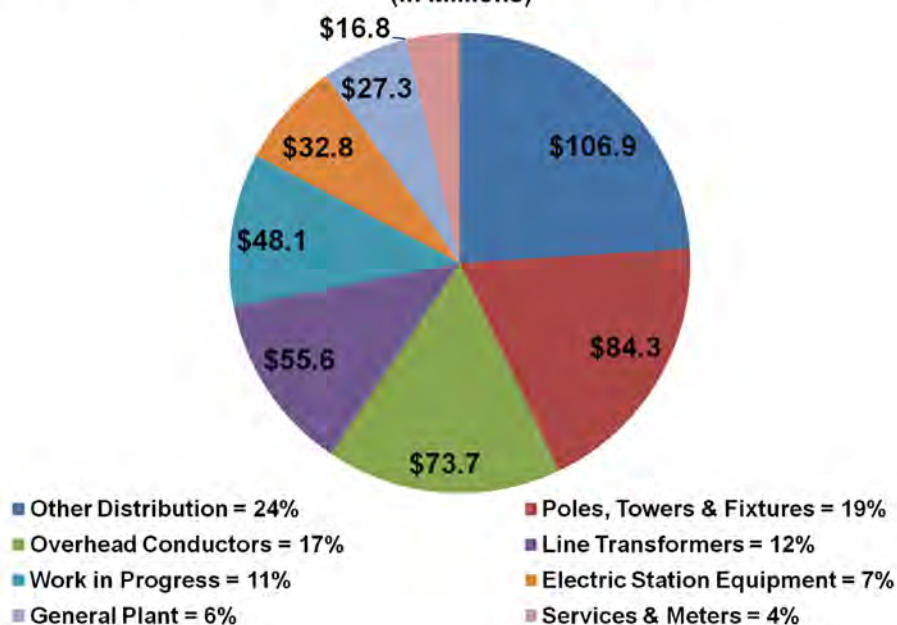
Management's Discussion and Analysis

June 30, 2015 and 2014

Fiscal Year 2014 Compared to Fiscal Year 2013

As of June 30, 2014, the Division had \$445.5 million invested in a variety of capital assets, as reflected in the schedule of capital assets, which represents a net increase (including additions, retirements, and depreciation) of \$39.5 million or 9.7 percent over the end of the last fiscal year.

FY 2014 Electric Division Capital Assets = \$445.5 Million (in Millions)



Major capital asset expenditures during the year were as follows:

- \$31.8 million for various electric distribution improvements
- \$8.7 million for pole replacements
- \$5.5 million for installation of new electric services and the upgrade or replacement of existing services
- \$2.7 million for fleet and heavy equipment

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Knoxville Utilities Board Electric Division

Management's Discussion and Analysis

June 30, 2015 and 2014

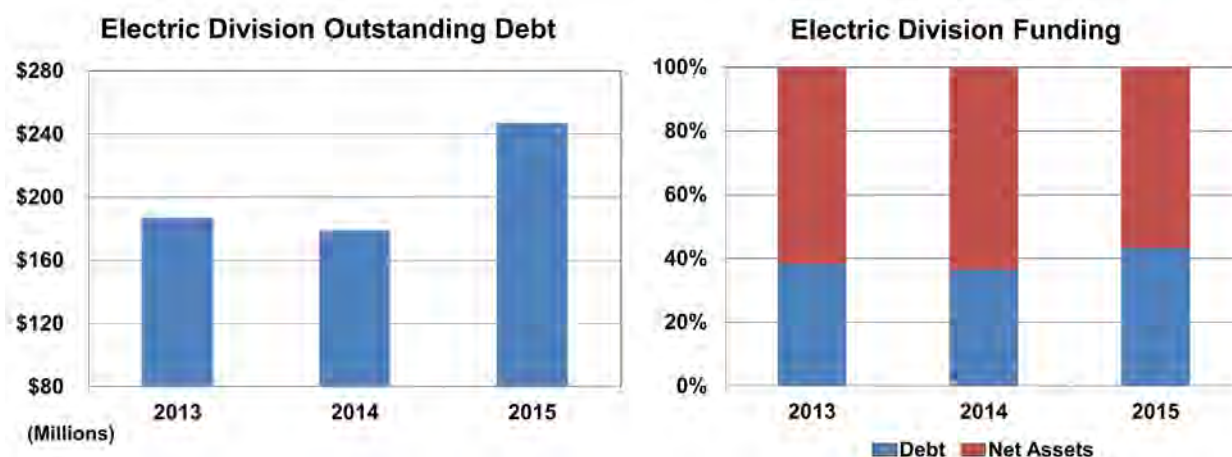
Debt Administration

The Division's outstanding debt reached \$247.1 million in fiscal year 2015. The bonds are secured solely by revenues of the Electric Division. Debt as a percentage of the Division's capital structure was 43.3 percent in 2015, 36.4 percent in 2014 and 38.3 percent at the end of fiscal year 2013. KUB's Debt Management Policy limits the Division's debt ratio to 60 percent or less.

Outstanding Debt As of June 30

(in thousands of dollars)

	2015	2014	2013
Revenue bonds	\$ 247,055	\$ 178,940	\$ 186,510
Total outstanding debt	\$ 247,055	\$ 178,940	\$ 186,510



The Division will pay \$116.4 million in principal payments over the next ten years, representing 47.1 percent of the outstanding bonds. KUB's Debt Management Policy requires that a minimum of 30 percent of electric debt principal be repaid over the next ten years.

Fiscal Year 2015 Compared to Fiscal Year 2014

As of June 30, 2015, the Division had \$247.1 million in outstanding debt (including the current portion of revenue bonds), compared to \$178.9 million last year, an increase of \$68.2 million or 38.1 percent. The Division's weighted average cost of debt at June 30, 2015 was 3.89 percent.

The increase is attributable to the issuance of revenue bonds during the fiscal year of \$40 million in August 2014 and \$35 million in April 2015. The increase was partially offset by the scheduled repayment of bond debt.

In April 2015, KUB issued \$28.6 million of revenue refunding bonds. The refunding of certain bonds at lower interest rates will provide debt service savings of \$2.2 million over the life of the bonds.

The Division's outstanding debt is rated by Standard & Poor's and Moody's Investors Service. As of June 30, 2015, the Division's revenue bonds were rated AA+ by Standard & Poor's and Aa2 by Moody's Investors Service.

Knoxville Utilities Board Electric Division

Management's Discussion and Analysis

June 30, 2015 and 2014

Fiscal Year 2014 Compared to Fiscal Year 2013

As of June 30, 2014, the Division had \$178.9 million in outstanding debt (including the current portion of revenue bonds), compared to \$186.5 million last year, a decrease of \$7.6 million or 4.1 percent. The Division's weighted average cost of debt at June 30, 2014 was 4.08 percent.

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

The Division's outstanding debt is rated by Standard & Poor's and Moody's Investors Service. As of June 30, 2014, the Division's revenue bonds were rated AA+ by Standard & Poor's and Aa2 by Moody's Investors Service.

Impacts on Future Financial Position

KUB anticipates adding 1,100 additional electric customers in fiscal year 2016.

In June 2014, the KUB Board adopted three years of rate increases for the Electric Division to help fund the ongoing Century II infrastructure programs. The first rate increase was effective July 2014. The remaining two electric rate increases will be effective July 2015 and July 2016, respectively. Each rate increase will provide approximately \$5.2 million in additional Electric Division revenue.

This fiscal year KUB concluded the smart grid pilot project, of which a portion of the project was funded by the 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 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, of which the Division's share is \$78 million. 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.

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 \$25.2 million of Electric Division 2010 Build America Bonds (BABs) in which the U.S. Treasury provides a rebate to KUB for a portion of the interest. The interest rebates were subject to federal sequestration during the fiscal year and were reduced by 7.3 percent. Any future actions by Congress may also affect the anticipated rebates for future fiscal years.

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 the Division's financial position or results of operations during fiscal year 2015.

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

Financial Contact

The Division's financial statements are designed to present users (citizens, customers, investors, and creditors) with a general overview of the Division's financial position and results of operations for the fiscal years ending June 30, 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 Electric Division
Statements of Net Position
June 30, 2015 and 2014

	2015	2014
Assets and Deferred Outflows of Resources		
Current assets:		
Cash and cash equivalents	\$ 44,471,851	\$ 31,472,251
Short-term contingency fund investments	2,478,572	12,287,377
Other current assets	1,018,522	581,348
Accrued interest receivable	28,982	10,907
Accounts receivable, less allowance of uncollectible accounts of \$548,492 in 2015 and \$542,991 in 2014	58,078,711	57,128,365
Inventories	6,669,312	7,522,325
Prepaid expenses	649,770	1,112,036
Total current assets	<u>113,395,720</u>	<u>110,114,609</u>
Restricted assets:		
Electric bond fund	12,976,376	11,583,829
Other funds	21,071	20,620
Unused bond proceeds	20,519,850	-
Total restricted assets	<u>33,517,297</u>	<u>11,604,449</u>
Electric plant in service	789,895,908	750,921,975
Less accumulated depreciation	<u>(371,336,117)</u>	<u>(353,496,822)</u>
	418,559,791	397,425,153
Retirement in progress	568,243	801,031
Construction in progress	61,669,625	47,268,838
Net plant in service	<u>480,797,659</u>	<u>445,495,022</u>
Other assets:		
Net pension asset	2,890,382	-
Long-term contingency fund investments	27,725,842	14,753,028
TVA conservation program receivable	10,109,135	10,632,815
Other	2,720,927	4,530,705
Total other assets	<u>43,446,286</u>	<u>29,916,548</u>
Total assets	<u>671,156,962</u>	<u>597,130,628</u>
Deferred outflows of resources:		
Pension outflow	1,515,455	-
Unamortized bond refunding costs	3,895,275	1,415,368
Total deferred outflows of resources	<u>5,410,730</u>	<u>1,415,368</u>
Total assets and deferred outflows of resources	<u>\$ 676,567,692</u>	<u>\$ 598,545,996</u>

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

Knoxville Utilities Board Electric Division
Statements of Net Position
June 30, 2015 and 2014

	2015	2014
Liabilities, Deferred Inflows, and Net Position		
Current liabilities:		
Current portion of revenue bonds	\$ 9,070,000	\$ 7,935,000
Sales tax collections payable	910,574	878,073
Accounts payable	42,598,006	44,031,673
Accrued expenses	17,658,067	21,760,276
Customer deposits plus accrued interest	11,084,371	10,526,010
Accrued interest on revenue bonds	3,906,251	3,648,729
Total current liabilities	<u>85,227,269</u>	<u>88,779,761</u>
Other liabilities:		
TVA conservation program	10,336,682	10,885,245
Accrued compensated absences	3,922,730	3,819,218
Customer advances for construction	1,280,962	755,380
Over recovered purchased power cost	500,522	4,412,769
Other	220,247	124,804
Total other liabilities	<u>16,261,143</u>	<u>19,997,416</u>
Long-term debt:		
Electric revenue bonds	237,985,000	171,005,000
Unamortized premiums/discounts	10,345,326	5,779,555
Total long-term debt	<u>248,330,326</u>	<u>176,784,555</u>
Total liabilities	<u>349,818,738</u>	<u>285,561,732</u>
Deferred inflows of resources:		
Pension inflow	3,061,589	-
Total deferred inflows of resources	<u>3,061,589</u>	<u>-</u>
Total liabilities and deferred inflows of resources	<u>352,880,327</u>	<u>285,561,732</u>
Net position		
Net investment in capital assets	228,768,196	262,994,767
Restricted for:		
Debt service	9,070,125	7,935,100
Other	21,070	20,620
Unrestricted	85,827,974	42,033,777
Total net position	<u>323,687,365</u>	<u>312,984,264</u>
Total liabilities, deferred inflows, and net position	<u>\$ 676,567,692</u>	<u>\$ 598,545,996</u>

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

Knoxville Utilities Board Electric Division
Statements of Revenues, Expenses and Changes in Net Position
Years Ended June 30, 2015 and 2014

	2015	2014
Operating revenues	\$ 533,205,845	\$ 527,832,791
Operating expenses		
Purchased power	419,773,131	419,557,996
Distribution	34,407,647	32,904,889
Customer service	6,546,034	5,858,398
Administrative and general	13,821,576	13,350,746
Provision for depreciation	25,887,777	23,190,530
Taxes and tax equivalents	15,069,402	13,626,589
Total operating expenses	<u>515,505,567</u>	<u>508,489,148</u>
Operating income	<u>17,700,278</u>	<u>19,343,643</u>
Non-operating revenues (expenses)		
Contributions in aid of construction	1,551,247	1,726,458
Interest and dividend income	322,222	289,857
Interest expense	(8,548,826)	(7,739,346)
Amortization of debt costs	72,445	70,355
Write-down of plant for costs recovered through contributions	(1,551,247)	(1,726,458)
Other	1,512,078	(282,969)
Total non-operating revenues (expenses)	<u>(6,642,081)</u>	<u>(7,662,103)</u>
Change in net position before capital contributions	11,058,197	11,681,540
Capital contributions	11,611	306,250
Change in net position	11,069,808	11,987,790
Net position, beginning of year, as previously reported	312,984,264	300,996,474
Change in method of accounting for pension	(366,707)	-
Net position, beginning of year, as restated	<u>312,617,557</u>	<u>300,996,474</u>
Net position, end of year	<u>\$ 323,687,365</u>	<u>\$ 312,984,264</u>

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

Knoxville Utilities Board Electric Division

Statements of Cash Flows

Years Ended June 30, 2015 and 2014

	2015	2014
Cash flows from operating activities:		
Cash receipts from customers	\$ 526,079,765	\$ 520,465,490
Cash receipts from other operations	8,687,968	6,753,607
Cash payments to suppliers of goods or services	(460,073,403)	(450,856,828)
Cash payments to employees for services	(22,949,363)	(22,182,793)
Payment in lieu of taxes	(13,309,981)	(11,905,037)
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>38,410,104</u>	<u>42,266,527</u>
Cash flows from capital and related financing activities:		
Net proceeds from bond issuance	77,011,071	-
Principal paid on revenue bonds and notes payable	(7,935,000)	(7,570,000)
(Increase) decrease in unused bond proceeds	(20,519,850)	-
Interest paid on revenue bonds and notes payable	(7,849,367)	(7,405,114)
Acquisition and construction of electric plant	(63,915,204)	(66,014,116)
Changes in electric bond fund, restricted	(1,392,547)	(257,294)
Customer advances for construction	525,582	166,939
Proceeds received on disposal of plant	-	606,719
Cash received from developers and individuals for capital purposes	1,551,247	1,726,458
Net cash used in capital and related financing activities	<u>(22,524,068)</u>	<u>(78,746,408)</u>
Cash flows from investing activities:		
Changes in deposit and investment accounts:		
Purchase of investment securities	(7,518,767)	(2,056,857)
Maturities of investment securities	4,354,758	9,159,439
Interest received	304,148	302,020
Other property and investments	(26,575)	(38,529)
Net cash (used in) provided by investing activities	<u>(2,886,436)</u>	<u>7,366,073</u>
Net increase (decrease) in cash and cash equivalents	12,999,600	(29,113,808)
Cash and cash equivalents, beginning of year	<u>31,472,251</u>	<u>60,586,059</u>
Cash and cash equivalents, end of year	<u>44,471,851</u>	<u>\$ 31,472,251</u>
Reconciliation of operating income to net cash provided by operating activities		
Operating income	\$ 17,700,278	\$ 19,343,643
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization expenses	26,978,350	24,273,528
Changes in operating assets and liabilities:		
Accounts receivable	602,185	(401,473)
Inventories	853,013	(917,202)
Prepaid expenses	20,329	(4,602)
TVA conservation program receivable	523,680	(904,534)
Other assets	(1,782,164)	(1,089,896)
Sales tax collections payable	32,501	(4,750)
Accounts payable and accrued expenses	(2,711,061)	1,679,690
Overrecovered purchased power cost	(3,912,247)	(514,812)
TVA conservation program payable	(548,563)	879,506
Customer deposits plus accrued interest	558,360	111,899
Other liabilities	95,443	(184,470)
Net cash provided by operating activities	<u>\$ 38,410,104</u>	<u>\$ 42,266,527</u>
Noncash capital activities:		
Acquisition of plant assets through developer contributions	\$ 11,611	\$ 306,250

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

Knoxville Utilities Board Electric Division

Notes to Financial Statements

June 30, 2015 and 2014

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. The Electric Division (Division) provides services to certain customers in Knox County and in seven surrounding counties in East Tennessee. The Division's accounts are maintained in conformity with the Uniform Division of Accounts of the Federal Energy Regulatory Commission (FERC) and the Governmental Accounting Standards Board (GASB), as applicable. The financial statements present only the Electric Division and do not purport to, and do not, present fairly the consolidated financial position of Knoxville Utilities Board at June 30, 2015 and 2014, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

2. Summary of Significant Accounting Policies

Basis of Accounting

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 financial statements are prepared on the accrual basis of accounting, whereby revenues are recognized when earned and expenses are recognized when incurred. The accounting and financial reporting treatment applied to the Division is determined by measurement focus. The transactions of the Division are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operations are included on the Statement of Net Position. Net position (i.e., total assets and deferred outflows of resources net of total liabilities and deferred inflows of resources) 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

Knoxville Utilities Board Electric Division

Notes to Financial Statements

June 30, 2015 and 2014

used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service.

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.

Electric Plant

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

The provision for depreciation of electric plant in service is based on the estimated useful lives of the assets, which range from three to forty years, and is computed using the straight-line method. Pursuant to FERC, the caption "Provision for depreciation" in the Statements of Revenues, Expenses and Changes in Net Position does not include depreciation for transportation equipment of \$1,090,573 in fiscal year 2015 and \$1,082,998 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 the KUB Electric Division. Operating revenue is recorded when the service is rendered, on a cycle basis, and includes an estimate of unbilled revenue. Revenues are reported net of bad debt expense of \$1,987,329 in fiscal year 2015 and \$1,166,257 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 net assets available, it is KUB's policy to apply those expenses to restricted net assets to the extent such are available and then to unrestricted net assets.

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 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.

Knoxville Utilities Board Electric Division

Notes to Financial Statements

June 30, 2015 and 2014

- 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 (Division's share \$366,707) to increase the net pension liability by \$3,515,317 (Division's share \$1,687,352) based on revised actuarial assumptions to conform with GASB 68 and to reclassify 2014 expenses of \$2,751,341 (Division's share \$1,320,645) 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 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.

Knoxville Utilities Board Electric Division

Notes to Financial Statements

June 30, 2015 and 2014

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 and is recorded as amortization expense.

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 and is recorded as amortization expense.

Knoxville Utilities Board Electric Division

Notes to Financial Statements

June 30, 2015 and 2014

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 and is recorded 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 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 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.

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

Knoxville Utilities Board Electric Division

Notes to Financial Statements

June 30, 2015 and 2014

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.

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

Knoxville Utilities Board Electric Division
Notes to Financial Statements
June 30, 2015 and 2014

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.

Classification of deposits and investments per Statement of Net Position:

	2015	2014
Current assets		
Cash and cash equivalents	\$ 44,471,851	\$ 31,472,251
Short-term contingency fund investments	2,478,572	12,287,377
Other assets		
Long-term contingency fund investments	27,664,712	14,667,816
Restricted assets		
Unused bond proceeds	20,519,583	-
Electric bond fund	12,976,376	11,583,829
Other funds	21,071	20,620
	<u>\$ 108,132,165</u>	<u>\$ 70,031,893</u>

The above amounts do not include accrued interest of \$61,397 in fiscal year 2015 and \$85,212 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:

	Deposit and Investment Maturities (in Years)		
	Fair Value	Less Than 1	1-5
Supersweep NOW and Other Deposits	\$ 39,145,727	\$ 39,145,727	\$ -
State Treasurer's Investment Pool	22,140,648	22,140,648	-
Agency Bonds	37,007,109	2,478,572	34,528,537
Certificates of Deposits	12,002,810	11,355,310	647,500
	<u>\$ 110,296,294</u>	<u>\$ 75,120,257</u>	<u>\$ 35,176,037</u>

Knoxville Utilities Board Electric Division
Notes to Financial Statements
June 30, 2015 and 2014

4. Accounts Receivable

Accounts receivable consists of the following:

	2015	2014
Wholesale and retail customers		
Billed services	\$ 35,223,950	\$ 33,814,769
Unbilled services	19,677,853	21,080,325
Other	3,725,400	2,776,262
Allowance for uncollectible accounts	(548,492)	(542,991)
	<u>\$ 58,078,711</u>	<u>\$ 57,128,365</u>

5. Accounts Payable and Accruals

Accounts payable and accruals were composed of the following:

	2015	2014
Trade accounts	\$ 42,598,006	\$ 44,031,673
Salaries and wages	802,644	664,201
Advances on pole rental	1,147,346	1,156,634
Self-insurance liabilities	815,352	738,983
Other current liabilities	14,892,725	19,200,458
	<u>\$ 60,256,073</u>	<u>\$ 65,791,949</u>

Knoxville Utilities Board Electric Division
Notes to Financial Statements
June 30, 2015 and 2014

6. Long-Term Obligations

Long-term debt consists of the following:

	Balance				Balance	Amounts
	June 30,				June 30,	Due
	2014	Additions	Payments	Defeased	2015	Within
						One Year
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	<u>\$ 178,940,000</u>	<u>\$ 103,550,000</u>	<u>\$ 7,935,000</u>	<u>\$ 27,500,000</u>	<u>\$ 247,055,000</u>	<u>\$ 9,070,000</u>
Unamortized Premium	<u>5,779,555</u>	<u>5,617,592</u>	<u>411,968</u>	<u>639,853</u>	<u>10,345,326</u>	<u>-</u>
Total long term debt	<u>\$ 184,719,555</u>	<u>\$ 109,167,592</u>	<u>\$ 8,346,968</u>	<u>\$ 28,139,853</u>	<u>\$ 257,400,326</u>	<u>\$ 9,070,000</u>

	Balance				Balance	Amounts
	June 30,				June 30,	Due
	2013	Additions	Payments	Defeased	2014	Within
						One Year
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>

Knoxville Utilities Board Electric Division
Notes to Financial Statements
June 30, 2015 and 2014

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

Fiscal Year	Principal	Total Interest	Grand Total
2016	\$ 9,070,000	\$ 8,535,208	\$ 17,605,208
2017	10,110,000	9,069,156	19,179,156
2018	10,515,000	8,674,203	19,189,203
2019	10,955,000	8,237,917	19,192,917
2020	11,405,000	7,785,808	19,190,808
2021-2025	64,385,000	31,183,201	95,568,201
2026-2030	57,255,000	18,637,139	75,892,139
2031-2035	22,910,000	11,024,799	33,934,799
2036-2040	23,800,000	7,214,266	31,014,266
2041-2045	24,800,000	2,595,875	27,395,875
2046	1,850,000	37,000	1,887,000
Total	<u>\$ 247,055,000</u>	<u>\$ 112,994,572</u>	<u>\$ 360,049,572</u>

The Division has pledged sufficient revenue, after deduction of all current operating expenses (exclusive of tax equivalents), to meet the revenue bonds principal and interest payments when due. Such bond requirements are being met through monthly deposits to the Electric Bond Fund as required by the bond covenants. As of June 30, 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 to fund electric system capital improvements. Concurrent with the issuance of these bonds, KUB transferred funds to an irrevocable trust to pay a portion of the Series U 2001 bonds, as such amounts mature. KUB's Electric Division also issued Series X 2006 bonds in part to retire certain existing debt and to fund electric system capital improvements. Concurrent with the issuance of these bonds, KUB transferred funds to an irrevocable trust to pay the remaining maturities of principal and interest on the Series S 1998 bonds.

During fiscal year 2009, KUB's Electric Division issued Series Y 2009 bonds to fund electric system capital improvements.

During fiscal year 2011, KUB's Electric Division issued Series Z 2010 bonds to fund electric system capital improvements. The bonds were issued as federally taxable Build America Bonds with a 35 percent interest payment rebate to be received from the United States Government for each interest payment. Effective 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

Knoxville Utilities Board Electric Division

Notes to Financial Statements

June 30, 2015 and 2014

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 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.

Other liabilities consist of the following:

	Balance June 30, 2014	Increase	Decrease	Balance June 30, 2015
TVA conservation program	\$ 10,885,245	\$ 2,629,945	\$ (3,178,508)	\$ 10,336,682
Accrued compensated absences	3,819,218	7,232,021	(7,128,509)	3,922,730
Customer advances for construction	755,380	996,838	(471,256)	1,280,962
Other	124,804	247,406	(151,963)	220,247
	<u>\$ 15,584,647</u>	<u>\$ 11,106,210</u>	<u>\$ (10,930,236)</u>	<u>\$ 15,760,621</u>

7. Lease Commitments

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

2016	\$ 22,012
2017	13,179
2018	5,986
2019	3,931
2020	3,931
Total operating minimum lease payments	<u>\$ 49,039</u>

Knoxville Utilities Board Electric Division
Notes to Financial Statements
June 30, 2015 and 2014

8. Capital Assets

Capital asset activity was as follows:

	Beginning 6/30/2014	Increase	Decrease	Ending 6/30/2015
Distribution Plant				
Services and Meters	\$ 41,235,171	\$ 2,176,349	\$ (224,197)	\$ 43,187,323
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	178,735,315	8,051,035	(511,771)	186,274,579
Total Distribution Plant	<u>\$ 675,535,165</u>	<u>\$ 41,985,354</u>	<u>\$ (7,372,747)</u>	<u>\$ 710,147,772</u>
General Plant	<u>75,386,810</u>	<u>5,489,993</u>	<u>(1,128,667)</u>	<u>79,748,136</u>
Total Plant Assets	<u>\$ 750,921,975</u>	<u>\$ 47,475,347</u>	<u>\$ (8,501,414)</u>	<u>\$ 789,895,908</u>
Less Accumulated Depreciation	<u>(353,496,822)</u>	<u>(26,741,232)</u>	<u>8,901,937</u>	<u>(371,336,117)</u>
Net Plant Assets	<u>\$ 397,425,153</u>	<u>\$ 20,734,115</u>	<u>\$ 400,523</u>	<u>\$ 418,559,791</u>
Work In Progress	<u>48,069,869</u>	<u>62,377,843</u>	<u>(48,209,844)</u>	<u>62,237,868</u>
Total Net Plant	<u><u>\$ 445,495,022</u></u>	<u><u>\$ 83,111,958</u></u>	<u><u>\$ (47,809,321)</u></u>	<u><u>\$ 480,797,659</u></u>

	Beginning 6/30/2013	Increase	Decrease	Ending 6/30/2014
Distribution Plant				
Services and Meters	\$ 40,494,806	\$ 898,255	\$ (157,890)	\$ 41,235,171
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	168,436,833	11,769,390	(1,470,908)	178,735,315
Total Distribution Plant	<u>\$ 637,355,822</u>	<u>\$ 48,375,279</u>	<u>\$ (10,195,936)</u>	<u>\$ 675,535,165</u>
General Plant	<u>70,951,345</u>	<u>6,057,153</u>	<u>(1,621,688)</u>	<u>75,386,810</u>
Total Plant Assets	<u>\$ 708,307,167</u>	<u>\$ 54,432,432</u>	<u>\$ (11,817,624)</u>	<u>\$ 750,921,975</u>
Less Accumulated Depreciation	<u>(342,470,640)</u>	<u>(22,707,126)</u>	<u>11,680,944</u>	<u>(353,496,822)</u>
Net Plant Assets	<u>\$ 365,836,527</u>	<u>\$ 31,725,306</u>	<u>\$ (136,680)</u>	<u>\$ 397,425,153</u>
Work In Progress	<u>40,189,273</u>	<u>60,112,686</u>	<u>(52,232,090)</u>	<u>48,069,869</u>
Total Net Plant	<u><u>\$ 406,025,800</u></u>	<u><u>\$ 91,837,992</u></u>	<u><u>\$ (52,368,770)</u></u>	<u><u>\$ 445,495,022</u></u>

Knoxville Utilities Board Electric Division
Notes to Financial Statements
June 30, 2015 and 2014

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 \$815,352 resulting from the following changes:

	2015	2014
Balance, beginning of year	\$ 738,983	\$ 816,900
Current year claims and changes in estimates	6,885,119	5,685,495
Claims payments	(6,808,750)	(5,763,412)
Balance, end of year	\$ <u>815,352</u>	\$ <u>738,983</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. For purposes of this disclosure, presentation is on a consolidated basis unless division's share is specified.

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.

Knoxville Utilities Board Electric Division

Notes to Financial Statements

June 30, 2015 and 2014

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

	2014	2013
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>

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 percent of the first \$4,800 of annual earnings and 5 percent 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

Knoxville Utilities Board Electric Division

Notes to Financial Statements

June 30, 2015 and 2014

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.

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. Of these amounts, \$3,030,911 and \$2,586,258 are attributable to the Electric Division. 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. The Electric Division's portion of this contribution is \$2,721,302.

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. The Electric Division's portion of this contribution is \$2,310,678. 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

Knoxville Utilities Board Electric Division
Notes to Financial Statements
June 30, 2015 and 2014

based on the December 31, 2014 measurement date. The division's share of the net pension asset is \$2,890,382.

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

	2014	2013
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

Knoxville Utilities Board Electric Division

Notes to Financial Statements

June 30, 2015 and 2014

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 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:

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

Knoxville Utilities Board Electric Division
Notes to Financial Statements
June 30, 2015 and 2014

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 (Division's share \$1,319,954).

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 (Division's share \$3,061,589). 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 (Division's share \$1,515,455) 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	-

Knoxville Utilities Board Electric Division

Notes to Financial Statements

June 30, 2015 and 2014

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 (Division's share \$764,808) and \$1,463,184 (Division's share \$687,696), 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

Knoxville Utilities Board Electric Division

Notes to Financial Statements

June 30, 2015 and 2014

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)	3,500,284	3,319,013
f) Employer Contributions	3,497,372	4,057,091
g) Net OPEB Obligation/(Asset) at end of fiscal year (a+e-f)	\$ (174,410)	\$ (177,322)

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:

Schedule of Employer Contributions					
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)

Knoxville Utilities Board Electric Division

Notes to Financial Statements

June 30, 2015 and 2014

Total contributions to the OPEB Trust for the fiscal year ended June 30, 2015 were \$3,497,372 (Division's share \$1,678,739). 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 (Division's share \$1,678,739). As of June 30, 2015, the employer's OPEB obligation has been exceeded by \$174,410 (Division's share \$83,717).

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 (Division's share \$457,546).

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 (Division's share \$22,917,907). The actuarial value of the Plan's assets was \$47,705,478 (Division's share \$22,898,629). As a result, the Plan's unfunded actuarial accrued liability was \$40,162 (Division's share \$19,278). 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 (Division's share \$297,607). 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

Knoxville Utilities Board Electric Division

Notes to Financial Statements

June 30, 2015 and 2014

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 Division, P.O. Box 59017, Knoxville, TN 37950-9017.

13. Related Party Transactions

The Division, in the normal course of operations, is involved in transactions with the City of Knoxville and with other divisions of KUB. Such transactions for the years ended June 30, 2015 and 2014 are summarized as follows:

	2015	2014
City of Knoxville		
Amounts billed by the Division for utilities and related services	\$ 8,591,649	\$ 7,258,070
Payments by the Division in lieu of property tax	6,764,881	5,887,808
Payments by the Division for services provided	75,417	80,560
Other divisions of KUB		
Amounts billed to other divisions for utilities and related services provided	5,530,344	5,706,628
Interdivisional rental expense	-	-
Interdivisional rental income	786,190	743,721
Amounts billed to the Division by other divisions for utilities services provided	212,051	226,003

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

	2015	2014
Accounts receivable	\$ 539,053	\$ 522,669

14. Other Commitments and Contingencies

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

Knoxville Utilities Board Electric Division
Required Supplementary Information – Schedule of Funding Progress
June 30, 2015
(Unaudited)

Other Post-Employment Benefits (OPEB)

Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded Actuarial Accrued Liability (UAAL) (b-a)	Funded Ratio (a)/(b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll [(b)-(a)]/(c)
January 1, 2008	\$ -	\$ 108,329,141	\$ 108,329,141	0%	\$ 31,234,509	346.8%
January 1, 2009	14,593,487	100,726,738	86,133,251	14%	31,846,091	270.5%
January 1, 2010	21,275,643	58,475,364	37,199,721	36%	30,069,028	123.7%
January 1, 2011	40,749,815	64,289,254	23,539,439	63%	28,878,791	81.5%
January 1, 2012	37,907,357	61,603,466	23,696,109	62%	28,269,123	83.8%
January 1, 2013	38,571,803	63,341,531	24,769,728	61%	27,566,340	89.9%
* 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 Electric Division
Required Supplementary Information – Schedule of Changes in Net Pension
Liability and Related Ratios
June 30, 2015
(Unaudited)

	2014
Total pension liability	
Service cost	\$ 4,092,808
Interest	14,698,657
Benefit payments, including refunds of member contributions	<u>(15,533,167)</u>
Net change in total pension liability	<u>3,258,298</u>
Total pension liability - beginning	<u>199,515,466</u>
Total pension liability - ending (a)	<u><u>\$ 202,773,764</u></u>
Plan fiduciary net position	
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>
Net change in plan fiduciary net position**	<u>12,795,245</u>
Plan fiduciary net position - beginning**	<u>196,000,149</u>
Plan fiduciary net position - ending (b)**	<u><u>\$ 208,795,394</u></u>
Plan's net pension liability - ending (a) - (b)	<u><u>\$ (6,021,630)</u></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 Electric Division
Required Supplementary Information – Schedule of Employer Pension
Contributions
June 30, 2015
(Unaudited)

	<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:

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:

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	34101-06616	\$ 227,006
		Total Program 97.036		\$ 227,006
		Total Federal Awards		\$ 227,006

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 Electric Division
Supplemental Information - Schedule of Insurance in Force
June 30, 2015
(Unaudited)

Schedule 2

Insurance coverage is for KUB as a consolidated entity.

Crime

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

Directors' and Officers' Liability Insurance

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

Employment Practices Liability

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

Fiduciary

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

Pollution Legal Liability

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

Property Insurance

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

Travel Accident

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

Excess Insurance for General Liability

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

Excess Insurance for Workers' Compensation

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

Employee Health Plan Stop Loss Coverage

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

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Electric Division
Supplemental Information - Schedule of Debt Maturities by Fiscal Year
June 30, 2015
(Unaudited)

Schedule 3
Continued on Next Page

FY	W-2005		X-2006		Y-2009		Z-2010			AA-2012	
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Rebate*	Principal	Interest
15-16	\$ 1,870,000	\$ 1,299,481	\$ 1,825,000	\$ 45,625	\$ 1,600,000	\$ 196,750	\$ 1,285,000	\$ 1,265,436	\$ 442,903	\$ 990,000	\$ 1,442,213
16-17	1,940,000	1,218,606			1,675,000	151,625	1,305,000	1,225,919	429,072	2,540,000	1,353,963
17-18	2,015,000	1,139,506			1,750,000	100,250	1,330,000	1,180,440	413,154	2,670,000	1,223,713
18-19	2,095,000	1,057,306			1,850,000	37,000	1,355,000	1,128,729	395,055	2,805,000	1,086,838
19-20	2,185,000	970,341					1,390,000	1,070,710	374,749	2,955,000	942,838
20-21	2,275,000	878,354					1,425,000	1,007,355	352,575	3,100,000	791,463
21-22	2,370,000	781,069					1,470,000	939,300	328,756	3,270,000	632,213
22-23	2,470,000	678,219					1,515,000	866,145	303,151	3,415,000	482,163
23-24	2,580,000	569,294					1,560,000	787,710	275,698	3,540,000	360,763
24-25	2,695,000	453,903					1,615,000	703,545	246,241	3,640,000	253,063
25-26	2,820,000	333,263					1,670,000	613,180	214,614	1,105,000	180,506
26-27	2,950,000	205,201					1,725,000	516,395	180,739	1,140,000	144,025
27-28	3,085,000	69,413					1,785,000	413,266	144,643	1,180,000	106,325
28-29							1,850,000	303,738	106,308	1,225,000	65,713
29-30							1,925,000	187,156	65,505	1,265,000	22,138
30-31							2,000,000	63,500	22,225		
31-32											
32-33											
33-34											
34-35											
35-36											
36-37											
37-38											
38-39											
39-40											
40-41											
41-42											
42-43											
43-44											
44-45											
45-46											
Total	<u>\$ 31,350,000</u>	<u>\$ 9,653,956</u>	<u>\$ 1,825,000</u>	<u>\$ 45,625</u>	<u>\$ 6,875,000</u>	<u>\$ 485,625</u>	<u>\$ 25,205,000</u>	<u>\$ 12,272,524</u>	<u>\$ 4,295,388</u>	<u>\$ 34,840,000</u>	<u>\$ 9,087,937</u>

*Series Z-2010 bonds were issued as federally taxable Build America Bonds. KUB is scheduled to receive a 35 percent interest rebate payment from the United States Government for each interest payment. Effective 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.

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Electric Division
Supplemental Information - Schedule of Debt Maturities by Fiscal Year
June 30, 2015
(Unaudited)

Schedule 3

Continued from Previous Page

FY	BB-2012		CC-2013		DD-2014		EE-2015		FF-2015		Total		Grand Total (P + I)
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	
15-16	\$ 650,000	\$ 1,037,500	\$ 50,000	\$ 314,850	\$ 675,000	\$ 1,374,994	\$ 125,000	\$ 655,175	\$ -	\$ 903,184	\$ 9,070,000	\$ 8,535,208	\$ 17,605,208
16-17	675,000	1,017,625	450,000	305,099	700,000	1,354,369	150,000	977,450	675,000	1,464,500	10,110,000	9,069,156	19,179,156
17-18	700,000	997,000	475,000	286,600	725,000	1,332,994	150,000	969,950	700,000	1,443,750	10,515,000	8,674,203	19,189,203
18-19	725,000	972,000	475,000	267,600	775,000	1,314,369	150,000	962,450	725,000	1,411,625	10,955,000	8,237,917	19,192,917
19-20	750,000	942,500	500,000	248,100	800,000	1,298,619	2,075,000	937,950	750,000	1,374,750	11,405,000	7,785,808	19,190,808
20-21	800,000	911,500	515,000	227,800	825,000	1,282,369	2,135,000	863,825	775,000	1,336,625	11,850,000	7,299,291	19,149,291
21-22	825,000	879,000	540,000	206,700	875,000	1,256,619	2,235,000	788,100	800,000	1,297,250	12,385,000	6,780,251	19,165,251
22-23	875,000	849,375	560,000	187,497	900,000	1,221,119	2,300,000	708,250	825,000	1,256,625	12,860,000	6,249,393	19,109,393
23-24	900,000	822,750	575,000	170,475	950,000	1,184,119	2,415,000	590,375	850,000	1,214,750	13,370,000	5,700,236	19,070,236
24-25	950,000	795,000	590,000	153,000	975,000	1,145,619	2,555,000	478,900	900,000	1,171,000	13,920,000	5,154,030	19,074,030
25-26	975,000	766,125	640,000	134,550	1,025,000	1,110,744	2,670,000	387,750	925,000	1,125,375	11,830,000	4,651,493	16,481,493
26-27	1,025,000	736,125	650,000	115,200	1,075,000	1,079,244	2,735,000	306,675	950,000	1,078,500	12,250,000	4,181,365	16,431,365
27-28	1,075,000	704,625	670,000	95,400	1,125,000	1,046,244	2,850,000	222,900	975,000	1,030,375	12,745,000	3,688,548	16,433,548
28-29	1,125,000	671,625	675,000	75,225	1,175,000	1,011,744	2,955,000	135,825	1,025,000	985,500	10,030,000	3,249,370	13,279,370
29-30	1,175,000	637,125	710,000	54,450	1,225,000	975,744	3,050,000	45,750	1,050,000	944,000	10,400,000	2,866,363	13,266,363
30-31	1,225,000	601,125	725,000	32,925	1,275,000	938,244			1,100,000	901,000	6,325,000	2,536,794	8,861,794
31-32	1,275,000	563,625	735,000	11,023	1,325,000	897,919			1,125,000	856,500	4,460,000	2,329,067	6,789,067
32-33	1,325,000	524,625			1,375,000	854,375			1,175,000	810,500	3,875,000	2,189,500	6,064,500
33-34	1,375,000	484,125			1,450,000	808,469			1,225,000	762,500	4,050,000	2,055,094	6,105,094
34-35	1,450,000	441,750			1,500,000	759,594			1,250,000	713,000	4,200,000	1,914,344	6,114,344
35-36	1,500,000	397,500			1,575,000	707,703			1,300,000	662,000	4,375,000	1,767,203	6,142,203
36-37	1,575,000	351,375			1,650,000	652,250			1,350,000	609,000	4,575,000	1,612,625	6,187,625
37-38	1,625,000	303,375			1,725,000	593,188			1,400,000	554,000	4,750,000	1,450,563	6,200,563
38-39	1,700,000	253,500			1,800,000	531,500			1,450,000	497,000	4,950,000	1,282,000	6,232,000
39-40	1,775,000	201,375			1,875,000	462,500			1,500,000	438,000	5,150,000	1,101,875	6,251,875
40-41	1,850,000	147,000			1,950,000	386,000			1,550,000	377,000	5,350,000	910,000	6,260,000
41-42	1,950,000	90,000			2,025,000	306,500			1,600,000	314,000	5,575,000	710,500	6,285,500
42-43	2,025,000	30,375			2,125,000	223,500			1,675,000	248,500	5,825,000	502,375	6,327,375
43-44					2,225,000	136,500			1,725,000	180,500	3,950,000	317,000	4,267,000
44-45					2,300,000	46,000			1,800,000	110,000	4,100,000	156,000	4,256,000
45-46									1,850,000	37,000	1,850,000	37,000	1,887,000
Total	\$ 33,875,000	\$ 17,129,625	\$ 9,535,000	\$ 2,886,494	\$ 40,000,000	\$ 26,293,152	\$ 28,550,000	\$ 9,031,325	\$ 35,000,000	\$ 26,108,309	\$ 247,055,000	\$ 112,994,572	\$ 360,049,572

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Electric Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2015
(Unaudited)

Schedule 4

Rate Class	Base Charge	Number of Customers
Residential	Customer Charge: \$15.60 per month, less Hydro Allocation Credit: \$1.60 per month. Energy Charge: Summer Period 8.722 cents per kWh per month. Winter Period 8.681 cents per kWh per month. Transition Period 8.681 cents per kWh per month.	177,550
Commercial/ Industrial	<p>A. 1. If (a) the higher of (i) the customer's currently effective contract demand, if any, or (ii) its highest billing demand during the latest 12-month period is not more than 50 kWh, and (b) customer's monthly energy takings for any month during such period do not exceed 15,000 kWh:</p> Customer Charge: \$20.00 per delivery point per month. Energy Charge: Summer Period 10.133 cents per kWh. Winter Period 10.092 cents per kWh. Transition Period 10.092 cents per kWh.	19,463
	<p>2. If (a) the higher of (i) the customer's currently effective contract demand or (ii) its highest billing demand during the latest 12-month period is greater than 50 kW but not more than 1,000 kW, or (b) if the customer's billing demand is less than 50 kW and its energy takings for any month during such period exceed 15,000 kWh:</p> Customer Charge: \$55.00 per delivery point per month. Demand Charge: First 50 kW of billing demand per month, no demand charge. Excess over 50 kW of billing demand per month, at Summer Period \$13.05 per kW. Winter Period \$12.26 per kW. Transition Period \$12.26 per kW. Energy Charge: Summer Period First 15,000 kWh per month at 11.214 cents per kWh Additional kWh per month at 5.939 cents per kWh. Winter Period First 15,000 kWh per month at 11.173 cents per kWh Additional kWh per month at 5.939 cents per kWh. Transition Period First 15,000 kWh per month at 11.173 cents per kWh Additional kWh per month at 5.939 cents per kWh.	2,781

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Electric Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2015
(Unaudited)

Schedule 4

Rate Class	Number of Customers												
<p>3. If (a) the higher of the customer's currently effective contract demand or (b) its highest billing demand during the latest 12-month period is greater than 1,000 kW:</p> <p>Customer Charge: \$150.00 per delivery point per month.</p> <p>Demand Charge:</p> <table> <tr> <td data-bbox="753 480 926 500">Summer Period</td><td data-bbox="993 480 1738 626">First 1,000 kW of billing demand per month, at \$13.10 per kW. Excess over 1,000 kW of billing demand per month, at \$14.26 per kW, plus an additional \$14.26 per kW per month for each kW, if any, of the amount by which the customer's billing demand exceeds the higher of 2,500 kW or its contract demand.</td></tr> <tr> <td data-bbox="753 634 905 654">Winter Period</td><td data-bbox="993 634 1738 781">First 1,000 kW of billing demand per month, at \$12.34 per kW. Excess over 1,000 kW of billing demand per month, at \$13.50 per kW, plus an additional \$13.50 per kW per month for each kW, if any, of the amount by which the customer's billing demand exceeds the higher of 2,500 kW or its contract demand.</td></tr> <tr> <td data-bbox="753 789 936 808">Transition Period</td><td data-bbox="993 789 1738 935">First 1,000 kW of billing demand per month, at \$12.34 per kW. Excess over 1,000 kW of billing demand per month, at \$13.50 per kW, plus an additional \$13.50 per kW per month for each kW, if any, of the amount by which the customer's billing demand exceeds the higher of 2,500 kW or its contract demand.</td></tr> </table> <p>Energy Charge:</p> <table> <tr> <td data-bbox="753 943 926 963">Summer Period</td><td data-bbox="993 943 1220 963">6.324 cents per kWh.</td></tr> <tr> <td data-bbox="753 971 905 990">Winter Period</td><td data-bbox="993 971 1220 990">6.324 cents per kWh.</td></tr> <tr> <td data-bbox="753 998 936 1018">Transition Period</td><td data-bbox="993 998 1220 1018">6.324 cents per kWh.</td></tr> </table>	Summer Period	First 1,000 kW of billing demand per month, at \$13.10 per kW. Excess over 1,000 kW of billing demand per month, at \$14.26 per kW, plus an additional \$14.26 per kW per month for each kW, if any, of the amount by which the customer's billing demand exceeds the higher of 2,500 kW or its contract demand.	Winter Period	First 1,000 kW of billing demand per month, at \$12.34 per kW. Excess over 1,000 kW of billing demand per month, at \$13.50 per kW, plus an additional \$13.50 per kW per month for each kW, if any, of the amount by which the customer's billing demand exceeds the higher of 2,500 kW or its contract demand.	Transition Period	First 1,000 kW of billing demand per month, at \$12.34 per kW. Excess over 1,000 kW of billing demand per month, at \$13.50 per kW, plus an additional \$13.50 per kW per month for each kW, if any, of the amount by which the customer's billing demand exceeds the higher of 2,500 kW or its contract demand.	Summer Period	6.324 cents per kWh.	Winter Period	6.324 cents per kWh.	Transition Period	6.324 cents per kWh.	55
Summer Period	First 1,000 kW of billing demand per month, at \$13.10 per kW. Excess over 1,000 kW of billing demand per month, at \$14.26 per kW, plus an additional \$14.26 per kW per month for each kW, if any, of the amount by which the customer's billing demand exceeds the higher of 2,500 kW or its contract demand.												
Winter Period	First 1,000 kW of billing demand per month, at \$12.34 per kW. Excess over 1,000 kW of billing demand per month, at \$13.50 per kW, plus an additional \$13.50 per kW per month for each kW, if any, of the amount by which the customer's billing demand exceeds the higher of 2,500 kW or its contract demand.												
Transition Period	First 1,000 kW of billing demand per month, at \$12.34 per kW. Excess over 1,000 kW of billing demand per month, at \$13.50 per kW, plus an additional \$13.50 per kW per month for each kW, if any, of the amount by which the customer's billing demand exceeds the higher of 2,500 kW or its contract demand.												
Summer Period	6.324 cents per kWh.												
Winter Period	6.324 cents per kWh.												
Transition Period	6.324 cents per kWh.												

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Electric Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2015
(Unaudited)

Schedule 4

Rate Class	Base Charge	Number of Customers
Commercial/ Industrial	B. This rate shall apply to the firm electric power requirements where a customer's currently effective contract demand is greater than 5,000 kW but not more than 15,000 kW:	1
	Customer Charge: \$1,500 per delivery point per month.	
	Administrative Charge: \$700 per delivery point per month.	
	Demand Charge:	
	Summer Period \$17.92 per kW per month of the customer's onpeak billing demand, plus \$4.75 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus \$17.92 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.	
	Winter Period \$10.40 per kW per month of the customer's onpeak billing demand, plus \$4.75 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus \$10.40 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.	
	Transition Period \$4.75 per kW per month of the customer's offpeak billing demand, plus \$10.40 per kW per month for each kW of the amount, if any, by which the customer's offpeak billing demand exceeds its offpeak contract demand.	

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Electric Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2015
(Unaudited)

Schedule 4

Energy Charge:	Summer Period	10.043 cents per kWh per month for all metered onpeak kWh, plus 6.369 cents per kWh per month for the first 425 hours of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 4.394 cents per kWh per month for the next 195 hours use of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 2.714 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours multiplied by the ratio of offpeak energy to total energy.
	Winter Period	6.796 cents per kWh per month for all metered onpeak kWh, plus 6.369 cents per kWh per month for the first 425 hours of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 4.394 cents per kWh per month for the next 195 hours use of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 2.714 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours multiplied by the ratio of offpeak energy to total energy.
	Transition Period	6.369 cents per kWh per month for the first 425 hours use of maximum metered demand, plus 4.394 cents per kWh per month for the next 195 hours use of maximum metered demand, plus 2.714 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours.

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Electric Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2015
(Unaudited)

Schedule 4

Rate Class	Base Charge	Number of Customers
Commercial/Industrial	<p>C. This rate shall apply to the firm electric power requirements where a customer's currently effective contract demand is greater than 15,000 kW but not more than 25,000 kW:</p> <p>Customer Charge: \$1,500 per delivery point per month.</p> <p>Administrative Charge: \$700 per delivery point per month.</p> <p>Demand Charge: Summer Period \$17.46 per kW per month of the customer's onpeak billing demand, plus \$4.29 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus \$17.46 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.</p> <p>Winter Period \$9.94 per kW per month of the customer's onpeak billing demand, plus \$4.29 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus \$9.94 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.</p> <p>Transition Period \$4.29 per kW per month of the customer's offpeak billing demand, plus \$9.94 per kW per month for each kW of the amount, if any, by which the customer's offpeak billing demand exceeds its offpeak contract demand.</p>	1

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Electric Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2015
(Unaudited)

Schedule 4

Energy Charge:	Summer Period	9.662 cents per kWh per month for all metered onpeak kWh, plus 6.091 cents per kWh per month for the first 425 hours of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 4.114 cents per kWh per month for the next 195 hours use of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 2.434 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours multiplied by the ratio of offpeak energy to total energy.
	Winter Period	6.492 cents per kWh per month for all metered onpeak kWh, plus 6.091 cents per kWh per month for the first 425 hours of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 4.114 cents per kWh per month for the next 195 hours use of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 2.434 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours multiplied by the ratio of offpeak energy to total energy.
	Transition Period	6.091 cents per kWh per month for the first 425 hours use of maximum metered demand, plus 4.114 cents per kWh per month for the next 195 hours use of maximum metered demand, plus 2.434 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours.

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Electric Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2015
(Unaudited)

Schedule 4

Rate Class	Base Charge	Number of Customers
Commercial/ Industrial	D. This rate shall apply to the firm electric power requirements where a customer's currently effective contract demand is greater than 25,000 kW:	1
	Customer Charge: \$1,500 per delivery point per month.	
	Administrative Charge: \$700 per delivery point per month.	
	Demand Charge:	
	Summer Period \$17.69 per kW per month of the customer's onpeak billing demand, plus \$4.52 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus \$17.69 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.	
	Winter Period \$10.17 per kW per month of the customer's onpeak billing demand, plus \$4.52 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus \$10.17 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.	
	Transition Period \$4.52 per kW per month of the customer's offpeak billing demand, plus \$10.17 per kW per month for each kW of the amount, if any, by which the customer's offpeak billing demand exceeds its offpeak contract demand.	

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Electric Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2015
(Unaudited)

Schedule 4

Energy Charge:	Summer Period	9.533 cents per kWh per month for all metered onpeak kWh, plus 5.853 cents per kWh per month for the first 425 hours of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 3.874 cents per kWh per month for the next 195 hours use of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 2.196 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours multiplied by the ratio of offpeak energy to total energy.
	Winter Period	6.273 cents per kWh per month for all metered onpeak kWh, plus 5.853 cents per kWh per month for the first 425 hours of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 3.874 cents per kWh per month for the next 195 hours use of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 2.196 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours multiplied by the ratio of offpeak energy to total energy.
	Transition Period	5.853 cents per kWh per month for the first 425 hours use of maximum metered demand, plus 3.874 cents per kWh per month for the next 195 hours use of maximum metered demand, plus 2.196 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours.

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Electric Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2015
(Unaudited)

Schedule 4

Rate Class	Base Charge	Number of Customers
Seasonal Time of Use	<p>A. This rate shall apply to the firm electric power requirements where a customer's currently effective contract demand is greater than 1,000 kW but not more than 5,000 kW:</p> <p>Customer Charge: \$1,500 per delivery point per month.</p> <p>Administrative Charge: \$700 per delivery point per month.</p> <p>Demand Charge: Summer Period \$17.92 per kW per month of the customer's onpeak billing demand, plus \$4.75 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus \$17.92 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.</p> <p>Winter Period \$10.40 per kW per month of the customer's onpeak billing demand, plus \$4.75 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus \$10.40 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.</p> <p>Transition Period \$4.75 per kW per month of the customer's offpeak billing demand, plus \$10.40 per kW per month for each kW of the amount, if any, by which the customer's offpeak billing demand exceeds its offpeak contract demand.</p>	-

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Electric Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2015
(Unaudited)

Schedule 4

Energy Charge:	Summer Period	10.043 cents per kWh per month for all metered onpeak kWh, plus 6.369 cents per kWh per month for the first 425 hours of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 4.394 cents per kWh per month for the next 195 hours use of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 2.714 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours multiplied by the ratio of offpeak energy to total energy.
	Winter Period	6.796 cents per kWh per month for all metered onpeak kWh, plus 6.369 cents per kWh per month for the first 425 hours of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 4.394 cents per kWh per month for the next 195 hours use of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 2.714 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours multiplied by the ratio of offpeak energy to total energy.
	Transition Period	6.369 cents per kWh per month for the first 425 hours use of maximum metered demand, plus 4.394 cents per kWh per month for the next 195 hours use of maximum metered demand, plus 2.714 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours.

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Electric Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2015
(Unaudited)

Schedule 4

Rate Class	Base Charge		Number of Customers												
Seasonal	B.	<p>This rate shall apply to the firm electric power requirements where a customer's currently effective contract demand is greater than 5,000 kW but not more than 15,000 kW:</p> <p>Customer Charge: \$1,500 per delivery point per month.</p> <p>Administrative Charge: \$700 per delivery point per month.</p> <p>Demand Charge:</p> <table><tr><td>Summer Period</td><td>\$23.42 per kW per month of the customer's billing demand, plus \$23.42 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.</td></tr><tr><td>Winter Period</td><td>\$16.72 per kW per month of the customer's billing demand, plus \$16.72 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.</td></tr><tr><td>Transition Period</td><td>\$11.69 per kW per month of the customer's billing demand, plus \$11.69 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.</td></tr></table> <p>Energy Charge:</p> <table><tr><td>Summer Period</td><td>5.053 cents per kWh per month.</td></tr><tr><td>Winter Period</td><td>4.617 cents per kWh per month.</td></tr><tr><td>Transition Period</td><td>4.522 cents per kWh per month.</td></tr></table>	Summer Period	\$23.42 per kW per month of the customer's billing demand, plus \$23.42 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.	Winter Period	\$16.72 per kW per month of the customer's billing demand, plus \$16.72 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.	Transition Period	\$11.69 per kW per month of the customer's billing demand, plus \$11.69 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.	Summer Period	5.053 cents per kWh per month.	Winter Period	4.617 cents per kWh per month.	Transition Period	4.522 cents per kWh per month.	3
Summer Period	\$23.42 per kW per month of the customer's billing demand, plus \$23.42 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.														
Winter Period	\$16.72 per kW per month of the customer's billing demand, plus \$16.72 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.														
Transition Period	\$11.69 per kW per month of the customer's billing demand, plus \$11.69 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.														
Summer Period	5.053 cents per kWh per month.														
Winter Period	4.617 cents per kWh per month.														
Transition Period	4.522 cents per kWh per month.														

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Electric Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2015
(Unaudited)

Schedule 4

Rate Class	Base Charge	Number of Customers
Seasonal	<p>C. This rate shall apply to the firm electric power requirements where a customer's currently effective contract demand is greater than 15,000 kW but not more than 25,000 kW:</p> <p>Customer Charge: \$1,500 per delivery point per month.</p> <p>Administrative Charge: \$700 per delivery point per month.</p> <p>Demand Charge: Summer Period \$22.96 per kW per month of the customer's billing demand, plus \$22.96 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.</p> <p>Winter Period \$16.26 per kW per month of the customer's billing demand, plus \$16.26 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.</p> <p>Transition Period \$11.23 per kW per month of the customer's billing demand, plus \$11.23 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.</p> <p>Energy Charge: Summer Period 5.067 cents per kWh per month.</p> <p>Winter Period 4.621 cents per kWh per month.</p> <p>Transition Period 4.529 cents per kWh per month.</p>	-

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Electric Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2015
(Unaudited)

Schedule 4

Rate Class	Base Charge	Number of Customers
Seasonal	<p>D. This rate shall apply to the firm electric power requirements where a customer's currently effective contract demand is greater than 25,000 kW:</p> <p>Customer Charge: \$1,500 per delivery point per month.</p> <p>Administrative Charge: \$700 per delivery point per month.</p> <p>Demand Charge: Summer Period \$26.99 per kW per month of the customer's billing demand, plus \$26.99 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.</p> <p>Winter Period \$20.25 per kW per month of the customer's billing demand, plus \$20.25 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.</p> <p>Transition Period \$15.24 per kW per month of the customer's billing demand, plus \$15.24 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.</p> <p>Energy Charge: Summer Period 4.351 cents per kWh per month.</p> <p>Winter Period 3.963 cents per kWh per month.</p> <p>Transition Period 3.878 cents per kWh per month.</p>	-

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Electric Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2015
(Unaudited)

Schedule 4

Rate Class	Base Charge	Number of Customers						
Manufacturing	<p>B. This rate shall apply to the firm electric power requirements where (a) a customer's currently effective contract demand is greater than 5,000 kW but not more than 15,000 kW and (b) the major use of electricity is for activities conducted at the delivery point serving that customer which are classified with a 2-digit Standard Industrial Classification Code between 20 and 39, inclusive.</p> <p>Customer Charge: \$1,500 per delivery point per month.</p> <p>Administrative Charge: \$700 per delivery point per month.</p> <p>Demand Charge:</p> <table><tr><td>Summer Period</td><td>\$17.91 per kW per month of the customer's onpeak billing demand, plus \$4.74 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus \$17.91 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.</td></tr><tr><td>Winter Period</td><td>\$10.39 per kW per month of the customer's onpeak billing demand, plus \$4.74 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus \$10.39 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.</td></tr><tr><td>Transition Period</td><td>\$4.74 per kW per month of the customer's offpeak billing demand, plus \$10.39 per kW per month for each kW of the amount, if any, by which the customer's offpeak billing demand exceeds its offpeak contract demand.</td></tr></table>	Summer Period	\$17.91 per kW per month of the customer's onpeak billing demand, plus \$4.74 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus \$17.91 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.	Winter Period	\$10.39 per kW per month of the customer's onpeak billing demand, plus \$4.74 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus \$10.39 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.	Transition Period	\$4.74 per kW per month of the customer's offpeak billing demand, plus \$10.39 per kW per month for each kW of the amount, if any, by which the customer's offpeak billing demand exceeds its offpeak contract demand.	-
Summer Period	\$17.91 per kW per month of the customer's onpeak billing demand, plus \$4.74 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus \$17.91 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.							
Winter Period	\$10.39 per kW per month of the customer's onpeak billing demand, plus \$4.74 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus \$10.39 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.							
Transition Period	\$4.74 per kW per month of the customer's offpeak billing demand, plus \$10.39 per kW per month for each kW of the amount, if any, by which the customer's offpeak billing demand exceeds its offpeak contract demand.							

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Electric Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2015
(Unaudited)

Schedule 4

Energy Charge:	Summer Period	8.420 cents per kWh per month for all metered onpeak kWh, plus 4.788 cents per kWh per month for the first 425 hours of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 2.810 cents per kWh per month for the next 195 hours use of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 1.132 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours multiplied by the ratio of offpeak energy to total energy.
	Winter Period	5.239 cents per kWh per month for all metered onpeak kWh, plus 4.788 cents per kWh per month for the first 425 hours of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 2.810 cents per kWh per month for the next 195 hours use of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 1.132 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours multiplied by the ratio of offpeak energy to total energy.
	Transition Period	4.788 cents per kWh per month for the first 425 hours use of maximum metered demand, plus 2.810 cents per kWh per month for the next 195 hours use of maximum metered demand, plus 1.132 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours.

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Electric Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2015
(Unaudited)

Schedule 4

Rate Class	Base Charge	Number of Customers						
Manufacturing	<p>C. This rate shall apply to the firm electric power requirements where (a) a customer's currently effective contract demand is greater than 15,000 kW but not more than 25,000 kW and (b) the major use of electricity is for activities conducted at the delivery point serving that customer which are classified with a 2-digit Standard Industrial Classification Code between 20 and 39, inclusive.</p> <p>Customer Charge: \$1,500 per delivery point per month.</p> <p>Administrative Charge: \$700 per delivery point per month.</p> <p>Demand Charge:</p> <table><tr><td>Summer Period</td><td>\$17.47 per kW per month of the customer's onpeak billing demand, plus \$4.30 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus \$17.47 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.</td></tr><tr><td>Winter Period</td><td>\$9.95 per kW per month of the customer's onpeak billing demand, plus \$4.30 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus \$9.95 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.</td></tr><tr><td>Transition Period</td><td>\$4.30 per kW per month of the customer's offpeak billing demand, plus \$9.95 per kW per month for each kW of the amount, if any, by which the customer's offpeak billing demand exceeds its offpeak contract demand.</td></tr></table>	Summer Period	\$17.47 per kW per month of the customer's onpeak billing demand, plus \$4.30 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus \$17.47 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.	Winter Period	\$9.95 per kW per month of the customer's onpeak billing demand, plus \$4.30 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus \$9.95 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.	Transition Period	\$4.30 per kW per month of the customer's offpeak billing demand, plus \$9.95 per kW per month for each kW of the amount, if any, by which the customer's offpeak billing demand exceeds its offpeak contract demand.	-
Summer Period	\$17.47 per kW per month of the customer's onpeak billing demand, plus \$4.30 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus \$17.47 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.							
Winter Period	\$9.95 per kW per month of the customer's onpeak billing demand, plus \$4.30 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus \$9.95 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.							
Transition Period	\$4.30 per kW per month of the customer's offpeak billing demand, plus \$9.95 per kW per month for each kW of the amount, if any, by which the customer's offpeak billing demand exceeds its offpeak contract demand.							

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Electric Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2015
(Unaudited)

Schedule 4

Energy Charge:	Summer Period	8.507 cents per kWh per month for all metered onpeak kWh, plus 4.773 cents per kWh per month for the first 425 hours of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 2.797 cents per kWh per month for the next 195 hours use of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 1.119 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours multiplied by the ratio of offpeak energy to total energy.
	Winter Period	5.254 cents per kWh per month for all metered onpeak kWh, plus 4.773 cents per kWh per month for the first 425 hours of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 2.797 cents per kWh per month for the next 195 hours use of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 1.119 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours multiplied by the ratio of offpeak energy to total energy.
	Transition Period	4.773 cents per kWh per month for the first 425 hours use of maximum metered demand, plus 2.797 cents per kWh per month for the next 195 hours use of maximum metered demand, plus 1.119 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours.

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Electric Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2015
(Unaudited)

Schedule 4

Rate Class	Base Charge	Number of Customers		
Manufacturing	D.	This rate shall apply to the firm electric power requirements where (a) a customer's currently effective contract demand is greater than 25,000 kW and (b) the major use of electricity is for activities conducted at the delivery point serving that customer which are classified with a 2-digit Standard Industrial Classification Code between 20 and 39, inclusive.	-	
	Customer Charge:	\$1,500 per delivery point per month.		
	Administrative Charge:	\$700 per delivery point per month.		
	Demand Charge:	Summer Period	\$17.68 per kW per month of the customer's onpeak billing demand, plus \$4.51 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus \$17.68 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.	
		Winter Period	\$10.16 per kW per month of the customer's onpeak billing demand, plus \$4.51 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus \$10.16 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.	
		Transition Period	\$4.51 per kW per month of the customer's offpeak billing demand, plus \$10.16 per kW per month for each kW of the amount, if any, by which the customer's offpeak billing demand exceeds its offpeak contract demand.	

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Electric Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2015
(Unaudited)

Schedule 4

Energy Charge:	Summer Period	8.356 cents per kWh per month for all metered onpeak kWh, plus 4.625 cents per kWh per month for the first 425 hours of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 2.648 cents per kWh per month for the next 195 hours use of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 0.970 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours multiplied by the ratio of offpeak energy to total energy.
	Winter Period	5.086 cents per kWh per month for all metered onpeak kWh, plus 4.625 cents per kWh per month for the first 425 hours of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 2.648 cents per kWh per month for the next 195 hours use of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 0.970 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours multiplied by the ratio of offpeak energy to total energy.
	Transition Period	4.625 cents per kWh per month for the first 425 hours use of maximum metered demand, plus 2.648 cents per kWh per month for the next 195 hours use of maximum metered demand, plus 0.970 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours.

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Electric Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2015
(Unaudited)

Schedule 4

Rate Class	Base Charge	Number of Customers
Manufacturing Seasonal Time of Use	A. This rate shall apply to the firm electric power requirements where (a) a customer's currently effective contract demand is greater than 1,000 kW but not more than 5,000 kW and (b) the major use of electricity is for activities conducted at the delivery point serving that customer which are classified with a 2-digit Standard Industrial Classification Code between 20 and 39, inclusive.	1
	Customer Charge: \$1,500 per delivery point per month.	
	Administrative Charge: \$700 per delivery point per month.	
	Demand Charge: Summer Period \$17.91 per kW per month of the customer's onpeak billing demand, plus \$4.74 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus \$17.91 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.	
	Winter Period \$10.39 per kW per month of the customer's onpeak billing demand, plus \$4.74 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus \$10.39 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.	
	Transition Period \$4.74 per kW per month of the customer's offpeak billing demand, plus \$10.39 per kW per month for each kW of the amount, if any, by which the customer's offpeak billing demand exceeds its offpeak contract demand.	

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Electric Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2015
(Unaudited)

Schedule 4

Energy Charge:	Summer Period	8.420 cents per kWh per month for all metered onpeak kWh, plus 4.788 cents per kWh per month for the first 425 hours of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 2.810 cents per kWh per month for the next 195 hours use of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 1.132 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours multiplied by the ratio of offpeak energy to total energy.
	Winter Period	5.239 cents per kWh per month for all metered onpeak kWh, plus 4.788 cents per kWh per month for the first 425 hours of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 2.810 cents per kWh per month for the next 195 hours use of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 1.132 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours multiplied by the ratio of offpeak energy to total energy.
	Transition Period	4.788 cents per kWh per month for the first 425 hours use of maximum metered demand, plus 2.810 cents per kWh per month for the next 195 hours use of maximum metered demand, plus 1.132 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours.

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Electric Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2015
(Unaudited)

Schedule 4

				Number of Customers
Manufacturing				
Seasonal	B.	This rate shall apply to the firm electric power requirements where (a) a customer's currently effective contract demand is greater than 5,000 kW but not more than 15,000 kW and (b) the major use of electricity is for activities conducted at the delivery point serving that customer which are classified with a 2-digit Standard Industrial Classification Code between 20 and 39, inclusive.		1
		Customer Charge:	\$1,500 per delivery point per month.	
		Administrative Charge:	\$700 per delivery point per month.	
		Demand Charge:	Summer Period \$20.35 per kW per month of the customer's billing demand, plus \$20.35 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.	
			Winter Period \$13.65 per kW per month of the customer's billing demand, plus \$13.65 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.	
			Transition Period \$8.61 per kW per month of the customer's billing demand, plus \$8.61 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.	
		Energy Charge:	Summer Period 4.225 cents per kWh per month.	
			Winter Period 3.734 cents per kWh per month.	
			Transition Period 3.619 cents per kWh per month.	

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Electric Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2015
(Unaudited)

Schedule 4

**Number of
Customers**

Seasonal	C.	This rate shall apply to the firm electric power requirements where (a) a customer's currently effective contract demand is greater than 15,000 kW but not more than 25,000 kW and (b) the major use of electricity is for activities conducted at the delivery point serving that customer which are classified with a 2-digit Standard Industrial Classification Code between 20 and 39, inclusive.		
		Customer Charge:		\$1,500 per delivery point per month.
		Administrative Charge:		\$700 per delivery point per month.
		Demand Charge:	Summer Period	\$19.91 per kW per month of the customer's billing demand, plus \$19.91 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.
			Winter Period	\$13.21 per kW per month of the customer's billing demand, plus \$13.21 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.
			Transition Period	\$8.17 per kW per month of the customer's billing demand, plus \$8.17 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.
		Energy Charge:	Summer Period	4.193 cents per kWh per month.
			Winter Period	3.732 cents per kWh per month.
			Transition Period	3.621 cents per kWh per month.

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Electric Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2015
(Unaudited)

Schedule 4

				Number of Customers
Manufacturing				
Seasonal	D.	This rate shall apply to the firm electric power requirements where (a) a customer's currently effective contract demand is greater than 25,000 kW; and (b) the major use of electricity is for activities conducted at the delivery point serving that customer which are classified with a 2-digit Standard Industrial Classification Code between 20 and 39, inclusive.		1
		Customer Charge:	\$1,500 per delivery point per month.	
		Administrative Charge:	\$700 per delivery point per month.	
		Demand Charge:	Summer Period \$23.18 per kW per month of the customer's billing demand, plus \$23.18 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.	
			Winter Period \$16.48 per kW per month of the customer's billing demand, plus \$16.48 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.	
			Transition Period \$11.45 per kW per month of the customer's billing demand, plus \$11.45 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.	
		Energy Charge:	Summer Period 3.464 cents per kWh per month.	
			Winter Period 3.095 cents per kWh per month.	
			Transition Period 3.007 cents per kWh per month.	

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Electric Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2015
(Unaudited)

Schedule 4

Rate Class	Base Charge	Number of Customers
Outdoor Lighting		
	Part A - Charges for Street and Park Lighting Systems, Traffic Signal Systems, and Athletic Field Lighting Installations	52
	Energy Charge: Summer Period 7.117 cents per kWh per month. Winter Period 7.117 cents per kWh per month. Transition Period 7.117 cents per kWh per month.	
	Facility Charge: The annual facility charge shall be 14.45 percent of the installed cost to KUB's electric system of the facilities devoted to street and park lighting service specified in this Part A. Such installed cost shall be recomputed on July 1 of each year, or more often if substantial changes in the facilities are made. Each month, one-twelfth of the then total annual facility charge shall be billed to the customer. If any part of the facilities has not been provided at the electric system's expense, or if the installed cost of any portion thereof is reflected on the books of another municipality or agency or department, the annual facility charge shall be adjusted to reflect properly the remaining cost to be borne by the electric system.	
	Customer Charge: \$2.50.	
	Part B - Charges for Outdoor Lighting for Individual Customers	940
	Charges Per Fixture Per Month	
a. Type of Fixture	(Watts) (Lumens) Rated kWh Facility Charge Total Lamp Charge	
Mercury Vapor or Incandescent*	175 7,650 70 \$ 4.52 \$ 9.50 400 19,100 155 6.31 17.34 1000** 47,500 378 10.09 36.99	
High Pressure Sodium	100 8,550 42 4.52 7.51 250 23,000 105 5.36 12.83 400 45,000 165 6.31 18.05 1000** 126,000 385 10.09 37.49	
Decorative	100 8,550 42 5.14 8.13	
	* Mercury Vapor and Incandescent fixtures not offered for new service.	
	** 1,000 watt fixtures not offered for new service.	
b. Energy Charge:	For each lamp size under a. above, 7.117 cents per rated kWh per month.	
Additional pole charge:	\$3.00 per pole.	

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Electric Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2015
(Unaudited)

Schedule 4

Rate Class	Base Charge	Number of Customers
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LED Pilot Program

Service under the LED Pilot Program shall only be available for select outdoor (security) lighting facilities of governmental entities located in the KUB electric system service territory. Participation in the LED Pilot Program shall be on a voluntary basis.

Pilot Program Charges - No Capital Contribution

-

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

LED Fixture Type	Facility Charge	Rated kWh	Energy Charge Per kWh	Total Charge
LED - 150WE - Rectangular Head	\$ 12.11	38	\$ 0.07117	\$ 14.81
LED - 150WE - Cobra Head	11.05	38	0.07117	13.75
LED - 250WE - Rectangular Head	\$ 14.56	57	\$ 0.07117	\$ 18.62
LED - 250WE - Cobra Head	13.27	57	0.07117	17.33

Pilot Program Charges - Capital Contribution

-

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

LED Fixture Type	Facility Charge	Rated kWh	Energy Charge Per kWh	Total Charge
LED - 150WE - Rectangular Head	\$ 5.22	38	\$ 0.07117	\$ 7.92
LED - 150WE - Cobra Head	5.09	38	0.07117	7.79
LED - 250WE - Rectangular Head	\$ 6.07	57	\$ 0.07117	\$ 10.13
LED - 250WE - Cobra Head	5.90	57	0.07117	9.96

Additional pole charge: \$3.00 per pole.

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
Electric Division of the Knoxville Utilities Board
Knoxville, Tennessee

Report on the Financial Statements

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 Electric Division (the Division) of the Knoxville Utilities Board, 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 the Division'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 the Division'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 the Division's internal control. Accordingly, we do not express an opinion on the effectiveness of the Division'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 the Division'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
Electric Division of the Knoxville Utilities Board
Knoxville, Tennessee

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Division'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 the Division's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Division's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Coulter & Justus, P.C.

Knoxville, Tennessee
October 16, 2015

Knoxville Utilities Board Gas Division

**Financial Statements and Supplemental
Information**

June 30, 2015 and 2014

Knoxville Utilities Board Gas Division

Index

June 30, 2015 and 2014

	Page(s)
Independent Auditors' Report	1-2
Management's Discussion and Analysis	3-24
Basic Financial Statements	
Statements of Net Position.....	25-26
Statements of Revenues, Expenses and Changes in Net Position.....	27
Statements of Cash Flows	28
Notes to Financial Statements	29-50
Required Supplementary Information – Schedule of Funding Progress	51
Required Supplementary Information – Schedule of Changes in Net Pension Liability and Related Ratios	52
Required Supplementary Information – Schedule of Employer Pension Contributions.....	53
Supplemental Information	
Schedule 1 – Schedule of Insurance in Force	54
Schedule 2 – Schedule of Debt Maturities by Fiscal Year	55-56
Schedule 3 – Schedule of Current Rates in Force.....	57-61
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 <i>Government Auditing Standards</i>	62-63



Report of Independent Auditors

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

We have audited the accompanying financial statements of the Gas Division (the Division) 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 the Division'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 Division's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Division's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Gas Division of the Knoxville Utilities Board 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, the Division 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.

Board of Commissioners
The Gas Division of the Knoxville Utilities Board
Knoxville, Tennessee

Other Matters

Prior Period Financial Statements

The financial statements of the Division 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.

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 24 and the required supplementary information on pages 51 through 53 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 the Division's basic financial statements. The supplemental information is presented for purposes of additional analysis and is not a required part of the basic financial statements. The supplemental information 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 the Division's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Division's internal control over financial reporting and compliance.

Coulter & Justus, P.C.

Knoxville, Tennessee
October 16, 2015

Knoxville Utilities Board Gas Division

Management's Discussion and Analysis

June 30, 2015 and 2014

Knoxville Utilities Board (KUB), comprised of 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. The Gas Division (Division) provides services to certain customers in Knox County and portions of Anderson and Loudon counties. The Division's accounts are maintained in conformity with the Uniform System of Accounts of the Federal Energy Regulatory Commission and the Governmental Accounting Standards Board, as applicable. The financial statements present only the Gas Division and do not purport to, and do not, present fairly the consolidated financial position of Knoxville Utilities Board at June 30, 2015 and 2014, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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

The Division's Management Discussion and Analysis ("MD&A") focuses on the fiscal year ending June 30, 2015 activities, resulting changes and current known facts, and should be read in conjunction with the Division's financial statements.

Gas Division Highlights

System Highlights

KUB's natural gas system serves 98,693 customers, and its service territory covers 282 square miles. KUB maintains 2,301 miles of service mains to provide 12.8 million dekatherms of natural gas to its customers annually.

KUB's gas system service territory experienced its second consecutive colder than normal winter in fiscal year 2015. As a result, natural gas sales were approximately one percent higher than the previous fiscal year. Gas Division margin (operating revenue less purchased gas cost) was \$2.6 million higher in fiscal year 2015, reflecting a modest increase in sales volumes and additional revenue from gas system rate increases which were effective in October 2013 and October 2014, respectively.

The Gas Division experienced a new demand peak in February 2015 of 136,356 dekatherms. The previous natural gas system peak was 133,366 dekatherms in January 2014.

The typical residential gas customer's average monthly gas bill was \$57.15 for the twelve months ending June 30, 2015, representing a decrease of \$0.86 compared to last year based on the same volumes.

KUB issued \$11.8 million in natural gas system revenue refunding bonds in April 2015. This refunding will provide debt service savings of \$1.2 million over the life of the bonds. The Gas Division's high quality credit ratings were affirmed as part of the sale of the refunding bonds.

The natural gas system has added approximately 1,035 customers over the past three years representing annual growth less than 1 percent.

Knoxville Utilities Board Gas Division

Management's Discussion and Analysis

June 30, 2015 and 2014

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.

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

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 the Gas Division. Each gas rate increase will generate an additional \$1.8 million in Gas Division revenue.

KUB replaced 5.8 miles of cast iron/ductile iron gas main during fiscal year 2015. KUB also continued progress on the installation of an approximate 8 mile gas transmission main extending from its gate station in Southwest Knoxville to the University of Tennessee. This project, known as the South Loop, is on track to be completed and in service by October 31, 2015.

Financial Highlights

Fiscal Year 2015 Compared to Fiscal Year 2014

The Division's net position increased \$12.1 million in fiscal year 2015. This increase was \$1.5 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 \$0.1 million during fiscal year 2015. This change resulted in a net increase of \$12 million or 6.9 percent in the Division's net position.

Operating revenue decreased \$3 million or 2.5 percent. A modest increase of approximately one percent in sales volumes was offset by lower wholesale gas costs, which were directly flowed through to KUB's natural gas rates through the purchased gas adjustment mechanism. Purchased gas expense was \$5.6 million or 8.1 percent lower due to reduced natural gas commodity prices. Margin on gas sales (operating revenue less purchased gas expense) increased \$2.6 million or 5.5 percent, reflecting the modest increase in gas sales volumes and additional revenue from the rate increases.

Operating expenses (excluding purchased gas expense) increased \$1.3 million or 3.9 percent. Depreciation expense was \$1.2 million higher than the prior year. Operating and maintenance (O&M) expenses were \$0.2 million less than the prior fiscal year while taxes and tax equivalents increased \$0.3 million.

Wholesale purchased gas expense represented 57 percent of natural gas sales revenue for the fiscal year ended June 30, 2015.

Interest income was consistent with the prior fiscal year. Interest expense decreased \$0.1 million, the result of lower interest costs from the refinancing of certain outstanding bonds in April 2015.

Knoxville Utilities Board Gas Division

Management's Discussion and Analysis

June 30, 2015 and 2014

Total plant assets (net) increased \$26.7 million or 12 percent over the end of the last fiscal year reflecting capital investment associated with the replacement of key gas system assets and other major system projects, including the South Loop.

Long-term debt represented 36.6 percent of the Division's capital structure as of June 30, 2015, as compared to 39.2 percent last year. Capital structure equals long-term debt (which includes the current and long-term portion of revenue bonds and notes) plus net position.

The Division's bond covenants require a debt service coverage ratio of at least 1.2 times the maximum principal and interest payments over the life of the Division's outstanding bonds. Current year debt coverage for the fiscal year was 3.52. Maximum debt service coverage was 3.53.

Fiscal Year 2014 Compared to Fiscal Year 2013

The Division's net position increased \$10.6 million or 6.5 percent, compared to a \$5.4 million increase in fiscal year 2013.

Operating revenue increased \$13.5 million or 13.1 percent, the result of a 4.1 percent increase in sales volumes and revenue from a five percent rate increase effective October 2013. Purchased gas expense was \$6.9 million or 11.1 percent higher due to increased purchases to meet higher demand. Margin on gas sales (operating revenue less purchased gas expense) increased \$6.6 million or 16.1 percent, reflecting the higher level of gas sales volumes and additional revenue from the rate increase.

Operating expenses (excluding purchased gas expense) increased \$0.6 million or 1.9 percent. Depreciation expense was \$0.6 million higher than the prior year. Operating and maintenance (O&M) expenditures and taxes and tax equivalents were each consistent with fiscal year 2013.

Wholesale purchased gas cost represented 59 percent of natural gas system sales revenue for the fiscal year ended June 30, 2014.

Interest income was consistent with the prior fiscal year. Interest expense increased \$1 million compared with the prior year, the net result of additional interest cost from the \$25 million September 2013 bond sale, a full year of interest expense for bonds sold in December 2012 and lower interest expense resulting from bond refundings in 2012 and 2013.

Total plant assets (net) increased \$5.9 million or 2.7 percent due to the replacement and construction of gas mains. KUB replaced 6.6 miles of cast iron/ductile iron gas mains over the course of the fiscal year.

Long-term debt represented 39.2 percent of the Division's capital structure as of June 30, 2014, as compared to 36.1 percent last year. Capital structure equals long-term debt (which includes the current portion of revenue bonds and notes, as applicable, due to be retired next fiscal year) plus net position.

The Division's bond covenants require a debt service coverage ratio of at least 1.2 times the maximum principal and interest payments over the life of the Division's outstanding bonds. Current year debt coverage for the fiscal year was 3.52. Maximum debt service coverage was 3.20.

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Knoxville Utilities Board Gas Division

Management's Discussion and Analysis

June 30, 2015 and 2014

Division Cash Budget Appropriations

KUB's Board of Commissioners adopted a Gas Division budget of \$127.1 million for fiscal year 2015. In April 2015 additional appropriations were approved by the Board in the amount of \$15 million to cover higher than anticipated wholesale gas purchases and increased cost of capital projects. Actual disbursements exceeded the original budget by \$8.5 million, with purchased gas exceeding the original budget by \$3.6 million. Margin (operating receipts less purchased gas expense) was \$6.3 million higher than the budget. O&M and capital expenses exceeded the original budget by a total of \$5.1 million. O&M expense was \$1.1 million under budget, while capital was \$6.3 million greater than budget, reflecting higher than anticipated costs for the South Loop project. The general fund balance was \$3 million more than originally budgeted as a result of higher than anticipated margin, driven primarily by the colder than normal winter weather. The chart below depicts KUB's original budget compared to actual results and is presented on a cash basis.

Gas Division Cash Report As of June 30, 2015

<i>(in thousands of dollars)</i>	FY 2015 Budget**	FY 2015 Actual FYTD	Dollar Variance*	Percent Variance
Beginning Balance General Fund	\$ 44,014	\$ 44,014		
Operating Receipts	107,538	117,396	9,858	9.2%
Disbursements				
Purchased Gas Expense	60,994	64,584	(3,590)	-5.9%
Operation & Maintenance Expense	18,154	17,015	1,139	6.3%
Capital Expenditures	31,476	37,754	(6,278)	-19.9%
Debt Service	9,558	9,516	42	0.4%
Taxes & Tax Equivalents	6,964	6,746	218	3.1%
Total Disbursements	127,146	135,615	(8,469)	-6.7%
Bond Proceeds	-	1,055	1,055	
Net Flow-throughs and Transfers	(1,142)	(587)	555	48.6%
Ending General Fund Balance	\$ 23,264	\$ 26,263	\$ 2,999	12.9%

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

** Excludes additional appropriations of \$15 million

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Knoxville Utilities Board Gas Division

Management's Discussion and Analysis

June 30, 2015 and 2014

Knoxville Utilities Board Gas Division - Financial Statements

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

Statement of Net Position

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

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

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

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

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

Statement of Revenues, Expenses and Changes in Net Position

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

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

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

Statement of Cash Flows

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

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

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

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

Condensed Financial Statements

Statement of Net Position

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

Statements of Net Position
As of June 30

<i>(in thousands of dollars)</i>	2015	2014	2013
Current, restricted and other assets	\$ 63,520	\$ 85,266	\$ 57,553
Capital assets, net	248,032	221,372	215,490
Deferred outflows of resources	1,925	512	584
Total assets and deferred outflows of resources	<u>313,477</u>	<u>307,150</u>	<u>273,627</u>
Current and other liabilities	20,070	22,182	22,372
Long-term debt outstanding	105,919	110,650	87,565
Deferred inflows of resources	1,148	-	-
Total liabilities and deferred inflows of resources	<u>127,137</u>	<u>132,832</u>	<u>109,937</u>
Net position			
Net investment in capital assets	138,973	107,234	121,257
Restricted	1,801	1,725	1,602
Unrestricted	45,566	65,359	40,831
Total net position	<u>\$ 186,340</u>	<u>\$ 174,318</u>	<u>\$ 163,690</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 Gas Division

Management's Discussion and Analysis

June 30, 2015 and 2014

Impacts and Analysis

Current, Restricted and Other Assets

Fiscal Year 2015 Compared to Fiscal Year 2014

Current, restricted and other assets decreased \$21.7 million or 25.5 percent. General fund cash and investments decreased \$17.8 million in order to fund capital expenditures. Operating contingency reserves increased \$1 million. Accounts receivable decreased \$2.3 million compared to June 2014. Gas storage decreased \$0.8 million, reflecting lower commodity prices for natural gas which offset the impact of higher storage volumes.

Fiscal Year 2014 Compared to Fiscal Year 2013

Current, restricted and other assets increased \$27.7 million or 48.2 percent. General fund cash and investments increased \$23.9 million, due to a higher level of gas sales volumes and the use of \$25 million in proceeds from revenue bonds, rather than general fund cash, to fund capital expenditures. Operating contingency reserves increased \$1.3 million. Accounts receivable increased \$0.7 million compared to June 2013. Gas in storage rose \$0.9 million due to a 3.2 percent increase in storage volumes compared to last June, reflecting a timing variance in filling storage reserves.

Capital Assets

Fiscal Year 2015 Compared to Fiscal Year 2014

Capital assets increased \$26.7 million or 12 percent. Major capital expenditures during the year included \$24.2 million for the construction of mains and service extensions and \$6 million for gas main replacement. The Division also retired \$1.8 million of assets during the year.

Fiscal Year 2014 Compared to Fiscal Year 2013

Capital assets increased \$5.9 million or 2.7 percent. Major capital expenditures during the year included \$9.8 million for gas main replacement and \$5.6 million for the construction of mains and service extensions. The Division also retired \$1.6 million of assets during the year.

Deferred Outflows of Resources

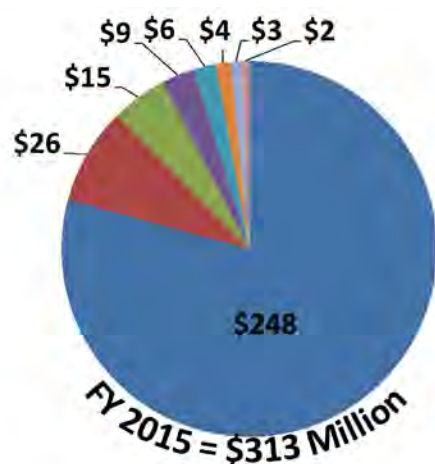
Fiscal Year 2015 Compared to Fiscal Year 2014

Deferred outflows of resources increased \$1.4 million compared to the prior fiscal year. This increase is attributable to a \$0.8 million increase in unamortized bond refunding costs and a \$0.6 million increase in pension outflow. For further explanation, see Notes to the Financial Statements.

Fiscal Year 2014 Compared to Fiscal Year 2013

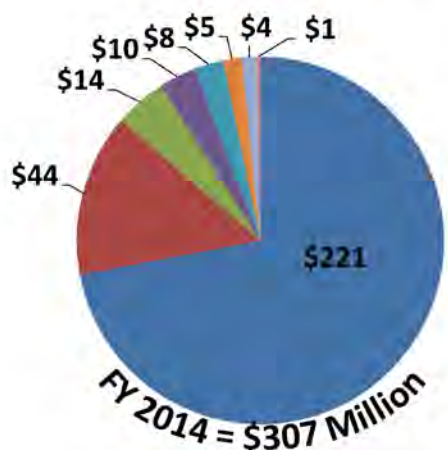
Deferred outflows of resources were consistent with the prior fiscal year.

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



**Gas Division Total Assets and
Deferred Outflows of Resources
(in Millions)**

	<u>FY15</u>	<u>FY14</u>
Plant	79%	72%
General Fund	8%	14%
Contingency Fund	5%	5%
Gas Storage	3%	3%
Accounts Receivable	2%	3%
Other Assets	1%	1%
Restricted Assets	1%	2%
Deferred Outflows of Resources	1%	<1%



Current and Other Liabilities

Fiscal Year 2015 Compared to Fiscal Year 2014

Current and other liabilities decreased \$2.1 million or 9.5 percent. The Division over recovered \$1.1 million in wholesale gas costs from its customers in fiscal year 2015, as compared to \$1.3 million over recovered in fiscal year 2014. This over recovery of costs will be flowed back to KUB's gas customers next fiscal year through adjustments to rates via the Purchased Gas Adjustment (see Notes to the Financial Statements). Accounts payable decreased \$1 million compared to the prior fiscal year. Current payables for bond debt increased \$0.3 million and accrued interest on bonds decreased \$0.1 million.

Fiscal Year 2014 Compared to Fiscal Year 2013

Current and other liabilities decreased \$0.2 million or 0.8 percent, partially due to a \$2.1 million decline in other bond related costs. The Division 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. This over recovery of costs will be flowed back to KUB's gas customers in fiscal year 2015 through adjustments to rates via the Purchased Gas Adjustment. Current payables for bond debt and accrued interest increased \$0.4 million and \$0.3 million, respectively. Accounts payable increased \$0.1 million compared to the fiscal year 2013.

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

Long-Term Debt

Fiscal Year 2015 Compared to Fiscal Year 2014

Long-term debt was \$4.7 million or 4.3 percent lower than the prior year, primarily the result of the scheduled repayment of bond debt during the fiscal year.

Fiscal Year 2014 Compared to Fiscal Year 2013

Long-term debt was \$23.1 million or 26.4 percent higher than the prior year, the net result of \$25 million additional debt and the scheduled repayment of bond debt during the fiscal year.

Deferred Inflows of Resources

Fiscal Year 2015 Compared to Fiscal Year 2014

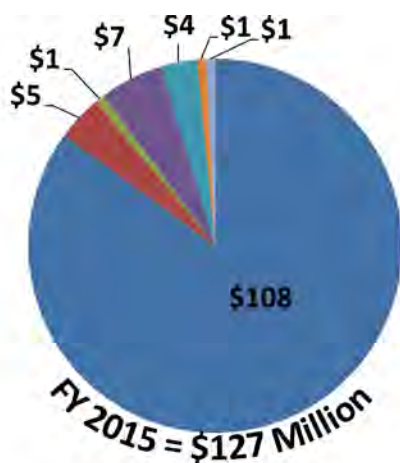
Deferred inflows of resources increased \$1.1 million due to the addition of pension inflow. For further explanation, see Notes to the Financial Statements.

Fiscal Year 2014 Compared to Fiscal Year 2013

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

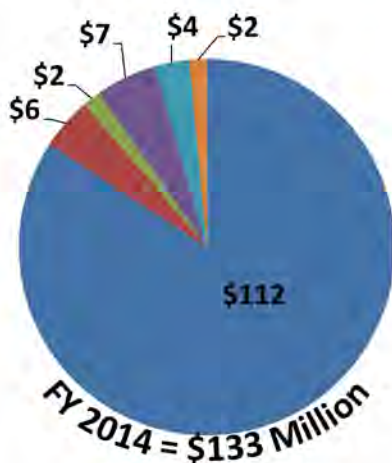
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Knoxville Utilities Board Gas Division
Management's Discussion and Analysis
June 30, 2015 and 2014



**Gas Division Total Liabilities and
Deferred Inflows of Resources
(in Millions)**

	<u>FY15</u>	<u>FY14</u>
Bond Debt	84%	84%
Payables	4%	5%
Misc Current	1%	2%
Other Liabilities	6%	5%
Customer Deposits	3%	3%
Interest Accrued	1%	1%
Deferred Inflows of Resources	1%	-



Net Position

Fiscal Year 2015 Compared to Fiscal Year 2014

Net investment in capital assets, net of debt increased \$31.7 million or 29.6 percent, primarily from an increase in net plant in service of \$26.7 million offset by a decrease of \$4.7 million in long term debt. Restricted net position increased \$0.1 million compared to the prior fiscal year. Unrestricted net position decreased \$19.8 million primarily due to a \$17.8 million decrease in general fund cash compared to June of the prior year.

Fiscal Year 2014 Compared to Fiscal Year 2013

Net investment in capital assets, net of debt decreased \$14 million or 11.6 percent, primarily attributed to an increase of \$23.1 million in long term debt offset by an increase in net plant in service of \$5.9 million. Restricted net position was up \$0.1 million based on the net increase of the bond fund and accrued interest payable. Unrestricted net position increased \$24.5 million primarily due to a \$23.9 million rise in general fund cash compared to June of 2013.

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

Statement of Revenues, Expenses and Changes in Net Position

The following table reflects the condensed Statement of Revenues, Expenses and Changes in Net Position for the Gas Division compared to the prior year 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>	2015	2014	2013
Operating revenues	\$ 114,169	\$ 117,146	\$ 103,597
Less: Purchased gas expense	<u>63,735</u>	<u>69,351</u>	<u>62,415</u>
Margin from sales	<u>50,434</u>	<u>47,795</u>	<u>41,182</u>
Operating expenses			
Distribution	7,922	7,617	7,897
Customer service	2,688	2,626	2,484
Administrative and general	5,843	6,460	6,333
Depreciation	10,895	9,675	9,113
Taxes and tax equivalents	<u>6,657</u>	<u>6,336</u>	<u>6,275</u>
Total operating expenses	<u>34,005</u>	<u>32,714</u>	<u>32,102</u>
Operating income	<u>16,429</u>	<u>15,081</u>	<u>9,080</u>
Interest income	159	144	149
Interest expense	(4,537)	(4,772)	(3,780)
Other income/(expense)	<u>105</u>	<u>175</u>	<u>(80)</u>
Change in net position before capital contributions	<u>12,156</u>	<u>10,628</u>	<u>5,369</u>
Capital contributions	<u>4</u>	<u>-</u>	<u>-</u>
Change in net position	<u>\$ 12,160</u>	<u>\$ 10,628</u>	<u>\$ 5,369</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 natural gas sales for the fiscal year. Any change (increase/decrease) in retail gas rates would also be a cause of change in operating revenue. The Division utilizes a Purchased Gas Adjustment (PGA) mechanism in setting its monthly retail gas rates. Through the PGA, the Division adjusts its retail rates each month based on current wholesale gas prices. If wholesale gas prices increase/decrease, the Division increases/decreases its retail gas rates accordingly.
- Volumes of gas purchased from the Division's wholesale gas suppliers for resale to customers impact purchased gas expense. The Division purchases gas for resale to its customers from a variety of wholesale suppliers. Changes (increase/decrease) in wholesale gas prices would also result in a change in purchased gas expense.
- Operating expenses (distribution, customer service, administrative and general) are normally impacted by changes in areas including, but not limited to, labor costs (staffing, wage rates), active employee and retiree medical costs, and gas distribution system maintenance.
- Depreciation expense is impacted by plant additions and retirements during the fiscal year.

Knoxville Utilities Board Gas Division

Management's Discussion and Analysis

June 30, 2015 and 2014

- Taxes & tax equivalents are impacted by plant additions/retirements, changes in property tax rates, and margin (operating revenue less purchased gas expense) levels.
- Interest income is impacted by the level of interest rates and investments.
- Interest expense on debt is impacted by the level of outstanding debt and the interest rates on the outstanding debt.
- Other income/(expense) is impacted by miscellaneous non-operating revenues and expenses.

Impacts and Analysis

Margin from Sales

Fiscal Year 2015 Compared to Fiscal Year 2014

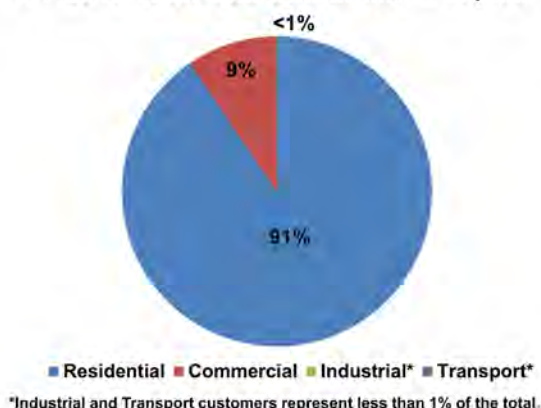
The Division's net position increased \$12.1 million. This increase was \$1.5 million greater than the prior year's change in net position. A restatement to the prior fiscal year's net position based on a change in method of accounting for the pension reduced the total net position by \$0.1 million during fiscal year 2015. This change resulted in a net increase of \$12 million or 6.9 percent in the Division's net position.

Higher earnings were primarily attributable to increased margin on gas sales. Margin on gas sales (operating revenue less purchased gas expense) increased \$2.6 million or 5.5 percent due to a 0.7 percent increase in billed sales volumes as well as revenue from rate increases that were effective October 2013 and October 2014.

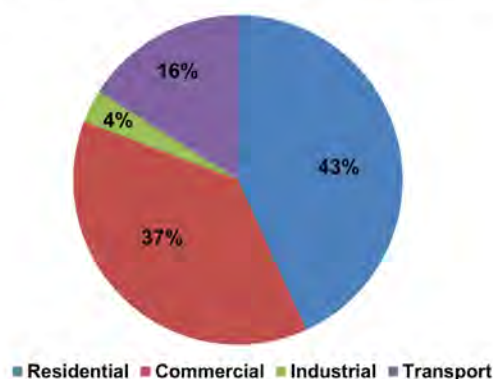
Operating revenue decreased \$3 million or 2.5 percent for the fiscal year ending June 30, 2015, the net result of lower purchased gas commodity prices flowed through to customer rates and additional revenue from the rate increases.

Purchased gas expense decreased \$5.6 million or 8.1 percent, due to reduced commodity prices for natural gas during the fiscal year. KUB purchased 2.3 percent more gas from its suppliers during the fiscal year to meet a modest increase in customer demand and maintain gas storage levels. The net result was a 0.9 percent increase in total volumes delivered to KUB's gas distribution system. The Division's weighted average cost of gas purchased for fiscal year 2015 was \$3.62 per dekatherm, as compared to \$4.08 per dekatherm last year.

FY 2015 Total Gas Customers = 98,693



FY 2015 Gas Sales = 125 million Therms



Knoxville Utilities Board Gas Division

Management's Discussion and Analysis

June 30, 2015 and 2014

Residential customers, whose natural gas is primarily used as a heat source during winter months, accounted for 91 percent of customers billed and 43 percent of total volumes sold during the year.

Commercial and industrial sales volumes (including transportation customers) increased 2.9 percent. KUB's ten largest gas customers accounted for 23.3 percent of KUB's billed gas volumes. Those ten customers represent five industrial and five commercial customers, including one governmental customer. KUB also has 14 transport customers who purchase gas directly from a supplier other than KUB. KUB provides transportation service on its gas distribution system to those customers.

Fiscal Year 2014 Compared to Fiscal Year 2013

The Division's net position increased \$10.6 million. This increase was \$5.3 million greater than the prior year's change in net position. The growth in net position reflected the increase in margin on sales.

Margin on gas sales (operating revenue less purchased gas expense) increased \$6.6 million or 16.1 percent due to a 4.2 percent increase in billed sales volumes. The increased sales volume resulted from a colder winter than the previous fiscal year. In addition, a five percent rate increase was effective during the last three quarters of fiscal year 2014.

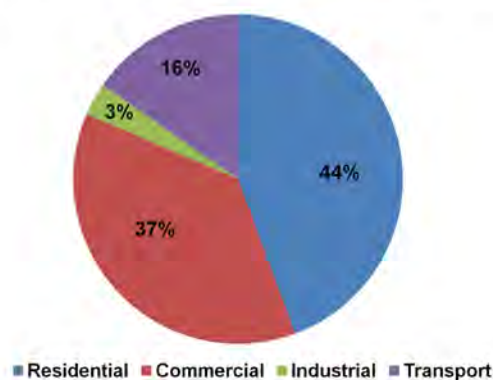
Operating revenue increased \$13.5 million or 13.1 percent for the fiscal year ending June 30, 2014, the result of higher sales volumes and additional revenue from the rate increase.

Purchased gas expense increased \$6.9 million or 11.1 percent, due to higher customer demand associated with the colder winter. KUB purchased 20.4 percent more gas from its suppliers during the fiscal year to meet increased customer demand and maintain gas storage levels. The net result was a 2 million dekatherm or 16.9 percent increase in total volumes delivered to KUB's gas distribution system. The Division's weighted average cost of gas purchased for fiscal year 2014 was \$4.08 per dekatherm, as compared to \$3.61 per dekatherm last year.

FY 2014 Total Gas Customers = 97,930



FY 2014 Gas Sales = 125 million Therms



Residential customers, whose natural gas is primarily used as a heating source during winter months, accounted for 91 percent of customers billed and 44 percent of total volumes sold during the year. Sales throughout the winter heating season of fiscal year 2014 were significantly higher than fiscal year 2013, resulting in an increase in residential sales volumes of 9.6 percent.

Commercial and industrial sales volumes (including transportation customers) were consistent with the prior year. KUB's ten largest gas customers accounted for 21.9 percent of KUB's billed gas volumes. Those ten customers represent five industrial and five commercial customers, including one governmental

Knoxville Utilities Board Gas Division

Management's Discussion and Analysis

June 30, 2015 and 2014

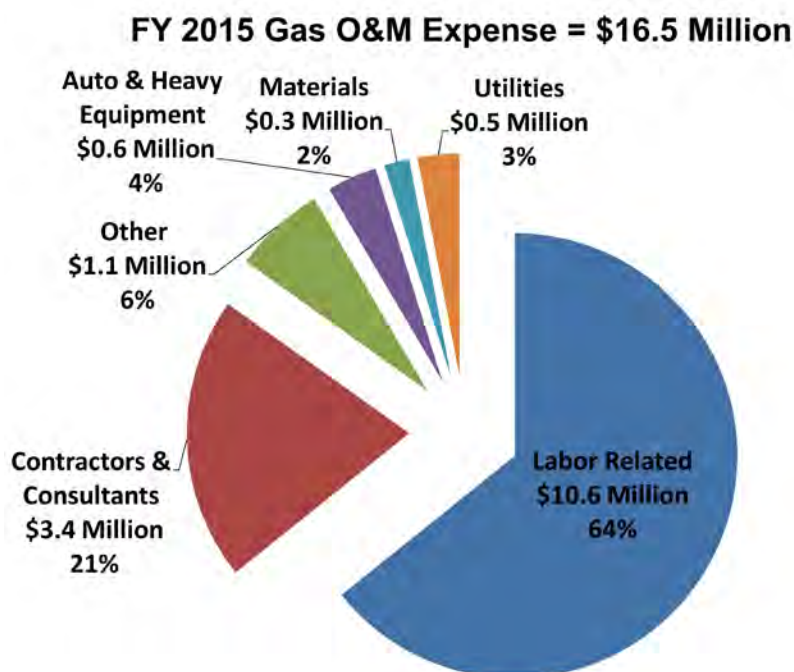
customer. KUB also has 14 transport customers who purchase gas directly from a supplier other than KUB. KUB provides transportation service on its gas distribution system to those customers.

Operating Expenses

Fiscal Year 2015 Compared to Fiscal Year 2014

Operating expenses (excluding purchased gas expense) increased \$1.3 million or 3.9 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 distribution, customer service and administrative and general.

- Distribution system operating and maintenance expenses were \$0.3 million higher than the prior fiscal year, due to an increase in labor related expenses.
- Customer service expenses increased \$0.1 million compared to last fiscal year.
- Administrative and general expenses decreased \$0.6 million or 9.6 percent primarily due to a decrease in pension expense.



- Depreciation expense was \$1.2 million higher than the prior year, the result of a full year of depreciation for \$23.4 million of assets added to plant in service in fiscal year 2014 and a partial year of depreciation for \$17.6 million of assets added to plant in service in fiscal year 2015. In addition, \$1.8 million in assets were retired during the fiscal year.
- Taxes and tax equivalents were \$0.3 million higher than the prior fiscal year due to an increase in tax equivalent payments to the City of Knoxville, Knox County, and other taxing jurisdictions. The City of Knoxville's property tax rate increased this year and higher plant in service levels contributed to the growth in tax equivalent payments.

Knoxville Utilities Board Gas Division

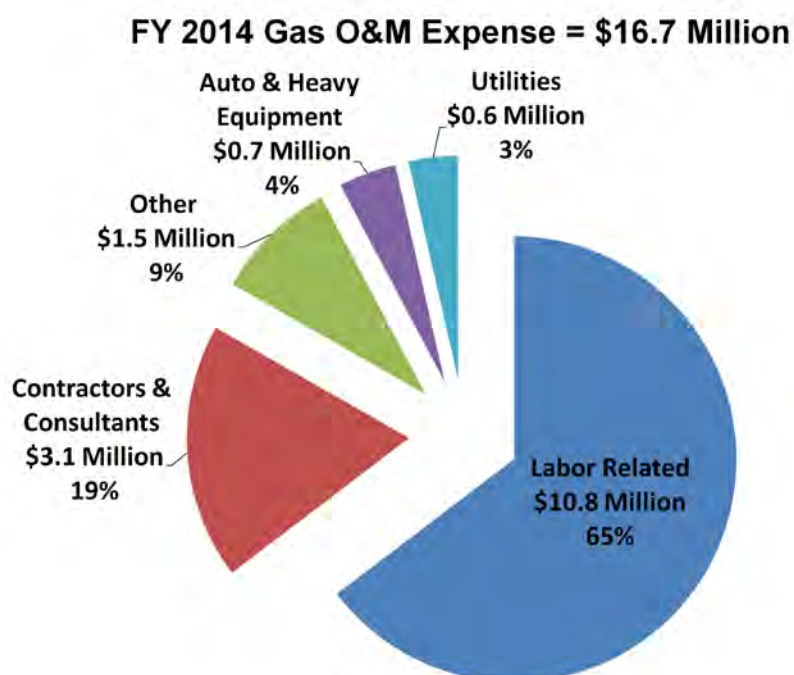
Management's Discussion and Analysis

June 30, 2015 and 2014

Fiscal Year 2014 Compared to Fiscal Year 2013

Operating expenses (excluding purchased gas expense) increased \$0.6 million or 1.9 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 distribution, customer service and administrative and general.

- Distribution system operating and maintenance expenses were \$0.3 million lower than the prior fiscal year, due to a decline in outside consultant expenses.
- Customer service expenses increased \$0.1 million compared to last fiscal year.
- Administrative and general expenses increased \$0.1 million or 2 percent.

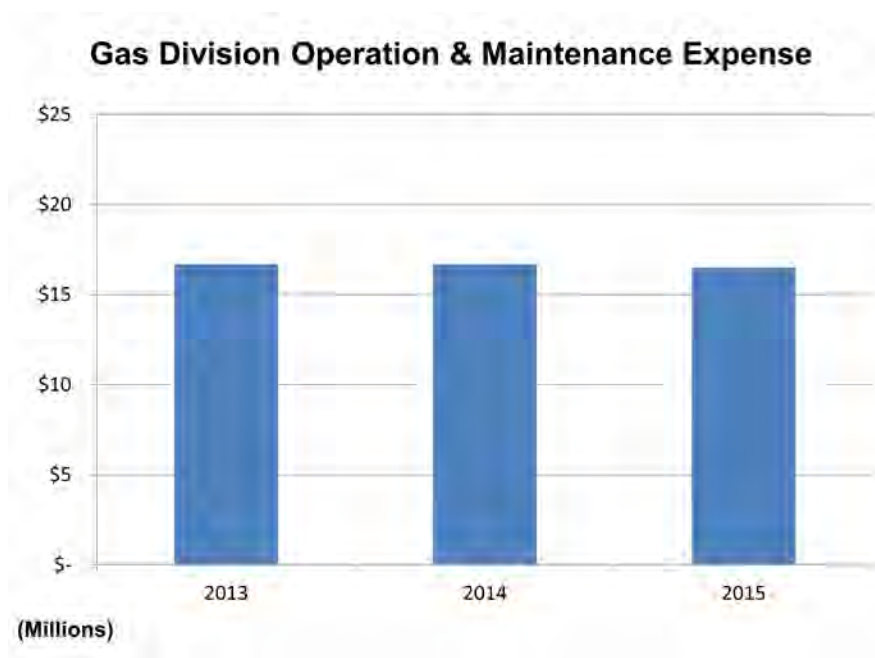


- Depreciation expense was \$0.6 million higher than the prior year, the result of a full year of depreciation for \$17.4 million of assets added to plant in service in fiscal year 2013 and a partial year of depreciation for \$23.4 million of assets added to plant in service in fiscal year 2014. In addition, \$1.6 million of assets were retired during the fiscal year.
- Taxes and tax equivalents were consistent with the prior fiscal year.

Knoxville Utilities Board Gas Division

Management's Discussion and Analysis

June 30, 2015 and 2014



Other Income and Expense

Fiscal Year 2015 Compared to Fiscal Year 2014

Contributions in aid of construction decreased \$3.9 million. This was due to a \$3.9 million contribution from the University of Tennessee during fiscal year 2014, representing a portion of the University's contribution for the South Loop project.

Interest income was consistent with the prior fiscal year.

Interest expense decreased \$0.1 million compared with the prior year, reflecting interest savings from the bond refunding in April 2015 in addition to previous bond refundings.

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

Fiscal Year 2014 Compared to Fiscal Year 2013

Contributions in aid of construction increased \$2.9 million in fiscal year 2014. 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.

Interest income was consistent with the prior fiscal year.

Interest expense increased \$1 million over fiscal year 2013, the net result of additional interest from a \$25 million September 2013 bond issue, a full year of interest expense for bonds sold in December 2012 and lower interest expense resulting from bond refundings in 2012 and 2013.

Other income (net) was \$0.2 million higher than the prior fiscal year.

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

Capital Assets

Capital Assets
As of June 30
(Net of Depreciation)

<i>(in thousands of dollars)</i>	2015	2014	2013
Distribution Plant			
Mains	\$ 149,720	\$ 144,218	\$ 131,533
Services and Meters/Regulators	52,580	50,238	48,911
Other	766	901	940
Total Distribution Plant	<u>203,066</u>	<u>195,357</u>	<u>181,384</u>
Total General Plant	<u>7,688</u>	<u>8,551</u>	<u>8,718</u>
Total Plant Assets	<u>210,754</u>	<u>203,908</u>	<u>190,102</u>
Work In Progress	37,278	17,464	25,388
Total Net Plant	<u><u>\$ 248,032</u></u>	<u><u>\$ 221,372</u></u>	<u><u>\$ 215,490</u></u>

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Knoxville Utilities Board Gas Division

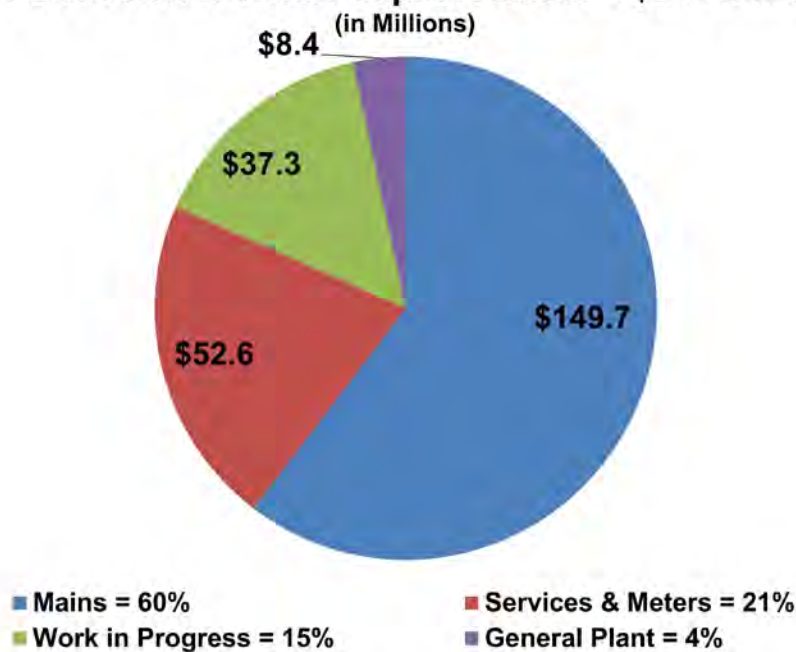
Management's Discussion and Analysis

June 30, 2015 and 2014

Fiscal Year 2015 Compared to Fiscal Year 2014

As of June 30, 2015, the Division had \$248 million invested in a variety of capital assets, as reflected in the schedule of capital assets, which represents a net increase (including additions, retirements, and depreciation) of \$26.7 million or 12 percent over the end of last fiscal year.

FY 2015 Gas Division Capital Assets = \$248 Million



Major capital asset expenditures during the year were as follows:

- \$24.2 million for installation of new main and service extensions
- \$6 million for main replacement
- \$1.5 million for information systems upgrades

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Knoxville Utilities Board Gas Division

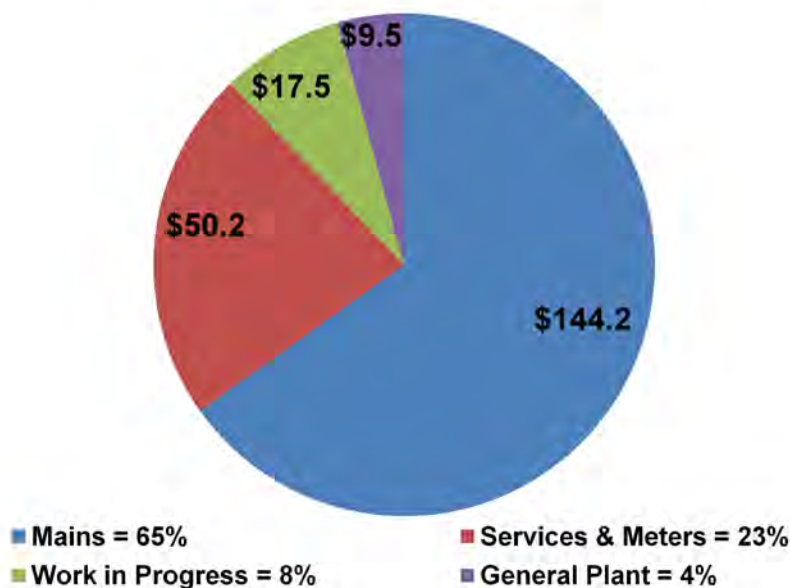
Management's Discussion and Analysis

June 30, 2015 and 2014

Fiscal Year 2014 Compared to Fiscal Year 2013

As of June 30, 2014, the Division had \$221.4 million invested in a variety of capital assets, as reflected in the schedule of capital assets, which represents a net increase (including additions, retirements, and depreciation) of \$5.9 million or 2.7 percent over the end of last fiscal year.

FY 2014 Gas Division Capital Assets = \$221.4 Million (in Millions)



Major capital asset expenditures during the year were as follows:

- \$9.8 million for main replacement
- \$5.6 million for installation of new main and service extensions

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Knoxville Utilities Board Gas Division

Management's Discussion and Analysis

June 30, 2015 and 2014

Debt Administration

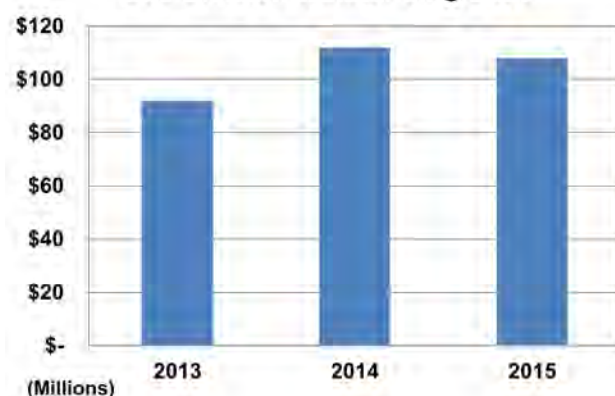
As of June 30, 2015 KUB had \$107.5 million in outstanding gas system bonds. The Gas Division's level of debt peaked in fiscal year 2014 at \$112.4 million. The bonds are secured solely by revenues of the Gas Division. Debt as a percentage of the Division's capital structure represented 36.6 percent in 2015, 39.2 percent in 2014, and 36.1 percent at the end of fiscal year 2013. KUB's Debt Management Policy limits the Division's debt ratio to 60 percent or less.

Outstanding Debt As of June 30

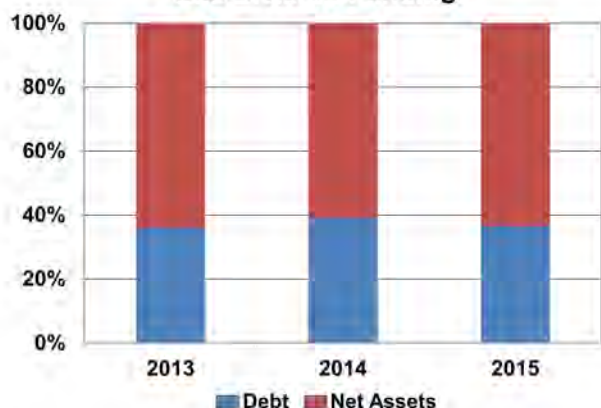
(in thousands of dollars)

	2015	2014	2013
Revenue bonds	\$ 107,545	\$ 112,365	\$ 92,350
Total outstanding debt	\$ <u>107,545</u>	\$ <u>112,365</u>	\$ <u>92,350</u>

Gas Division Outstanding Debt



Gas Division Funding



The Division will pay \$60.8 million in principal payments over the next ten years, representing 56.6 percent of the outstanding bonds. KUB's Debt Management Policy requires a minimum of 30 percent of gas debt principal be repaid over the next ten years.

Fiscal Year 2015 Compared to Fiscal Year 2014

As of June 30, 2015, the Division had \$107.5 million in outstanding debt (including current portions of revenue bonds), compared to \$112.4 million last year, representing a decrease of \$4.9 million or 4.3 percent. The Division's weighted average cost of debt as of June 30, 2015 was 3.86 percent.

In April 2015, the Division issued \$11.8 million in gas system revenue refunding bonds to refinance certain outstanding bonds at lower interest rates. The refunding of certain bonds at lower interest rates will provide debt service savings of \$1.2 million over the life of the bonds.

The Division's outstanding debt is rated by Standard & Poor's and Moody's Investors Service. As of June 30, 2015, the Division's revenue bonds were rated AA by Standard & Poor's and Aa2 by Moody's Investors Service.

Knoxville Utilities Board Gas Division

Management's Discussion and Analysis

June 30, 2015 and 2014

Fiscal Year 2014 Compared to Fiscal Year 2013

As of June 30, 2014, the Division had \$112.4 million in outstanding debt (including current portions of revenue bonds), compared to \$92.4 million at June 30, 2013, representing an increase of \$20 million or 21.7 percent. The Division's weighted average cost of debt as of June 30, 2014 was 3.9 percent.

In September 2013, the Division sold \$25 million in gas system revenue bonds to fund capital system improvements.

The Division's outstanding debt is rated by Standard & Poor's and Moody's Investors Service. As of June 30, 2014, the Division's revenue bonds were rated AA by Standard & Poor's and Aa2 by Moody's Investors Service.

Impacts on Future Financial Position

KUB expects to add 750 new gas customers during the course of the next fiscal year.

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 first of three rate increases was effective October 2014. 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 system revenue.

This fiscal year KUB concluded the smart grid pilot project, of which a portion of the project was funded by the 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 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, of which the Division's share is \$9 million. 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 long-term debt includes \$12 million of Gas Division 2010 Build America Bonds (BABs) in which the U.S. Treasury provides a rebate to KUB for a portion of the interest. The interest rebates were subject to federal sequestration during the fiscal year and were reduced by 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 by 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.

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

No other facts, decisions, or conditions are currently known which would have a significant impact on the Division's financial position or results of operations during fiscal year 2015.

Financial Contact

The Division's financial statements are designed to present users (citizens, customers, investors, and creditors) with a general overview of the Division's financial position and results of operations for the fiscal years ending June 30, 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 Gas Division
Statements of Net Position
June 30, 2015 and 2014

	2015	2014
Assets and Deferred Outflows of Resources		
Current assets:		
Cash and cash equivalents	\$ 26,262,919	\$ 44,014,211
Short-term contingency fund investments	2,950,146	6,711,417
Other current assets	375,832	731,670
Accrued interest receivable	1,108	2,020
Accounts receivable, less allowance of uncollectible accounts of \$34,907 in 2015 and \$37,851 in 2014	5,930,278	8,245,324
Inventories	465,596	375,458
Gas storage	9,447,403	10,281,088
Prepaid expenses	55,502	419,558
Total current assets	<u>45,488,784</u>	<u>70,780,746</u>
Restricted assets:		
Gas bond fund	3,111,502	3,180,894
Other funds	7,901	8,336
Unused bond proceeds	-	1,055,410
Total restricted assets	<u>3,119,403</u>	<u>4,244,640</u>
Gas plant in service	324,150,132	308,375,915
Less accumulated depreciation	<u>(113,395,656)</u>	<u>(104,468,506)</u>
	210,754,476	203,907,409
Retirement in progress	89,960	200,850
Construction in progress	37,187,771	17,263,291
Net plant in service	<u>248,032,207</u>	<u>221,371,550</u>
Other assets:		
Net pension asset	1,083,893	-
Long-term contingency fund investments	12,186,218	7,419,619
Other	1,641,273	2,820,678
Total other assets	<u>14,911,384</u>	<u>10,240,297</u>
Total assets	<u>311,551,778</u>	<u>306,637,233</u>
Deferred outflows of resources:		
Pension outflow	568,296	-
Unamortized bond refunding costs	1,357,050	511,898
Total deferred outflows of resources	<u>1,925,346</u>	<u>511,898</u>
Total assets and deferred outflows of resources	<u>\$ 313,477,124</u>	<u>\$ 307,149,131</u>

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

Knoxville Utilities Board Gas Division
Statements of Net Position
June 30, 2015 and 2014

	2015	2014
Liabilities, Deferred Inflows, and Net Position		
Current liabilities:		
Current portion of revenue bonds	\$ 5,420,000	\$ 5,150,000
Sales tax collections payable	74,674	83,660
Accounts payable	5,321,481	6,296,865
Accrued expenses	1,005,599	2,376,263
Customer deposits plus accrued interest	3,576,615	3,456,133
Accrued interest on revenue bonds	1,318,069	1,464,127
Total current liabilities	<u>16,716,438</u>	<u>18,827,048</u>
Other liabilities:		
Accrued compensated absences	1,507,803	1,521,736
Customer advances for construction	718,096	539,984
Over recovered purchased gas costs	1,063,761	1,278,144
Other	63,182	15,123
Total other liabilities	<u>3,352,842</u>	<u>3,354,987</u>
Long-term debt:		
Gas revenue bonds	102,125,000	107,215,000
Unamortized premiums/discounts	3,794,404	3,434,514
Total long-term debt	<u>105,919,404</u>	<u>110,649,514</u>
Total liabilities	<u>125,988,684</u>	<u>132,831,549</u>
Deferred inflows of resources:		
Pension inflow	1,148,096	-
Total deferred inflows of resources	<u>1,148,096</u>	<u>-</u>
Total liabilities and deferred inflows of resources	<u>127,136,780</u>	<u>132,831,549</u>
Net position		
Net investment in capital assets	138,973,111	107,234,408
Restricted for:		
Debt service	1,793,433	1,716,767
Other	7,901	8,336
Unrestricted	45,565,899	65,358,071
Total net position	<u>186,340,344</u>	<u>174,317,582</u>
Total liabilities, deferred inflows, and net position	<u>\$ 313,477,124</u>	<u>\$ 307,149,131</u>

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

Knoxville Utilities Board Gas Division
Statements of Revenues, Expenses and Changes in Net Position
Years Ended June 30, 2015 and 2014

	2015	2014
Operating revenues	\$ 114,168,784	\$ 117,145,734
Operating expenses		
Purchased gas	63,735,433	69,351,087
Distribution	7,922,463	7,617,334
Customer service	2,687,961	2,626,258
Administrative and general	5,842,471	6,459,558
Provision for depreciation	10,894,826	9,674,685
Taxes and tax equivalents	6,657,038	6,336,412
Total operating expenses	<u>97,740,192</u>	<u>102,065,334</u>
Operating income	<u>16,428,592</u>	<u>15,080,400</u>
Non-operating revenues (expenses)		
Contributions in aid of construction	450,281	4,381,057
Interest and dividend income	158,779	143,753
Interest expense	(4,642,526)	(4,771,622)
Amortization of debt costs	106,159	97,613
Write-down of plant for costs recovered through contributions	(450,281)	(4,381,057)
Other	104,921	77,656
Total non-operating revenues (expenses)	<u>(4,272,667)</u>	<u>(4,452,600)</u>
Change in net position before capital contributions	12,155,925	10,627,800
Capital contributions	4,353	-
Change in net position	12,160,278	10,627,800
Net position, beginning of year, as previously reported	174,317,582	163,689,782
Change in method of accounting for pension	(137,516)	-
Net position, beginning of year, as restated	<u>174,180,066</u>	<u>163,689,782</u>
Net position, end of year	<u>\$ 186,340,344</u>	<u>\$ 174,317,582</u>

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

Knoxville Utilities Board Gas Division

Statements of Cash Flows

June 30, 2015 and 2014

	2015	2014
Cash flows from operating activities:		
Cash receipts from customers	\$ 115,921,501	\$ 116,038,078
Cash (payments to) receipts from other operations	1,047,805	1,160,789
Cash payments to suppliers of goods or services	(73,855,383)	(76,930,255)
Cash payments to employees for services	(8,047,999)	(8,269,996)
Payment in lieu of taxes	(6,081,256)	(5,761,856)
Net cash provided by operating activities	<u>28,984,668</u>	<u>26,236,760</u>
Cash flows from capital and related financing activities:		
Net proceeds from bond issuance	-	24,755,243
Principal paid on revenue bonds and notes payable	(5,150,000)	(4,985,000)
(Increase) decrease in unused bond proceeds	1,055,410	(1,055,410)
Interest paid on revenue bonds and notes payable	(4,435,230)	(3,926,186)
Acquisition and construction of gas plant	(38,191,918)	(20,235,230)
Changes in gas bond fund, restricted	69,391	(432,651)
Customer advances for construction	178,113	231,897
Proceeds received on disposal of plant	-	125,000
Cash received from developers and individuals for capital purposes	450,281	4,381,057
Net cash used in capital and related financing activities	<u>(46,023,953)</u>	<u>(1,141,280)</u>
Cash flows from investing activities:		
Changes in deposit and investment accounts:		
Purchase of investment securities	(3,282,494)	(1,383,364)
Maturities of investment securities	2,277,167	88,058
Interest received	159,691	142,972
Other property and investments	133,629	(31,856)
Net cash provided by (used in) investing activities	<u>(712,007)</u>	<u>(1,184,190)</u>
Net increase (decrease) in cash and cash equivalents	(17,751,292)	23,911,290
Cash and cash equivalents, beginning of year	<u>44,014,211</u>	<u>20,102,921</u>
Cash and cash equivalents, end of year	<u>\$ 26,262,919</u>	<u>\$ 44,014,211</u>
Reconciliation of operating income to net cash provided by operating activities		
Operating income	\$ 16,428,592	\$ 15,080,400
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization expenses	11,083,056	9,956,968
Changes in operating assets and liabilities:		
Accounts receivable	2,315,045	(724,751)
Inventories	(90,138)	(48,392)
Prepaid expenses	844,387	(947,273)
Other assets	(145,258)	558,339
Sales tax collections payable	(8,986)	9,840
Accounts payable and accrued expenses	(1,396,187)	182,631
Overrecovered gas costs	(214,383)	2,119,923
Customer deposits plus accrued interest	120,482	112,347
Other liabilities	48,058	(63,272)
Net cash provided by operating activities	<u>\$ 28,984,668</u>	<u>\$ 26,236,760</u>
Noncash capital activities:		
Acquisition of plant assets through developer contributions	\$ 4,353	\$ -

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

Knoxville Utilities Board Gas Division

Notes to Financial Statements

June 30, 2015 and 2014

1. Description of Business

Knoxville Utilities Board (KUB), comprised of 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. The Gas Division (Division) provides services to certain customers in Knox County and in two surrounding counties in East Tennessee. The Division's accounts are maintained in conformity with the Uniform System of Accounts of the Federal Energy Regulatory Commission (FERC) and the Governmental Accounting Standards Board (GASB), as applicable. The financial statements present only the Gas Division and do not purport to, and do not, present fairly the consolidated financial position of Knoxville Utilities Board at June 30, 2015 and 2014, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

2. Significant Accounting Policies

Basis of Accounting

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 financial statements are prepared on the accrual basis of accounting, whereby revenues are recognized when earned and expenses are recognized when incurred. The accounting and financial reporting treatment applied to the Division is determined by measurement focus. The transactions of the Division are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operations are included on the Statement of Net Position. Net position (i.e., total assets and deferred outflows of resources net of total liabilities and deferred inflows of resources) 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

Knoxville Utilities Board Gas Division

Notes to Financial Statements

June 30, 2015 and 2014

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.

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.

Gas Plant

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

The provision for depreciation of gas plant in service is based on the estimated useful lives of the assets, which range from three to thirty-three years, and is computed using the straight-line method. Pursuant to FERC, the caption "Provision for depreciation" in the Statements of Revenues, Expenses and Changes in Net Position does not include depreciation for transportation equipment of \$188,229 in fiscal year 2015 and \$282,282 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 the KUB Gas Division. Operating revenue is recorded when the service is rendered, on a cycle basis, and includes an estimate of unbilled revenue. Revenues are reported net of bad debt expense of \$134,460 in fiscal year 2015 and \$88,807 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 net assets available, it is KUB's policy to apply those expenses to restricted net assets to the extent such are available and then to unrestricted net assets.

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 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

Knoxville Utilities Board Gas Division

Notes to Financial Statements

June 30, 2015 and 2014

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 (Division's share \$137,516) to increase the net pension liability by \$3,515,317 (Division's share \$632,757) based on revised actuarial assumptions to conform with GASB 68 and to reclassify 2014 expenses of \$2,751,341 (Division's share \$495,241) 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 prior twelve months. Therefore, KUB's measurements as of June 30, 2015 are based on December 31, 2014 measurement date.

Knoxville Utilities Board Gas Division

Notes to Financial Statements

June 30, 2015 and 2014

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 Gas Division

Notes to Financial Statements

June 30, 2015 and 2014

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.

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 fiscal year 2014 balances to conform to fiscal year 2015 presentation.

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.

Knoxville Utilities Board Gas Division

Notes to Financial Statements

June 30, 2015 and 2014

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.

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.

Knoxville Utilities Board Gas Division

Notes to Financial Statements

June 30, 2015 and 2014

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.

Classification of deposits and investments per Statement of Net Position:

	2015	2014
Current assets		
Cash and cash equivalents	\$ 26,262,919	\$ 44,014,211
Short-term contingency fund investments	2,950,146	6,711,417
Other assets		
Long-term contingency fund investments	12,150,457	7,369,579
Restricted assets		
Unused bond proceeds	-	1,055,410
Gas bond fund	3,111,502	3,180,894
Other funds	7,901	8,336
	<u>\$ 44,482,925</u>	<u>\$ 62,339,847</u>

The above amounts do not include accrued interest of \$35,761 in fiscal year 2015 and \$50,040 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:

Deposit and Investment Maturities (in Years)			
	Fair Value	Less Than 1	1-5
Supersweep NOW and Other Deposits	\$ 27,850,243	\$ 27,850,243	\$ -
State Treasurer's Investment Pool	2,362,668	2,362,668	-
Agency Bonds	12,551,528	847,946	11,703,582
Certificates of Deposits	3,297,909	2,851,034	446,875
	<u>\$ 46,062,348</u>	<u>\$ 33,911,891</u>	<u>\$ 12,150,457</u>

4. Accounts Receivable

Accounts receivable consists of the following:

	2015	2014
Wholesale and retail customers		
Billed services	\$ 4,610,243	\$ 6,483,622
Unbilled services	1,121,876	1,446,920
Other	233,066	352,633
Allowance for uncollectible accounts	(34,907)	(37,851)
	<u>\$ 5,930,278</u>	<u>\$ 8,245,324</u>

Knoxville Utilities Board Gas Division
Notes to Financial Statements
June 30, 2015 and 2014

5. Accounts Payable and Accruals

Accounts payable and accruals were composed of the following:

	2015	2014
Trade accounts	\$ 5,321,481	\$ 6,296,865
Salaries and wages	219,134	184,428
Self-insurance liabilities	306,714	298,833
Other current liabilities	479,751	1,893,002
	<u>\$ 6,327,080</u>	<u>\$ 8,673,128</u>

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
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	<u>\$ 112,365,000</u>	<u>\$ 11,780,000</u>	<u>\$ 5,150,000</u>	<u>\$ 11,450,000</u>	<u>\$ 107,545,000</u>	<u>\$ 5,420,000</u>
Unamortized Premium	3,434,514	701,501	296,934	44,677	3,794,404	-
Total long term debt	<u>\$ 115,799,514</u>	<u>\$ 12,481,501</u>	<u>\$ 5,446,934</u>	<u>\$ 11,494,677</u>	<u>\$ 111,339,404</u>	<u>\$ 5,420,000</u>

	Balance June 30, 2013	Additions	Payments	Defeased	Balance June 30, 2014	Amounts Due Within One Year
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>

Knoxville Utilities Board Gas Division

Notes to Financial Statements

June 30, 2015 and 2014

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

Fiscal Year	Principal	Total Interest	Grand Total
2016	\$ 5,420,000	\$ 4,087,418	\$ 9,507,418
2017	5,450,000	3,987,262	9,437,262
2018	5,590,000	3,793,753	9,383,753
2019	5,780,000	3,599,143	9,379,143
2020	5,985,000	3,390,981	9,375,981
2021 - 2025	32,595,000	13,082,694	45,677,694
2026 - 2030	30,415,000	6,934,301	37,349,301
2031 - 2035	16,310,000	1,781,350	18,091,350
Total	\$ 107,545,000	\$ 40,656,902	\$ 148,201,902

The Division has pledged sufficient revenue, after deduction of all current operating expenses (exclusive of tax equivalents), to meet bond principal and interest payments when due. The requirements for the bonds are being met through monthly deposits to the Gas Bond Fund, as required by the bond covenants. As of June 30, 2015, these bond covenant requirements had been satisfied.

During fiscal year 2006, KUB's Gas Division issued Series L 2005 bonds to retire certain existing debt and fund gas system capital improvements. Concurrent with the issuance of these bonds, KUB transferred funds to an irrevocable trust to pay a portion of the Series J 2001 bonds, as such amounts mature.

During fiscal year 2008, KUB's Gas Division issued Series N 2007 bonds to fund gas system capital improvements.

During fiscal year 2010, KUB's Gas Division issued Series O 2010 bonds to retire Series I 2001 bonds.

During fiscal year 2011, KUB's Gas Division issued Series P 2010 bonds to fund gas system capital improvements. These bonds were issued as federally taxable Build America Bonds with a 35 percent interest payment rebate to be received from the United States Government for each interest payment. Effective 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 a portion of 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

Knoxville Utilities Board Gas Division

Notes to Financial Statements

June 30, 2015 and 2014

(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.

Other liabilities consist of the following:

	Balance June 30, 2014	Increase	Decrease	Balance June 30, 2015
Accrued compensated absences	\$ 1,521,736	\$ 2,451,707	\$ (2,465,640)	\$ 1,507,803
Customer advances for construction	539,984	364,358	(186,246)	718,096
Other	15,123	112,622	(64,563)	63,182
	<u>\$ 2,076,843</u>	<u>\$ 2,928,687</u>	<u>\$ (2,716,449)</u>	<u>\$ 2,289,081</u>

7. Lease Commitments

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

2016	\$ 7,796
2017	4,667
2018	2,202
2019	1,474
2020	<u>1,474</u>
Total operating minimum lease payments	<u>\$ 17,613</u>

Knoxville Utilities Board Gas Division
Notes to Financial Statements
June 30, 2015 and 2014

8. Capital Assets

Capital asset activity was as follows:

	Beginning 6/30/2014	Increase	Decrease	Ending 6/30/2015
Production Plant	\$ 14,640	\$ -	\$ -	\$ 14,640
Distribution Plant				
Mains	203,808,024	11,750,358	(323,741)	215,234,641
Services and Meters/Regulators	79,129,896	4,351,598	(1,084,445)	82,397,049
Other	1,493,396	2,585	(165,076)	1,330,905
Total Distribution Plant	<u>\$ 284,431,316</u>	<u>\$ 16,104,541</u>	<u>\$ (1,573,262)</u>	<u>\$ 298,962,595</u>
Total General Plant	<u>23,929,959</u>	<u>1,450,671</u>	<u>(207,733)</u>	<u>25,172,897</u>
Total Plant Assets	<u>\$ 308,375,915</u>	<u>\$ 17,555,212</u>	<u>\$ (1,780,995)</u>	<u>\$ 324,150,132</u>
Less Accumulated Depreciation	<u>(104,468,506)</u>	<u>(11,064,683)</u>	<u>2,137,533</u>	<u>(113,395,656)</u>
Net Plant Assets	<u>\$ 203,907,409</u>	<u>\$ 6,490,529</u>	<u>\$ 356,538</u>	<u>\$ 210,754,476</u>
Work In Progress	<u>17,464,141</u>	<u>36,852,089</u>	<u>(17,038,499)</u>	<u>37,277,731</u>
Total Net Plant	<u><u>\$ 221,371,550</u></u>	<u><u>\$ 43,342,618</u></u>	<u><u>\$ (16,681,961)</u></u>	<u><u>\$ 248,032,207</u></u>

	Beginning 6/30/2013	Increase	Decrease	Ending 6/30/2014
Production Plant	\$ 14,640	\$ -	\$ -	\$ 14,640
Distribution Plant				
Mains	186,488,818	18,158,365	(839,159)	203,808,024
Services and Meters/Regulators	76,004,168	3,621,018	(495,290)	79,129,896
Other Accounts	1,493,418	24,982	(25,004)	1,493,396
Total Distribution Plant	<u>\$ 263,986,404</u>	<u>\$ 21,804,365</u>	<u>\$ (1,359,453)</u>	<u>\$ 284,431,316</u>
Total General Plant	<u>22,600,192</u>	<u>1,618,598</u>	<u>(288,831)</u>	<u>23,929,959</u>
Total Plant Assets	<u>\$ 286,601,236</u>	<u>\$ 23,422,963</u>	<u>\$ (1,648,284)</u>	<u>\$ 308,375,915</u>
Less Accumulated Depreciation	<u>(96,499,232)</u>	<u>(9,564,636)</u>	<u>1,595,362</u>	<u>(104,468,506)</u>
Net Plant Assets	<u>\$ 190,102,004</u>	<u>\$ 13,858,327</u>	<u>\$ (52,922)</u>	<u>\$ 203,907,409</u>
Work In Progress	<u>25,387,830</u>	<u>14,664,114</u>	<u>(22,587,803)</u>	<u>17,464,141</u>
Total Net Plant	<u><u>\$ 215,489,834</u></u>	<u><u>\$ 28,522,441</u></u>	<u><u>\$ (22,640,725)</u></u>	<u><u>\$ 221,371,550</u></u>

9. Risk Management

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

Knoxville Utilities Board Gas Division
Notes to Financial Statements
June 30, 2015 and 2014

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 \$306,714 resulting from the following changes:

	2015	2014
Balance, beginning of year	\$ 298,833	\$ 331,386
Current year claims and changes in estimates	2,525,126	2,292,331
Claims payments	(2,517,245)	(2,324,884)
Balance, end of year	<u>\$ 306,714</u>	<u>\$ 298,833</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. For purposes of this disclosure, presentation is on a consolidated basis unless division's share is specified.

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:

	2014	2013
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>

Knoxville Utilities Board Gas Division

Notes to Financial Statements

June 30, 2015 and 2014

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 percent of the first \$4,800 of annual earnings and 5 percent 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.

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

Knoxville Utilities Board Gas Division

Notes to Financial Statements

June 30, 2015 and 2014

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. Of these amounts, \$1,136,592 and \$1,045,509 are attributable to the Gas Division. 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. The Gas Division's portion of this contribution is \$1,020,489.

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. The Gas Division's portion of this contribution is \$818,365. 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. The division's share of the net pension asset is \$1,083,893.

Knoxville Utilities Board Gas Division

Notes to Financial Statements

June 30, 2015 and 2014

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

	2014	2013
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 weighting the expected future real rates of return by the target asset allocation percentage

Knoxville Utilities Board Gas Division
Notes to Financial Statements
June 30, 2015 and 2014

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:

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

Knoxville Utilities Board Gas Division
Notes to Financial Statements
June 30, 2015 and 2014

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 (Division's share \$494,983).

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 (Division's share \$1,148,096). 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 (Division's share \$568,296) 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	-

Knoxville Utilities Board Gas Division

Notes to Financial Statements

June 30, 2015 and 2014

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 (Division's share \$286,803) and \$1,463,184 (Division's share \$278,005), 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

Knoxville Utilities Board Gas Division

Notes to Financial Statements

June 30, 2015 and 2014

applicable documentation was submitted to the State Funding Board and, in December 2007, the State Funding Board approved the Trust. The Trust was also approved by the Internal Revenue Service in June 2008. 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)	3,500,284	3,319,013
f) Employer Contributions	3,497,372	4,057,091
g) Net OPEB Obligation/(Asset) at end of fiscal year (a+e-f)	\$ (174,410)	\$ (177,322)

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:

Schedule of Employer Contributions

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)

Knoxville Utilities Board Gas Division

Notes to Financial Statements

June 30, 2015 and 2014

Total contributions to the OPEB Trust for the fiscal year ended June 30, 2015 were \$3,497,372 (Division's share \$629,527). 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 (Division's share \$629,527). As of June 30, 2015, the employer's OPEB obligation has been exceeded by \$174,410 (Division's share \$31,394).

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 (Division's share \$162,048).

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 (Division's share \$8,594,215). The actuarial value of the Plan's assets was \$47,705,478 (Division's share \$8,586,986). As a result, the Plan's unfunded actuarial accrued liability was \$40,162 (Division's share \$7,229). 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 (Division's share \$105,403). 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

Knoxville Utilities Board Gas Division

Notes to Financial Statements

June 30, 2015 and 2014

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.

13. Related Party Transactions

The Division, in the normal course of operations, is involved in transactions with the City of Knoxville and with other divisions of KUB. Such transactions for the years ended June 30, 2015 and 2014 are summarized as follows:

	2015	2014
City of Knoxville		
Amounts billed by the Division for utilities and related services	\$ 750,765	\$ 583,982
Payments by the Division in lieu of property tax	3,251,836	3,008,089
Payments by the Division for services provided	74,607	454,436
Other divisions of KUB		
Amounts billed to other divisions for utilities and related services provided	321,789	342,297
Interdivisional rental expense	453,442	430,112
Amounts billed to the Division by other divisions for utilities services provided	286,315	301,217

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

	2015	2014
Accounts receivable	\$ 5,902	\$ 6,920

Knoxville Utilities Board Gas Division
Notes to Financial Statements
June 30, 2015 and 2014

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.

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

Firm obligations related to purchased gas - demand

	2016	2017	2018	2019	2020
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>

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 values for Conoco, Shell Energy, and BP are based upon firm supply obligations and locked prices with those suppliers. The firm obligations value for CNX 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.

Knoxville Utilities Board Gas Division
Required Supplemental Information - Schedule of Funding Progress
June 30, 2015
(Unaudited)

Other Post-Employment Benefits (OPEB)

Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (b)	Unfunded Actuarial Accrued Liability (UAAL) (b-a)	Funded Ratio (a)/(b)	Annual Covered Payroll (c)	UAAL as a Percentage of Covered Payroll [(b)-(a)]/(c)
January 1, 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 Gas Division
Required Supplemental Information - Schedule of Changes in Net Pension
Liability and Related Ratios
June 30, 2015
(Unaudited)

	2014
Total pension liability	
Service cost	\$ 4,092,808
Interest	14,698,657
Benefit payments, including refunds of member contributions	(15,533,167)
Net change in total pension liability	<u>3,258,298</u>
Total pension liability - beginning	<u>199,515,466</u>
Total pension liability - ending (a)	<u><u>\$ 202,773,764</u></u>
Plan fiduciary net position	
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	(128,000)
Net change in plan fiduciary net position**	<u>12,795,245</u>
Plan fiduciary net position - beginning**	<u>196,000,149</u>
Plan fiduciary net position - ending (b)**	<u><u>\$ 208,795,394</u></u>
Plan's net pension liability - ending (a) - (b)	<u><u>\$ (6,021,630)</u></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 Gas Division
Required Supplemental Information - Schedule of Employer Pension
Contributions
June 30, 2015
(Unaudited)

	<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:

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:

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 Gas Division
Supplemental Information - Schedule of Insurance in Force
June 30, 2015
(Unaudited)

Schedule 1

Insurance coverage is for KUB as a consolidated entity.

Crime

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

Directors' and Officers' Liability Insurance

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

Employment Practices Liability

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

Fiduciary

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

Pollution Legal Liability

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

Property Insurance

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

Travel Accident

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

Excess Insurance for General Liability

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

Excess Insurance for Workers' Compensation

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

Employee Health Plan Stop Loss Coverage

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

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Gas Division
Supplemental Information - Schedule of Debt Maturities by Fiscal Year
June 30, 2015
(Unaudited)

Schedule 2
Continued on Next Page

FY	L-2005		N-2007		O-2010		P-2010			Q-2012	
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Rebate*	Principal	Interest
15-16	\$ 695,000	\$ 474,290	\$	\$ 27,500	\$ 3,475,000	\$ 104,250	\$	\$ 645,843	\$ 226,045	\$ 700,000	\$ 820,548
16-17	725,000	441,278	550,000	27,500			540,000	645,843	226,045	2,065,000	806,548
17-18	760,000	406,840					570,000	628,023	219,808	2,125,000	744,598
18-19	795,000	372,640					595,000	606,363	212,227	2,190,000	680,848
19-20	830,000	336,865					620,000	581,075	203,376	2,260,000	615,148
20-21	865,000	299,515					645,000	553,175	193,611	2,350,000	524,748
21-22	910,000	260,590					670,000	521,731	182,606	2,445,000	430,748
22-23	945,000	223,053					695,000	488,231	170,881	2,540,000	332,948
23-24	980,000	182,890					725,000	453,481	158,718	2,645,000	231,348
24-25	1,025,000	141,240					750,000	413,606	144,762	760,000	125,548
25-26	1,065,000	96,140					785,000	372,358	130,325	780,000	102,748
26-27	1,120,000	49,280					815,000	328,200	114,870	800,000	79,348
27-28							845,000	279,300	97,755	830,000	54,348
28-29							880,000	228,600	80,010	855,000	27,788
29-30							915,000	175,800	61,530		
30-31							950,000	120,900	42,315		
31-32							1,000,000	62,000	21,700		
32-33											
33-34											
34-35											
Total	\$ 10,715,000	\$ 3,284,621	\$ 550,000	\$ 55,000	\$ 3,475,000	\$ 104,250	\$ 12,000,000	\$ 7,104,529	\$ 2,486,584	\$ 23,345,000	\$ 5,577,262

*Series P-2010 bonds were issued as federally taxable Build America Bonds. KUB will receive a 35 percent interest rebate payment from the United States Government for each interest payment. Effective 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 in effect until intervening Congressional action, at which time the sequestration rate is subject to change.

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Gas Division
Supplemental Information - Schedule of Debt Maturities by Fiscal Year
June 30, 2015
(Unaudited)

Schedule 2

Continued from Previous Page

FY	R-2012		S-2013		T-2013		U-2015		Totals		Grand Total	Grand Total
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	(P + I)	(Less Rebate)
15-16	\$ 200,000	\$ 288,530	\$ 50,000	\$ 375,600	\$ 200,000	\$ 1,017,825	\$ 100,000	\$ 333,032	\$ 5,420,000	\$ 4,087,418	\$ 9,507,418	\$ 9,281,373
16-17	400,000	282,530	570,000	374,100	500,000	1,011,825	100,000	397,638	5,450,000	3,987,262	9,437,262	9,211,217
17-18	425,000	270,530	595,000	351,300	500,000	996,825	615,000	395,637	5,590,000	3,793,753	9,383,753	9,163,945
18-19	425,000	257,780	615,000	327,500	500,000	976,825	660,000	377,187	5,780,000	3,599,143	9,379,143	9,166,916
19-20	450,000	240,781	645,000	302,900	500,000	956,825	680,000	357,387	5,985,000	3,390,981	9,375,981	9,172,605
20-21	475,000	222,781	695,000	277,100	500,000	936,825	710,000	323,387	6,240,000	3,137,531	9,377,531	9,183,920
21-22	475,000	203,781	715,000	249,300	500,000	916,825	740,000	287,887	6,455,000	2,870,862	9,325,862	9,143,256
22-23	500,000	184,781	730,000	227,850	500,000	901,825	795,000	250,888	6,705,000	2,609,576	9,314,576	9,143,695
23-24	525,000	169,781	745,000	205,950	500,000	886,200	805,000	233,000	6,925,000	2,362,650	9,287,650	9,128,932
24-25	550,000	159,281	790,000	183,600	1,550,000	869,950	845,000	208,850	6,270,000	2,102,075	8,372,075	8,227,313
25-26	575,000	142,781	800,000	159,900	1,600,000	813,763	880,000	183,500	6,485,000	1,871,190	8,356,190	8,225,865
26-27	575,000	130,560	840,000	135,900	1,650,000	749,763	895,000	154,900	6,695,000	1,627,951	8,322,951	8,208,081
27-28	600,000	117,625	875,000	110,700	1,700,000	683,763	985,000	123,573	5,835,000	1,369,309	7,204,309	7,106,554
28-29	625,000	99,625	905,000	84,450	1,750,000	615,763	975,000	89,100	5,990,000	1,145,326	7,135,326	7,055,316
29-30	650,000	84,000	940,000	57,300	1,950,000	543,575	955,000	59,850	5,410,000	920,525	6,330,525	6,268,995
30-31	675,000	64,500	970,000	29,100	2,000,000	460,700	1,040,000	31,200	5,635,000	706,400	6,341,400	6,299,085
31-32	725,000	44,250			2,000,000	373,200			3,725,000	479,450	4,204,450	4,182,750
32-33	750,000	22,500			2,000,000	283,200			2,750,000	305,700	3,055,700	3,055,700
33-34					2,100,000	193,200			2,100,000	193,200	2,293,200	2,293,200
34-35					2,100,000	96,600			2,100,000	96,600	2,196,600	2,196,600
Total	\$ 9,600,000	\$ 2,986,397	\$ 11,480,000	\$ 3,452,550	\$ 24,600,000	\$ 14,285,277	\$ 11,780,000	\$ 3,807,016	\$ 107,545,000	\$ 40,656,902	\$ 148,201,902	\$ 145,715,318

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Gas Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2015
(Unaudited)

Schedule 3

Rate Class	Base Charge	Number of Customers
Residential (G-2)	<p>For the regular monthly billing period for the months of November to April, inclusive:</p> <p>Customer charge per month \$6.65</p> <p>First 30 therms per month at \$1.1517 per therm</p> <p>Excess over 30 therms per month at \$0.9395 per therm</p> <p>For the regular monthly billing periods for the months of May to October, inclusive:</p> <p>Customer charge per month \$6.65</p> <p>First 50 therms per month \$0.9730 per therm</p> <p>Excess over 50 therms per month at \$0.8544 per therm</p>	89,321
Commercial (G-4)	<p>Available to any commercial or industrial customer:</p> <p>Customer charge per month \$13.00</p> <p>First 250 therms per month at \$1.0703 per therm</p> <p>Excess over 250 therms per month at \$0.9571 per therm</p>	9,066
Commercial (G-6)	<p>Available to any commercial or industrial customer incurring a demand of twenty-seven therms or more during the current monthly billing period or during any of the eleven net preceding monthly billing periods.</p> <p>The net rate is the sum of the following demand and commodity charges:</p> <p>Customer charge: \$125.00 per month</p> <p>Demand charge: \$1.85 per therm of demand</p> <p>Commodity charge: First 30,000 therms per month at \$0.6996 per therm</p> <p>Excess over 30,000 therms per month at \$0.6095 per therm</p>	276
Industrial (G-7)	<p>Service under Rate Schedule G-7 shall be available to any customer who meets the following conditions:</p> <p>(a) Customer's annual Interruptible Gas use, on an actual or projected basis, shall not be less than 25,000 dekatherms;</p> <p>(b) Customer shall be permitted to purchase only one (1) dekatherm of Firm Gas under Rate Schedule G-7 for each two (2) dekatherms of Interruptible Gas which are purchased;</p> <p>(c) Customer must have standby equipment of sufficient capacity capable of providing the customer's normal gas service requirements for a period of five (5) working days without replenishment when Interruptible Gas is completely interrupted. Customer shall maintain such equipment ready for operation at any time and shall utilize a fuel other than gas furnished by KUB and shall be subject to periodic inspections by KUB to ensure compliance with this provision; and</p> <p>(d) KUB must determine that its existing distribution system facilities are adequate and available for the requested service.</p>	16

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Gas Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2015
(Unaudited)

Schedule 3

Rate Class	Base Charge	Number of Customers
	The net rate is the sum of the following demand and commodity charges:	
	Customer charge:	\$250.00 per month
	Demand charge:	\$18.50 per month per dekatherm of demand
	Commodity charge:	(a) Firm Gas - \$6.095 per dekatherm
		(b) Interruptible Gas - (i) First 3,000 dekatherms per month at \$5.482 per dekatherm; excess of 3,000 to 20,000 dekatherms per month at \$4.908 per dekatherm; plus excess over 20,000 to 50,000 dekatherms per month at \$4.142 per dekatherm; excess over 50,000 dekatherms per month at \$3.974 per dekatherm
		(c) Supplemental Gas - The Commodity Charge for Supplemental Gas shall be the total of:
		(a) the cost per dekatherm to KUB for the applicable Day of acquiring Supplemental Gas on the open market, subject to the approval of the Customer to purchase Supplemental Gas at or above such price and (b) the costs incurred by KUB in transporting such Supplemental Gas via connecting pipelines to one or more of KUB's delivery points.
	Transportation charge:	\$1.928 per dekatherm for the first 3,000 dekatherms of gas Redelivered plus Unauthorized Gas; plus \$1.354 per dekatherm for each dekatherm from 3,000 to and including 20,000 dekatherms of gas Redelivered plus Unauthorized Gas; plus \$.588 per dekatherm for each dekatherm from 20,000 to and including 50,000 dekatherms of gas Redelivered plus Unauthorized Gas; plus \$.430 per dekatherm for the excess over 50,000 dekatherms of gas Redelivered plus Unauthorized Gas.
	Unauthorized Gas charge:	\$15.00 per dekatherm of Unauthorized Gas as a penalty, plus the total of: (a) the cost per dekatherm of obtaining such gas on the open market as determined by the higher of (1) the applicable Gulf Coast Price Index for the applicable Day as published in <i>Gas Daily</i> or, if <i>Gas Daily</i> is no longer published, in a comparable reliable source for natural gas prices or (2) the applicable first of the month Gulf Coast Price Index as published in <i>Inside FERC</i> , or if <i>Inside FERC</i> is no longer published, in a comparable reliable source for natural gas prices and (b) the costs incurred by KUB in transporting such Unauthorized Gas via connecting pipelines to one or more of KUB's delivery points.

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Gas Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2015
(Unaudited)

Schedule 3

Rate Class	Base Charge	Number of Customers
G-11	<p>Service under Rate Schedule G-11 shall be available to any customer who meets the following conditions:</p> <ul style="list-style-type: none"> (a) Customer's annual gas usage (excluding Firm Gas), on an actual or projected basis, shall not be less than 25,000 dekatherms; (b) Customer shall be permitted to purchase only one (1) dekatherm of Firm Gas under Rate Schedule G-11 for each two (2) dekatherms of Transport Gas delivered by KUB to the Customer; (c) Customer must have standby equipment of sufficient capacity capable of providing the customer's normal gas service requirements for a period of five (5) working days without replenishment when Transport Gas is completely interrupted. Customer shall maintain such equipment ready for operation at any time and shall utilize a fuel other than gas furnished by KUB and shall be subject to periodic inspections by KUB to ensure compliance with this provision; (d) Customer's use under this rate shall not work a hardship on any other customers of KUB, nor adversely affect any other class of KUB's customers and further provided the Customer's use under this rate shall not adversely affect KUB's gas purchase plans and/or effective utilization of the daily demands under KUB's gas purchase contracts with its suppliers, as solely determined by KUB. (e) KUB must determine that its existing distribution system facilities are adequate and available for the requested service; and (f) Customer must execute a Transportation Service Agreement for interruptible transportation gas service. <p>The net rate is the sum of the following charges:</p> <ul style="list-style-type: none"> Customer charge: \$350.00 Demand charge: \$18.50 per dekatherm of demand Firm Gas charge: \$6.095 per dekatherm Transportation charge: \$1.928 per dekatherm for the first 3,000 dekatherms of non-Firm gas delivered to Customer; plus \$1.354 per dekatherm for each dekatherm from 3,000 to and including 20,000 dekatherms of non-Firm gas delivered to Customer; plus \$.588 per dekatherm for each dekatherm from 20,000 to and including 50,000 dekatherms of non-Firm gas delivered to Customer; plus \$.430 per dekatherm for the excess over 50,000 dekatherms of non-Firm gas delivered to Customer. Standby Gas charge: The charge for Standby Gas shall be the total of: (a) the cost per dekatherm to KUB for the applicable Day of acquiring Standby Gas on the open market, subject to the approval of the Customer to purchase Standby Gas at or above such price and (b) the costs incurred by KUB in transporting such Standby Gas via connecting pipelines to one or more of KUB's delivery points. 	10

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Gas Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2015
(Unaudited)

Schedule 3

Rate Class	Base Charge	Number of Customers
	<p>Unauthorized Gas charge: \$15.00 per dekatherm of Unauthorized Gas as a penalty, plus the total of: (a) the cost per dekatherm of obtaining such gas on the open market as determined by the higher of (1) the applicable Gulf Coast Price Index for the applicable Day as published in <i>Gas Daily</i> or, if <i>Gas Daily</i> is no longer published, in a comparable reliable source for natural gas prices or (2) the applicable first of the month Gulf Coast Price Index as published in <i>Inside FERC</i>, or if <i>Inside FERC</i> is no longer published, in a comparable reliable source for natural gas prices and (b) the costs incurred by KUB in transporting such Unauthorized Gas via connecting pipelines to one or more of KUB's delivery points.</p> <p>Other charges: Imbalance Charges, and any pipeline scheduling, balancing, transportation, or other similar charges incurred by KUB in connection with the transportation of gas on behalf of the Customer, as applicable.</p>	
G-12	<p>Service under Rate Schedule G-12 shall be available to any customer when the following conditions are met:</p> <ul style="list-style-type: none"> (a) Customer's annual gas usage, on an actual or projected basis, shall not be less than 12,500 dekatherms; (b) KUB must determine that its existing distribution system facilities are adequate and available for the requested service; (c) Customer must execute a Transportation Service Agreement for firm transportation gas service; and (d) Customer's use under this rate shall not work a hardship on any other customers of KUB, nor adversely affect any other class of KUB's customers and further provided the Customer's use under this rate shall not adversely affect KUB's gas purchase plans and/or effective utilization of the daily demands under KUB's gas purchase contracts with its suppliers, as solely determined by KUB. <p>The net rate is the sum of the following charges:</p> <ul style="list-style-type: none"> Customer charge: \$350.00 Demand charge: \$6.10 per dekatherm of demand Transportation charge: \$2.180 per dekatherm for the first 3,000 dekatherms of gas delivered to Customer; plus \$1.466 per dekatherm for each dekatherm from 3,000 to and including 20,000 dekatherms of gas delivered to Customer; plus \$.724 per dekatherm for each dekatherm from 20,000 to and including 50,000 dekatherms of gas delivered to Customer; plus \$.575 per dekatherm for the excess over 50,000 dekatherms of gas delivered to Customer. 	4

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Gas Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2015
(Unaudited)

Schedule 3

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

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
Gas Division of the Knoxville Utilities Board
Knoxville, Tennessee

Report on the Financial Statements

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 Gas Division (the Division) of the Knoxville Utilities Board, 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 the Division'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 the Division'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 the Division's internal control. Accordingly, we do not express an opinion on the effectiveness of the Division'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 the Division'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
Gas Division of the Knoxville Utilities Board
Knoxville, Tennessee

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Division'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 the Division's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Division's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Coulter & Justus, P.C.

Knoxville, Tennessee
October 16, 2015

Knoxville Utilities Board Water Division

**Financial Statements and Supplemental
Information**

June 30, 2015 and 2014

Knoxville Utilities Board Water Division

Index

June 30, 2015 and 2014

	Page(s)
Independent Auditors' Report	1-2
Management's Discussion and Analysis	3-24
Financial Statements	
Statements of Net Position.....	25-26
Statements of Revenues, Expenses and Changes in Net Position.....	27
Statements of Cash Flows	28
Notes to Financial Statements	29-49
Required Supplementary Information – Schedule of Funding Progress	50
Required Supplementary Information – Schedule of Changes in Net Pension Liability and Related Ratios	51
Required Supplementary Information – Schedule of Employer Pension Contributions	52
Supplemental Information	
Schedule 1 – Schedule of Insurance in Force	53
Schedule 2 – Schedule of Debt Maturities by Fiscal Year	54-55
Schedule 3 – Schedule of Current Rates in Force.....	56-57
Schedule 4 – Schedule of Unaccounted for Water	58-60
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 <i>Government Auditing Standards</i>	61-62



Report of Independent Auditors

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

We have audited the accompanying financial statements of the Water Division (the Division) 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 the Division'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 Division's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Division's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Water Division of the Knoxville Utilities Board 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, the Division 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.

Board of Commissioners
The Water Division of the Knoxville Utilities Board
Knoxville, Tennessee

Other Matters

Prior Period Financial Statements

The financial statements of the Division 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.

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 24 and the required supplementary information on pages 50 through 52 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 the Division's basic financial statements. The supplemental information is presented for purposes of additional analysis and is not a required part of the basic financial statements. The supplemental information 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 the Division's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Division's internal control over financial reporting and compliance.

Coulter & Justus, P.C.

Knoxville, Tennessee
October 16, 2015

Knoxville Utilities Board Water Division

Management's Discussion and Analysis

June 30, 2015 and 2014

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. The Water Division (Division) provides services to certain customers in Knox County and in two surrounding counties in East Tennessee. The Division's accounts are maintained in conformity with the Uniform System of Accounts of the National Association of Regulatory Utility Commissioners (NARUC) and the Governmental Accounting Standards Board (GASB), as applicable. The financial statements present only the Water Division and do not purport to, and do not, present fairly the consolidated financial position of Knoxville Utilities Board at June 30, 2015 and 2014, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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

The Division's Management Discussion and Analysis ("MD&A") focuses on the fiscal year ending June 30, 2015 activities, resulting changes and current known facts, and should be read in conjunction with the Division's financial statements.

Water Division Highlights

System Highlights

KUB serves 78,553 water system customers over a 188 square mile service area. KUB maintains 1,407 miles of service mains, 27 storage facilities, 24 booster pump stations, and 1 treatment plant, which provided 11.7 billion gallons of water to KUB's water customers in fiscal year 2015. The average daily flow for fiscal year 2015 was 32 million gallons.

KUB added 217 customers to its water system during the fiscal year.

The Division generated \$4.7 million of additional revenue during the fiscal year as a result of the January and July 2014 water rate increases, adopted by the KUB Board of Commissioners to help fund the Division's Century II infrastructure program.

The typical residential water customer's average monthly bill was \$21.45 as of June 30, 2015 (based on monthly use of 500 cubic feet or 3,740 gallons). The monthly bill increased \$2 compared to the prior fiscal year, the result of increased water rates.

In August 2014, KUB issued \$8 million in water system revenue bonds. In April 2015, KUB issued \$20 million in water system revenue bonds. These two issuances were to fund capital system improvements. KUB also issued \$23 million in water system revenue refunding bonds in April 2015 to refinance certain outstanding bonds at lower interest rates. This refunding will provide debt service savings of \$2.4 million over the life of the bonds. As part of the August 2014 bond sales, Standard & Poor's rating agency upgraded its bond ratings for the water system from AA+ to AAA, the highest credit rating available from S&P. As of June 30, 2015, water system bonds were rated AAA by S&P and Aa2 by Moody's Investors Service.

Knoxville Utilities Board Water Division

Management's Discussion and Analysis

June 30, 2015 and 2014

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

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 the 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 a ten year funding plan for the water system, including a revised ten-year funding plan for the water system which includes a combination of rate increases and debt issues to fully fund the programs for the next ten years.

In April 2014, KUB management provided the Board an updated assessment of the overall condition of each utility system and the progress made during the resumption of the Century II program. A revised ten-year funding plan for the water system, including recommendations for annual rate increases and debt issues to fully fund the programs for each division, was included in the assessment.

In June 2014, the Board approved the proposed three annual rate increases for the Water Division. The first rate increase went into effect in July 2014 generating \$3.6 million in additional Water Division revenue, while the July 2015 and July 2016 rate increases will result in additional annual Water Division revenue of \$2 million.

KUB replaced 9.4 miles of galvanized water main with a target metric of 12 miles. This metric was not obtained during the fiscal year due to increased unit costs of galvanized projects as well as new cast iron water main projects. 6.1 miles of cast iron water main were replaced during the fiscal year, which exceeded the target replacement goal of 5 miles. The water main replacements were achieved while staying within the Division's total capital budget during fiscal year 2015.

Financial Highlights

Fiscal Year 2015 Compared to Fiscal Year 2014

The Division's net position during the year increased \$5 million compared to a \$1.5 million increase last fiscal year. 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 \$0.1 million during fiscal year 2015. This change resulted in a net increase of \$4.9 million or 3.2 percent in the Division's net position.

Operating revenue increased \$4.8 million or 12.2 percent, the net result of additional revenue from the Century II water rate increases, which were effective January and July 2014, and a 1.6 percent increase in water sales volumes.

Operating expenses increased \$1.3 million or 3.8 percent. Operating and maintenance expenses ("O&M") decreased \$0.2 million compared to the prior year. Depreciation expense increased \$0.9 million or 12.4 percent. Taxes and tax equivalents increased \$0.6 million from the prior year.

Interest income was consistent with the prior fiscal year. However, interest expense was \$0.2 million higher than the prior year, due to additional interest expense from bonds sold in the August 2014 and April 2015.

Knoxville Utilities Board Water Division

Management's Discussion and Analysis

June 30, 2015 and 2014

Capital contributions were \$0.1 million higher than the prior fiscal year, the result of increased contributed assets from developers.

Total plant assets (net) increased \$18.4 million or 7.7 percent due to main replacement, treatment plant improvements and information system upgrades.

KUB sold two series of water system revenue bonds during fiscal year 2015 for the purpose of funding water system capital improvements totaling \$28 million. The \$20 million bond issue in April 2015 was accelerated to take advantage of the low interest rate environment which impacted the Division's debt rate and debt service coverage levels for fiscal year 2015. Long-term debt represented 48.6 percent of the Division's capital structure as of June 30, 2015, as compared to 44.8 percent last year. Capital structure equals long-term debt (which includes the current and long term portion of revenue bonds and notes) plus net position.

The Division's bond covenants require a debt service coverage ratio of at least 1.2 times the maximum principal and interest payments over the life of the Division's outstanding bonds. Current year debt coverage for the fiscal year was 2.35. Maximum debt service coverage was 2.06.

Fiscal Year 2014 Compared to Fiscal Year 2013

The Division's net position increased \$1.5 million or 1 percent, compared to a \$3 million increase in fiscal year 2013.

Operating revenue increased \$1.3 million or 3.4 percent, the net result of additional revenue from the Century II water rate increases, which were effective January 2013 and 2014 and a 2.3 percent decrease in water sales volumes.

Operating expenses increased \$2 million or 6.6 percent. Operating and maintenance expenses ("O&M") increased \$1.5 million or 6.7 percent compared to the prior year. Depreciation expense increased \$0.5 million or 8 percent. Taxes and tax equivalents increased \$0.1 million from the prior year.

Interest income was consistent with the prior fiscal year. However, interest expense was \$0.9 million higher than the prior year, due to additional expense from the \$25 million in bonds sold in September 2013.

Capital contributions were \$0.1 million higher than the prior fiscal year, the result of increased contributed assets from developers.

Total plant assets (net) increased \$13.7 million or 6.1 percent due to main replacement and treatment plant improvements.

Long-term debt represented 44.8 percent of the Division's capital structure as of June 30, 2014, as compared to 40.3 percent last year. Capital structure equals long-term debt (which includes the current portion of revenue bonds and notes, as applicable, due to be retired the next fiscal year) plus net position.

The Division's bond covenants require a debt service coverage ratio of at least 1.2 times the maximum principal and interest payments over the life of the Division's outstanding bonds. Current year debt coverage for the fiscal year was 2.11. Maximum debt service coverage was 1.83.

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Knoxville Utilities Board Water Division

Management's Discussion and Analysis

June 30, 2015 and 2014

Division Cash Budget Appropriations

KUB's Board of Commissioners adopted a Water Division budget of \$62.8 million for fiscal year 2015. In April 2015 additional appropriations of \$0.5 million were approved by the Board for higher than originally expected payments in lieu of taxes. Actual disbursements were under the original budget by \$0.6 million, with O&M and capital expenses under the budget by a total of \$1.2 million. The general fund balance was \$9.3 higher than originally budgeted primarily due to the acceleration of a \$20 million bond issue from fiscal year 2016. The chart below depicts KUB's original budget compared to actual results and is presented on a cash basis.

Water Division Cash Report As of June 30, 2015

<i>(in thousands of dollars)</i>	FY 2015 Budget**	FY 2015 Actual FYTD	Dollar Variance*	Percent Variance
Beginning Balance General Fund	\$ 22,179	\$ 22,179		
Operating Receipts	44,658	44,780	122	0.3%
Disbursements				
Operation & Maintenance Expense	23,422	23,170	252	1.1%
Capital Expenditures	27,179	26,236	943	3.5%
Debt Service	8,884	9,063	(179)	-2.0%
Taxes & Tax Equivalents	3,272	3,673	(401)	-12.3%
Total Disbursements	62,757	62,142	615	1.0%
Bond Proceeds	7,920	17,891	9,971	125.9%
Net Flow-Throughs and Transfers	47	(1,403)	(1,450)	-3,085%
Ending General Fund Balance	\$ 12,047	\$ 21,305	\$ 9,258	76.8%

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

**Excludes additional appropriations of \$0.5 million

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Knoxville Utilities Board Water Division

Management's Discussion and Analysis

June 30, 2015 and 2014

Knoxville Utilities Board Water Division - Financial Statements

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

Statement of Net Position

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

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

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

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

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

Statement of Revenues, Expenses, and Changes in Net Position

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

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

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

Statement of Cash Flows

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

The statement indicates the Division's beginning cash balance and ending cash balance and 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 Water Division
Management's Discussion and Analysis
June 30, 2015 and 2014

Condensed Financial Statements

Statement of Net Position

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

Statements of Net Position
As of June 30

<i>(in thousands of dollars)</i>	2015	2014	2013
Current, restricted and other assets	\$ 55,083	\$ 43,995	\$ 36,321
Capital assets, net	258,139	239,706	226,022
Deferred outflows of resources	2,459	260	280
Total assets and deferred outflows of resources	<u>315,681</u>	<u>283,961</u>	<u>262,623</u>
Current and other liabilities	10,996	10,584	13,205
Long-term debt outstanding	146,857	121,264	98,785
Deferred inflows of resources	829	-	-
Total liabilities and deferred inflows of resources	<u>158,682</u>	<u>131,848</u>	<u>111,990</u>
Net position			
Net investment in capital assets	110,579	116,197	123,858
Restricted	1,375	1,219	1,027
Unrestricted	45,045	34,697	25,748
Total net position	<u>\$ 156,999</u>	<u>\$ 152,113</u>	<u>\$ 150,633</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 Change in Net Position): impacts (increase/decrease) current and other assets and/or capital assets and unrestricted net position.
- Issuing debt for capital: increases deferred 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 Water Division

Management's Discussion and Analysis

June 30, 2015 and 2014

Impacts and Analysis

Current, Restricted and Other Assets

Fiscal Year 2015 Compared to Fiscal Year 2014

Current, restricted and other assets increased \$11.1 million or 25.2 percent. The increase reflects a higher level of unused bond proceeds of \$9.9 million and a \$1.2 million increase in operating contingency reserves. These increases were offset by a \$0.9 million decrease in the Division's general fund cash (consisting of cash and cash equivalents, short-term investments, and long-term investments).

Fiscal Year 2014 Compared to Fiscal Year 2013

Current, restricted and other assets increased \$7.7 million or 21.1 percent. The Division's general fund cash (consisting of cash and cash equivalents, short-term investments, and long-term investments) increased \$6.6 million compared to last year due to the use of \$25 million in proceeds from revenue bonds, rather than general fund cash, to fund water system capital projects.

Capital Assets

Fiscal Year 2015 Compared to Fiscal Year 2014

Capital assets, net of depreciation, increased \$18.4 million or 7.7 percent. Capital expenditures included \$12.5 million for water main replacement, \$7.8 million for treatment plant and system improvements and \$1.1 million for information system upgrades. \$2 million of water system assets were retired during the fiscal year.

Fiscal Year 2014 Compared to Fiscal Year 2013

Capital assets, net of depreciation, increased \$13.7 million or 6.1 percent. Capital expenditures included \$9.2 million for treatment plant and system improvements and \$7.7 million for water main replacement. \$2.7 million of water assets were retired during the fiscal year 2014.

Deferred Outflows of Resources

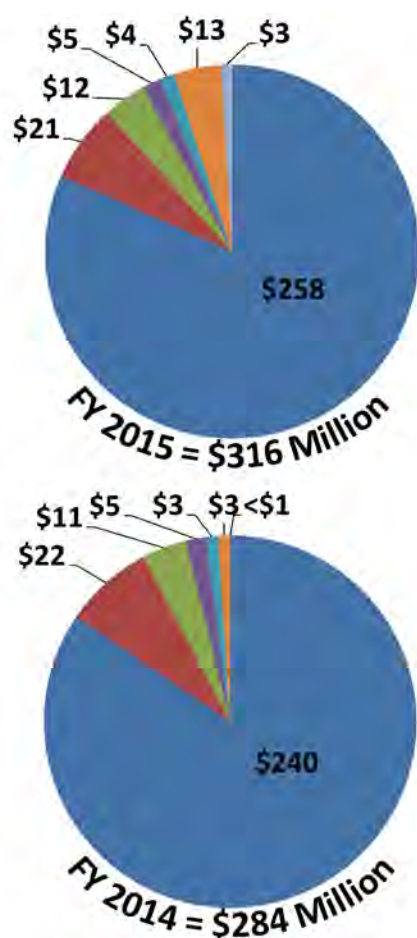
Fiscal Year 2015 Compared to Fiscal Year 2014

Deferred outflows of resources increased \$2.2 million compared to the prior fiscal year. The unamortized bond refunding costs increased \$1.8 million due to the April 2015 issuance of \$23 million in revenue refunding bonds.

Fiscal Year 2014 Compared to Fiscal Year 2013

Deferred outflows of resources were consistent with the prior year at \$0.3 million.

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



**Water Division Total Assets and
Deferred Outflows of Resources
(in Millions)**

	<u>FY15</u>	<u>FY14</u>
Plant	82%	84%
General Fund	7%	8%
Contingency Fund	4%	4%
Accounts Receivable	1%	2%
Other Assets	1%	1%
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 increased \$0.4 million over the prior fiscal year due to a \$0.8 million increase in the current portion of revenue bonds and a \$0.3 million increase in accounts payable.

Fiscal Year 2014 Compared to Fiscal Year 2013

Current and other liabilities decreased \$2.6 million in comparison to the prior fiscal year primarily due to a \$2.3 million decrease in accounts payable.

Knoxville Utilities Board Water Division

Management's Discussion and Analysis

June 30, 2015 and 2014

Long-Term Debt

Fiscal Year 2015 Compared to Fiscal Year 2014

Long-term debt increased \$25.6 million or 21.1 percent, the combined result of additional revenue bonds of \$8 million issued in August 2014 and \$20 million issued April 2015. The increase was partially offset by the scheduled repayment of bond debt.

Fiscal Year 2014 Compared to Fiscal Year 2013

Long-term debt increased \$22.5 million or 22.8 percent, the combined result of additional debt of \$25 million and the scheduled repayment of outstanding revenue bonds during the fiscal year.

Deferred Inflows of Resources

Fiscal Year 2015 Compared to Fiscal Year 2014

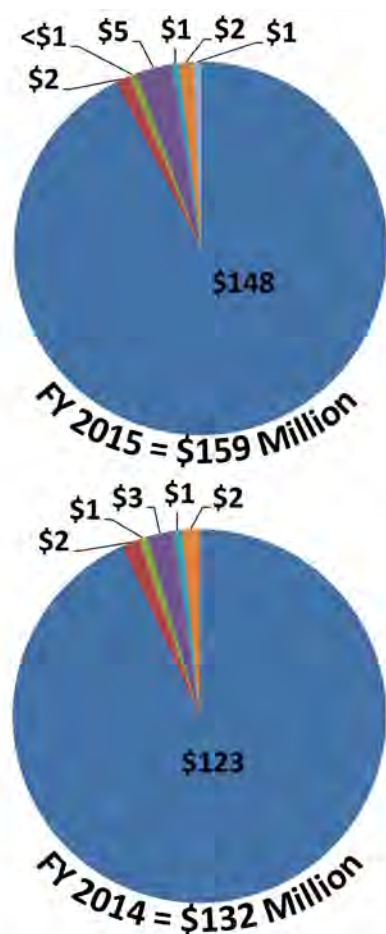
Deferred inflows of resources were \$0.8 million due to the addition of pension inflow. For further explanation, see Notes to the Financial Statements.

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 Water Division
Management's Discussion and Analysis
June 30, 2015 and 2014



**Water Division Total Liabilities and
Deferred Inflows of Resources
(in Millions)**

	<u>FY15</u>	<u>FY14</u>
Bond Debt	93%	94%
Payables	1%	1%
Misc Current	<1%	1%
Other Liabilities	3%	2%
Customer Deposits	<1%	1%
Interest Accrued	1%	1%
Deferred Inflows of Resources	1%	-

Net Position

Fiscal Year 2015 Compared to Fiscal Year 2014

Net position increased \$4.9 million this fiscal year. Net investment in capital assets decreased \$5.6 million, due to the net effect of an increase to net plant in service of \$18.4 million and additional debt of \$28 million. Unrestricted net position increased \$10.3 million, primarily due to unused bond proceeds for capital improvements in the general fund. Restricted assets increased \$0.2 million, due to additional funds restricted for debt service.

Fiscal Year 2014 Compared to Fiscal Year 2013

Net position increased \$1.5 million this fiscal year. Net investment in capital assets decreased \$7.7 million, due to the net effect of an increase to net plant in service of \$13.7 million and additional debt of \$25 million. Unrestricted net position increased \$8.9 million, reflecting the level of unused bond proceeds. Restricted assets increased \$0.2 million, due to additional funds restricted for debt service.

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

Statement of Revenues, Expenses, and Changes in Net Position

The following table reflects the condensed Statement of Revenues, Expenses, and Changes in Net Position for the Water Division compared to the prior year 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>	2015	2014	2013
Operating revenues	\$ 44,173	\$ 39,374	\$ 38,063
Operating expenses			
Treatment	3,789	3,355	2,954
Distribution	13,046	13,635	12,760
Customer service	1,653	1,517	1,462
Administrative and general	4,206	4,364	4,252
Depreciation	7,795	6,934	6,419
Taxes and tax equivalents	3,622	3,042	2,960
Total operating expenses	<u>34,111</u>	<u>32,847</u>	<u>30,807</u>
Operating income	<u>10,062</u>	<u>6,527</u>	<u>7,256</u>
Interest income	135	126	140
Interest expense	(5,421)	(5,258)	(4,364)
Other income/(expense)	<u>(23)</u>	<u>(73)</u>	<u>(96)</u>
Change in net position before capital contributions	<u>4,753</u>	<u>1,322</u>	<u>2,936</u>
Capital Contributions	<u>233</u>	<u>158</u>	<u>57</u>
Change in net position	<u>\$ 4,986</u>	<u>\$ 1,480</u>	<u>\$ 2,993</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 Change in Net Position presentation.

- Operating revenues are largely determined by the volumes of water sold during the fiscal year. Any change (increase/decrease) in retail water rates would also be a cause of change in operating revenue.
- Operating expenses (treatment, distribution, customer service, administrative and general) are normally impacted by changes in areas including, but not limited to, labor cost (staffing, wage rates), active employee and retiree medical costs, chemicals, and water system maintenance.
- Depreciation expense is impacted by plant additions and retirements during the fiscal year.
- Taxes and tax equivalents are impacted by plant additions/retirements and changes in property tax rates.
- Interest expense is impacted by the level of interest rates and investments.

Knoxville Utilities Board Water Division

Management's Discussion and Analysis

June 30, 2015 and 2014

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

Impacts and Analysis

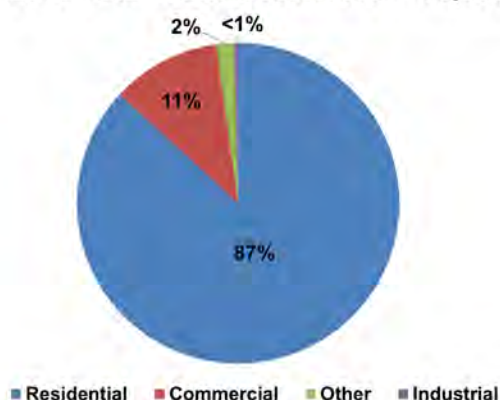
Margin from Sales

Fiscal Year 2015 Compared to Fiscal Year 2014

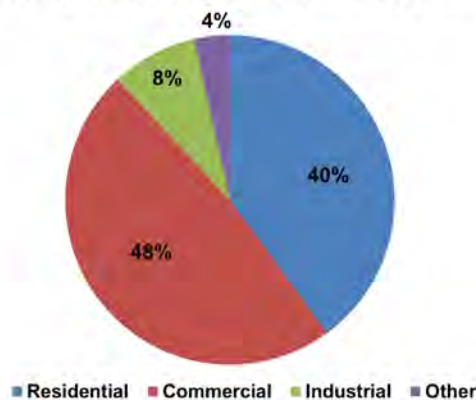
The Division's net position during the year increased \$5 million compared to a \$1.5 million increase last fiscal year. A restatement to the prior fiscal year's net position based on a change in method of accounting for the pension reduced the total net position by \$0.1 million. This change resulted in a net increase of \$4.9 million or 3.2 percent in the Division's net position.

Operating revenues increased \$4.8 million or 12.2 percent, reflecting additional revenue from the January and July 2014 water rate increases. Operating expenses rose \$1.3 million, interest expense increased \$0.2 million, and capital contributions from developers increased \$0.1 million.

FY 2015 Total Water Customers = 78,553



FY 2015 Water Sales = 8 Billion Gallons



Residential customers represented 87 percent of water customers and accounted for 40 percent of water sales volumes for the year. Commercial and industrial customers accounted for the largest portion (56 percent) of total sales volumes during the year.

KUB's ten largest water customers accounted for 11.1 percent of KUB's billed water volumes. Those ten customers represent five industrial and five commercial customers, including three governmental customers.

Residential water sales volumes were 0.8 percent higher than the prior fiscal year. Residential sales were higher throughout the majority of the year, due to lower precipitation levels during the fiscal year.

Commercial sales volumes increased 1.9 percent compared to the prior year. Industrial sales volumes decreased 1.3 percent compared to the prior year.

Knoxville Utilities Board Water Division

Management's Discussion and Analysis

June 30, 2015 and 2014

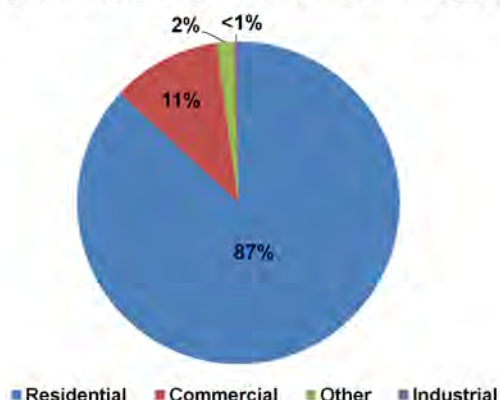
KUB has added 568 water customers over the past three years, representing annual growth of less than 1 percent. Water system growth has slowed in recent years, in large part due to the slowdown of new housing construction.

Fiscal year 2015 water sales volumes were higher than the prior fiscal year, reflecting higher water sales for residential and commercial customers. Sales volumes have remained relatively consistent by customer class over the last three years.

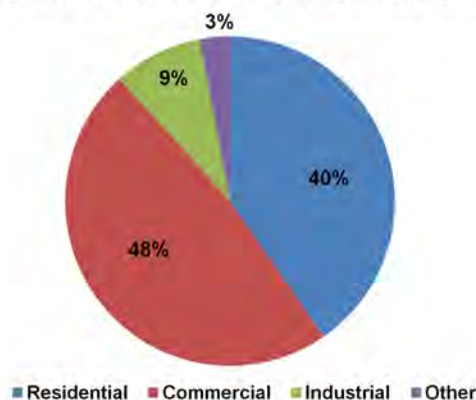
Fiscal Year 2014 Compared to Fiscal Year 2013

The Division's change in net position was \$1.5 million this fiscal year, which is \$1.5 million less than fiscal year 2013's \$3 million increase. Operating revenues increased \$1.3 million or 3.4 percent, the net result of a five percent rate increase on customers' bills in January 2013 and 2014 and a 2.3 percent reduction in water sales volumes. Operating expenses rose \$2 million, interest expense increased \$0.9 million, and capital contributions from developers increased \$0.1 million.

FY 2014 Total Water Customers = 78,336



FY 2014 Water Sales = 8 Billion Gallons



Residential customers represented 87 percent of water customers and accounted for 40 percent of water sales volumes in fiscal year 2014. Commercial and industrial customers accounted for the largest portion (57 percent) of total sales volumes during the year.

KUB's ten largest water customers accounted for 11.3 percent of KUB's billed water volumes. Those ten customers represent five industrial and five commercial customers, including three governmental customers.

Residential water sales volumes were 1.8 percent lower than the prior fiscal year. Residential sales were lower throughout the majority of the year, but particularly in the spring due to higher precipitation levels.

Commercial sales volumes decreased 1.7 percent compared to the prior year. Industrial sales volumes decreased 5.5 percent compared to the prior year.

KUB added 725 water customers over the fiscal years 2012 through 2014, representing annual growth of less than 1 percent. Water system growth has slowed in recent years, in large part due to the slowdown of new housing construction.

Fiscal year 2014 water sales volumes were less than fiscal year 2013 due to lower sales for all customer segments. Sales volumes have remained relatively consistent by customer segment since fiscal year 2012.

Knoxville Utilities Board Water Division

Management's Discussion and Analysis

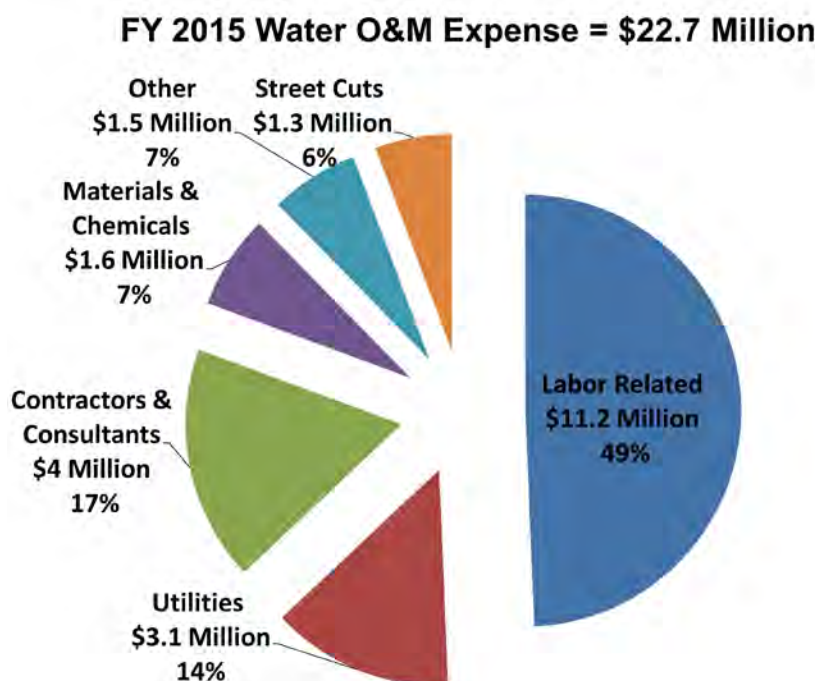
June 30, 2015 and 2014

Operating Expenses

Fiscal Year 2015 Compared to Fiscal Year 2014

Operating expenses increased \$1.3 million or 3.8 percent. Operating expenses include operations and maintenance (O&M) expense, depreciation, and taxes/tax equivalents. O&M expenses can be further classified as treatment, distribution, customer service and administrative and general.

- Treatment expenses increased \$0.4 million or 12.9 percent, primarily reflecting higher outside consultant expenses associated with a coagulation optimization study for the water treatment plant.
- Distribution expenses were \$0.6 million or 4.3 percent lower than the prior fiscal year, due to a decline in outside contractor costs and street cut expenses.
- Customer service expenses increased \$0.1 million or 9 percent.
- Administrative and general expenses decreased \$0.1 million or 3.6 percent.



- Depreciation expense was up \$0.9 million reflecting a full year of depreciation on \$23.9 million of water system assets added the previous fiscal year and a partial year of depreciation on \$14.2 million of assets added in fiscal year 2015. In addition, \$2.1 million of assets were retired during fiscal year 2015.
- Taxes and tax equivalents increased \$0.6 million from prior fiscal year due to an increase in tax equivalent payments to the City of Knoxville. The City of Knoxville's property tax rate increased this year and higher plant in service levels contributed to the growth in tax equivalent payments.

Knoxville Utilities Board Water Division

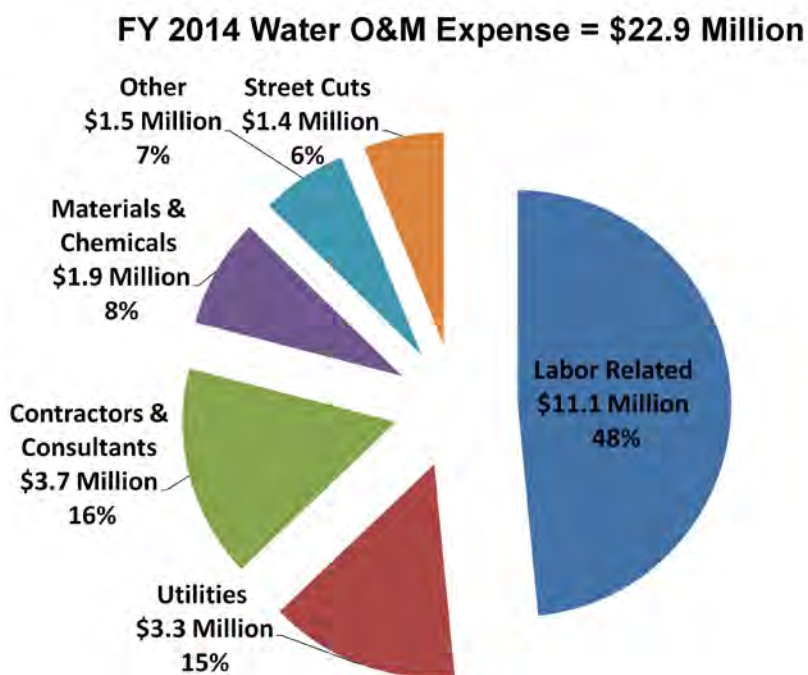
Management's Discussion and Analysis

June 30, 2015 and 2014

Fiscal Year 2014 Compared to Fiscal Year 2013

Operating expenses increased \$2 million or 6.6 percent. Operating expenses include operations and maintenance (O&M) expense, depreciation, and taxes/tax equivalents. O&M expenses can be further classified as treatment, distribution, customer service and administrative and general.

- Treatment expenses increased \$0.4 million or 13.6 percent, primarily reflecting higher labor related expenses.
- Distribution expenses were \$0.9 million or 6.9 percent higher than the prior fiscal year, due to increased outside contractor costs and labor related expenses.
- Customer service expenses increased \$0.1 million.
- Administrative and general expenses increased \$0.1 million or 2.6 percent.



- Depreciation expense was up \$0.5 million reflecting a full year of depreciation on \$21.4 million of water system assets added the previous fiscal year and a partial year of depreciation on \$23.9 million of assets added in fiscal year 2014. In addition, \$2.7 million of assets were retired during fiscal year 2014.
- Taxes and tax equivalents increased \$0.1 million from prior fiscal year.

Knoxville Utilities Board Water Division

Management's Discussion and Analysis

June 30, 2015 and 2014



Other Income and Expense

Fiscal Year 2015 Compared to Fiscal Year 2014

Interest income was consistent with the prior fiscal year.

Interest expense increased \$0.2 million, reflecting interest expense from the \$28 million in revenue bonds sold in fiscal year 2015.

Other income (net) was increased \$0.1 million compared to the prior fiscal year.

Capital contributions by developers were \$0.1 million higher than fiscal year 2014.

Fiscal Year 2014 Compared to Fiscal Year 2013

Interest income was consistent with the prior fiscal year.

Interest expense increased \$0.9 million, reflecting interest expense on \$25 million in water bonds sold during the fiscal year.

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

Capital contributions by developers were \$0.1 million higher than fiscal year 2013.

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

Capital Assets

	Capital Assets As of June 30 (Net of Depreciation)		
<i>(in thousands of dollars)</i>	2015	2014	2013
Production Plant	\$ 62	\$ 76	\$ 90
Pumping & Treatment Plant	39,411	41,201	41,719
Distribution Plant			
Distribution Mains	126,124	117,714	102,333
Transmission Mains	19,182	19,506	19,401
Services & Meters	18,541	18,561	17,427
Other	11,057	10,891	10,483
Total Distribution Plant	<u>174,904</u>	<u>166,672</u>	<u>149,644</u>
Total General Plant	<u>8,133</u>	<u>8,240</u>	<u>7,868</u>
Total Water Plant	<u>222,510</u>	<u>216,189</u>	<u>199,321</u>
Work In Progress	35,629	23,517	26,701
Total Net Plant	<u>\$ 258,139</u>	<u>\$ 239,706</u>	<u>\$ 226,022</u>

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Knoxville Utilities Board Water Division

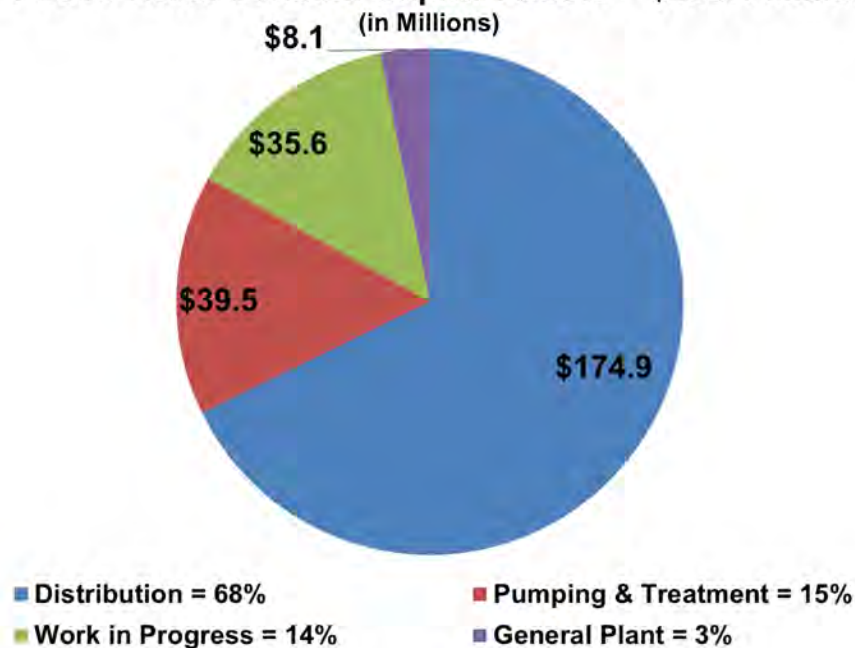
Management's Discussion and Analysis

June 30, 2015 and 2014

Fiscal Year 2015 Compared to Fiscal Year 2014

As of June 30, 2015, the Division had \$258.1 million invested in a variety of capital assets, as reflected in the schedule of capital assets, which represented a net increase (including additions, retirements, and depreciation) of \$18.4 million or 7.7 percent over the end of the last fiscal year.

FY 2015 Water Division Capital Assets = \$258.1 Million



Major capital asset expenditures during the year were as follows:

- \$12.5 million for galvanized and cast iron water main replacement
- \$7.8 million for major plant and system improvements
- \$1.1 million for information system upgrades

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Knoxville Utilities Board Water Division

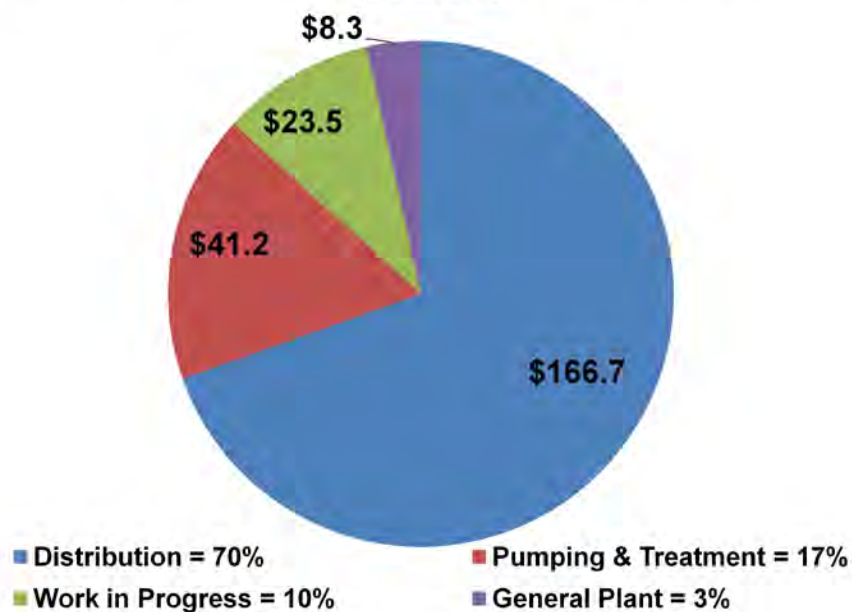
Management's Discussion and Analysis

June 30, 2015 and 2014

Fiscal Year 2014 Compared to Fiscal Year 2013

As of June 30, 2014, the Division had \$239.7 million invested in a variety of capital assets, as reflected in the schedule of capital assets, which represented a net increase (including additions, retirements, and depreciation) of \$13.7 million or 6.1 percent over the end of the last fiscal year.

FY 2014 Water Division Capital Assets = \$239.7 Million (in Millions)



Major capital asset expenditures during the year were as follows:

- \$9.2 million for major plant and system improvements
- \$7.7 million for galvanized and cast iron water main replacement

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Knoxville Utilities Board Water Division

Management's Discussion and Analysis

June 30, 2015 and 2014

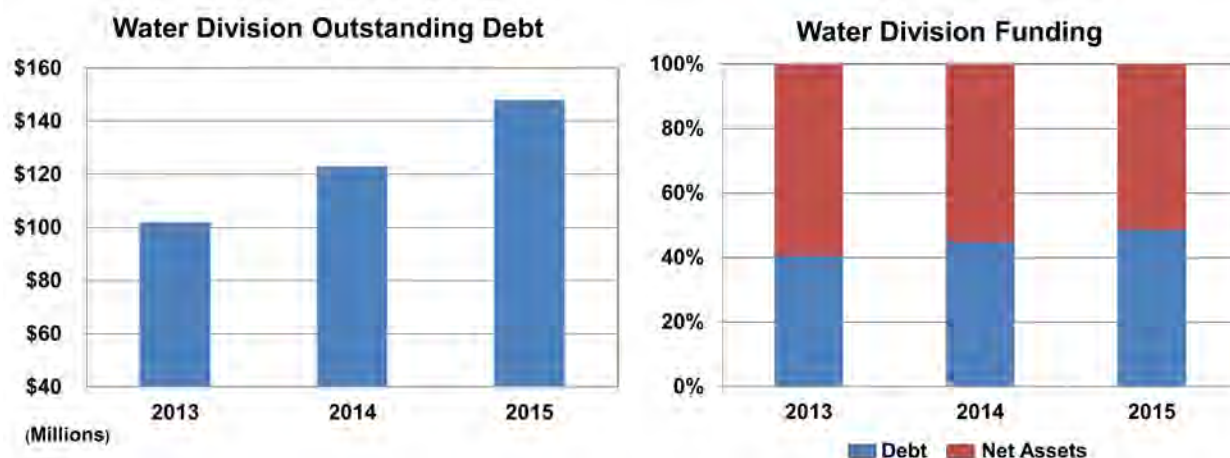
Debt Administration

The Water Division's level of debt has increased from \$101.9 million in fiscal year 2013 to \$148.4 million in fiscal year 2015. The increase in debt represented revenue bonds to fund capital improvements for the water system. The bonds are secured solely by revenues of the Water Division. Debt as a percentage of the Division's capital structure was 48.6 percent in 2015, 44.8 percent in 2014, and 40.3 percent at the end of fiscal year 2013. KUB's Debt Management Policy limits the Division's debt ratio to 60 percent or less.

Outstanding Debt As of June 30

(in thousands of dollars)

	2015	2014	2013
Revenue bonds	\$ 148,400	\$ 123,385	\$ 101,850
Total outstanding debt	\$ 148,400	\$ 123,385	\$ 101,850



The Division will pay \$52.2 million in principal payments over the next ten years, representing 35.1 percent of the outstanding bonds. KUB's Debt Management Policy requires a minimum of 30 percent of water debt principal be repaid over the next ten years.

Fiscal Year 2015 Compared to Fiscal Year 2014

As of June 30, 2015, the Division had \$148.4 million in outstanding debt (including the current portion of revenue bonds), compared to \$123.4 million last year, an increase of \$25 million or 20.3 percent. The Division's weighted average cost of debt as of June 30, 2015 was 3.82 percent.

The increase is attributable to the issuance of revenue bonds during the fiscal year of \$8 million in August 2014 and \$20 million in April 2015. The increase was partially offset by the scheduled repayment of bond debt.

In April 2015, KUB issued \$23 million of revenue refunding bonds. The refunding of certain bonds at lower interest rates will provide debt service savings of \$2.4 over the life of the bonds.

The Division's outstanding debt is rated by Standard & Poor's and Moody's Investors Service. As of June 30, 2015, the Division's revenue bonds were rated AAA by Standard & Poor's and Aa2 by Moody's.

Knoxville Utilities Board Water Division

Management's Discussion and Analysis

June 30, 2015 and 2014

Investors Service. 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, the Division had \$123.4 million in outstanding debt (including the current portion of revenue bonds), compared to \$101.9 million last year, an increase of \$21.5 million or 21.1 percent. The Division's weighted average cost of debt as of June 30, 2014 was 4.06 percent.

This increase in debt was the net effect of the \$25 million issuance of revenue bonds and the scheduled repayment of bond debt during the fiscal year.

The Division's outstanding debt is rated by Standard & Poor's and Moody's Investors Service. As of June 30, 2014, the Division's revenue bonds were rated AA+ by Standard & Poor's and Aa2 by Moody's Investors Service.

Impacts on Future Financial Position

KUB anticipates adding 50 additional water system customers during fiscal year 2016, including Fresenius Medical Care, which is anticipated to become one of KUB's largest water customers.

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 first of the three rate increases was effective July 2014. 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 system revenue increases of \$2 million.

This fiscal year KUB concluded the smart grid pilot project, of which a portion of the project was funded by the 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 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, of which the Division's share is \$15 million. 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.

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

Knoxville Utilities Board Water Division

Management's Discussion and Analysis

June 30, 2015 and 2014

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 the Division's financial position or results of operations during fiscal year 2015.

Financial Contact

The Division's financial statements are designed to present users (citizens, customers, investors, and creditors) with a general overview of the Division's financial position and results of operations for the fiscal years ending June 30, 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 Water Division
Statements of Net Position
June 30, 2015 and 2014

	2015	2014
Assets and Deferred Outflows of Resources		
Current assets:		
Cash and cash equivalents	\$ 21,304,494	\$ 15,178,461
Short-term investments	-	7,000,000
Short-term contingency fund investments	411,198	5,202,977
Other current assets	198,678	103,731
Accrued interest receivable	5,985	13,961
Accounts receivable, less allowance of uncollectible accounts of \$49,412 in 2015 and \$44,960 in 2014	4,987,019	4,565,871
Inventories	1,037,326	991,866
Prepaid expenses	39,980	324,602
Total current assets	<u>27,984,680</u>	<u>33,381,469</u>
Restricted assets:		
Water bond fund	2,969,210	2,883,036
Other funds	5,707	5,703
Unused bond proceeds	9,928,179	-
Total restricted assets	<u>12,903,096</u>	<u>2,888,739</u>
Water plant in service	325,586,934	313,478,645
Less accumulated depreciation	<u>(103,077,327)</u>	<u>(97,290,740)</u>
	222,509,607	216,187,905
Retirement in progress	94,481	51,740
Construction in progress	35,534,671	23,466,042
Net plant in service	<u>258,138,759</u>	<u>239,705,687</u>
Other assets:		
Net pension asset	782,812	-
Long-term contingency fund investments	11,751,074	5,768,571
Other	1,661,676	1,956,051
Total other assets	<u>14,195,562</u>	<u>7,724,622</u>
Total assets	<u>313,222,097</u>	<u>283,700,517</u>
Deferred outflows of resources:		
Pension outflow	410,436	-
Unamortized bond refunding costs	2,048,783	260,151
Total deferred outflows of resources	<u>2,459,219</u>	<u>260,151</u>
Total assets and deferred outflows of resources	<u>\$ 315,681,316</u>	<u>\$ 283,960,668</u>

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

Knoxville Utilities Board Water Division
Statements of Net Position
June 30, 2015 and 2014

	2015	2014
Liabilities, Deferred Inflows, and Net Position		
Current liabilities:		
Current portion of revenue bonds	\$ 4,410,000	\$ 3,640,000
Sales tax collections payable	265,897	237,391
Accounts payable	1,832,317	1,511,988
Accrued expenses	486,462	1,268,929
Customer deposits plus accrued interest	767,050	732,259
Accrued interest on revenue bonds	1,599,555	1,669,603
Total current liabilities	<u>9,361,281</u>	<u>9,060,170</u>
Other liabilities:		
Accrued compensated absences	1,524,489	1,491,316
Other	110,299	32,821
Total other liabilities	<u>1,634,788</u>	<u>1,524,137</u>
Long-term debt:		
Water revenue bonds	143,990,000	119,745,000
Unamortized premiums/discounts	2,866,890	1,518,734
Total long-term debt	<u>146,856,890</u>	<u>121,263,734</u>
Total liabilities	<u>157,852,959</u>	<u>131,848,041</u>
Deferred inflows of resources:		
Pension inflow	829,180	-
Total deferred inflows of resources	<u>829,180</u>	<u>-</u>
Total liabilities and deferred inflows of resources	<u>158,682,139</u>	<u>131,848,041</u>
Net position		
Net investment in capital assets	110,579,425	116,197,169
Restricted for:		
Debt service	1,369,655	1,213,433
Other	5,707	5,703
Unrestricted	45,044,390	34,696,322
Total net position	<u>156,999,177</u>	<u>152,112,627</u>
Total liabilities, deferred inflows, and net position	<u>\$ 315,681,316</u>	<u>\$ 283,960,668</u>

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

Knoxville Utilities Board Water Division
Statements of Revenues, Expenses and Changes in Net Position
Years Ended June 30, 2015 and 2014

	2015	2014
Operating revenues	\$ 44,173,190	\$ 39,373,714
Operating expenses		
Treatment	3,789,101	3,355,348
Distribution	13,045,508	13,635,443
Customer service	1,653,476	1,517,093
Administrative and general	4,206,064	4,363,596
Provision for depreciation	7,794,763	6,933,752
Taxes and tax equivalents	3,621,768	3,041,944
Total operating expenses	34,110,680	32,847,176
Operating income	10,062,510	6,526,538
Non-operating revenues (expenses)		
Contributions in aid of construction	475,386	464,748
Interest and dividend income	134,691	125,448
Interest expense	(5,421,300)	(5,257,923)
Amortization of debt costs	1,262	13,135
Write-down of plant for costs recovered through contributions	(475,386)	(464,748)
Other	(23,992)	(85,734)
Total non-operating revenues (expenses)	(5,309,339)	(5,205,074)
Change in net position before capital contributions	4,753,171	1,321,464
Capital contributions	232,696	157,859
Change in net position	4,985,867	1,479,323
Net position, beginning of year, as previously reported	152,112,627	150,633,304
Change in method of accounting for pension	(99,317)	-
Net position, beginning of year, as restated	152,013,310	150,633,304
Net position, end of year	\$ 156,999,177	\$ 152,112,627

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

Knoxville Utilities Board Water Division

Statements of Cash Flows

Years Ended June 30, 2015 and 2014

	2015	2014
Cash flows from operating activities:		
Cash receipts from customers	\$ 43,258,927	\$ 38,747,289
Cash receipts from other operations	585,142	904,124
Cash payments to suppliers of goods or services	(14,012,339)	(16,831,753)
Cash payments to employees for services	(9,284,435)	(9,559,997)
Payment in lieu of taxes	(2,943,719)	(2,377,350)
Net cash provided by operating activities	<u>17,603,576</u>	<u>10,882,313</u>
Cash flows from capital and related financing activities:		
Net proceeds from bond issuance	27,817,078	24,823,073
Principal paid on revenue bonds and notes payable	(3,765,000)	(3,465,000)
Decrease (increase) in unused bond proceeds	(9,928,179)	-
Interest paid on revenue bonds and notes payable	(5,212,045)	(4,518,219)
Acquisition and construction of water plant	(26,693,360)	(21,283,275)
Changes in water bond fund, restricted	(86,174)	(508,041)
Proceeds received on disposal of plant	-	23,064
Cash received from developers and individuals for capital purposes	475,386	464,748
Net cash used in capital and related financing activities	<u>(17,392,294)</u>	<u>(4,463,650)</u>
Cash flows from investing activities:		
Purchase of investment securities	(2,243,833)	(3,573,869)
Maturities of investment securities	8,053,080	90,858
Interest received	142,666	117,512
Other property and investments	(37,162)	2,057
Net cash provided by (used in) investing activities	<u>5,914,751</u>	<u>(3,363,442)</u>
Net increase (decrease) in cash and cash equivalents	6,126,033	3,055,221
Cash and cash equivalents, beginning of year	<u>15,178,461</u>	<u>12,123,240</u>
Cash and cash equivalents, end of year	<u>\$ 21,304,494</u>	<u>\$ 15,178,461</u>
Reconciliation of operating income to net cash provided by operating activities		
Operating income	\$ 10,062,510	\$ 6,526,538
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization expenses	8,008,940	7,181,731
Changes in operating assets and liabilities:		
Accounts receivable	(421,148)	(174,770)
Inventories	(45,461)	(59,762)
Prepaid expenses	5,317	525
Other assets	(455,412)	(133,901)
Sales tax collections payable	28,506	12,865
Accounts payable and accrued expenses	308,054	(2,415,740)
Customer deposits plus accrued interest	34,791	5,825
Other liabilities	77,479	(60,998)
Net cash provided by operating activities	<u>\$ 17,603,576</u>	<u>\$ 10,882,313</u>
Noncash capital activities:		
Acquisition of plant assets through developer contributions	\$ 232,696	\$ 157,859

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

Knoxville Utilities Board Water Division

Notes to Financial Statements

June 30, 2015 and 2014

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. The Water Division (Division) provides services to certain customers in Knox County and in two surrounding counties in East Tennessee. The Division's accounts are maintained in conformity with the Uniform System of Accounts of the National Association of Regulatory Utility Commissioners (NARUC) and the Governmental Accounting Standards Board (GASB), as applicable. The financial statements present only the Water Division and do not purport to, and do not, present fairly the consolidated financial position of Knoxville Utilities Board at June 30, 2015 and 2014, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

2. Significant Accounting Policies

Basis of Accounting

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 financial statements are prepared on the accrual basis of accounting, whereby revenues are recognized when earned and expenses are recognized when incurred. The accounting and financial reporting treatment applied to the Division is determined by measurement focus. The transactions of the Division are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operations are included on the Statement of Net Position. Net position (i.e., total assets and deferred outflows of resources net of total liabilities and deferred inflows of resources) 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

Knoxville Utilities Board Water Division

Notes to Financial Statements

June 30, 2015 and 2014

used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service.

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.

Water Plant

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

The provision for depreciation of water plant in service is based on the estimated useful lives of the assets, which range from three to sixty-seven years, and is computed using the straight-line method. Pursuant to NARUC, the caption "Provision for depreciation" in the Statements of Revenues, Expenses and Changes in Net Position does not include depreciation for transportation equipment of \$214,178 in fiscal year 2015 and \$247,979 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 the KUB Water Division. Operating revenue is recorded when the service is rendered, on a cycle basis, and includes an estimate of unbilled revenue. Revenues are reported net of bad debt expense of \$169,110 in fiscal year 2015 and \$107,707 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 net assets available, it is KUB's policy to apply those expenses to restricted net assets to the extent such are available and then to unrestricted net assets.

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 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.

Knoxville Utilities Board Water Division

Notes to Financial Statements

June 30, 2015 and 2014

- 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 (Division's share \$99,317) to increase the net pension liability by \$3,515,317 (Division's share \$456,991) based on revised actuarial assumptions to conform with GASB 68 and to reclassify 2014 expenses of \$2,751,341 (Division's share \$357,674) 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 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

Knoxville Utilities Board Water Division

Notes to Financial Statements

June 30, 2015 and 2014

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.

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.

Knoxville Utilities Board Water Division

Notes to Financial Statements

June 30, 2015 and 2014

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. 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.

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 fiscal year 2014 balances to conform to fiscal year 2015 presentation.

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.

KUB has not elected early implementation of these standards and has not completed the process of evaluating the impact of these statements on its financial statements.

Knoxville Utilities Board Water Division

Notes to Financial Statements

June 30, 2015 and 2014

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 Water Division
Notes to Financial Statements
June 30, 2015 and 2014

Classification of deposits and investments per Statement of Net Position:

	2015	2014
Current assets		
Cash and cash equivalents	\$ 21,304,494	\$ 15,178,461
Short-term investments	-	7,000,000
Short-term contingency fund investments	411,198	5,202,977
Other assets		
Long-term contingency fund investments	11,726,424	5,737,073
Restricted assets		
Unused bond proceeds	9,927,990	-
Water bond fund	2,969,210	2,883,036
Other funds	5,707	5,703
	<u>\$ 46,345,023</u>	<u>\$ 36,007,250</u>

The above amounts do not include accrued interest of \$24,839 in fiscal year 2015 and \$31,498 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:

	Deposit and Investment Maturities (in Years)		
	Fair Value	Less Than 1	1-5
Supersweep NOW and Other Deposits	\$ 19,947,382	\$ 19,947,382	\$ -
State Treasurer's Investment Pool	8,976,518	8,976,518	-
Agency Bonds	14,384,186	411,198	13,972,988
Certificates of deposits	4,168,932	3,920,682	248,250
	<u>\$ 47,477,018</u>	<u>\$ 33,255,780</u>	<u>\$ 14,221,238</u>

4. Accounts Receivable

Accounts receivable consists of the following:

	2015	2014
Wholesale and retail customers		
Billed services	\$ 3,275,895	\$ 2,831,835
Unbilled services	1,596,039	1,576,709
Other	164,497	202,287
Allowance for uncollectible accounts	(49,412)	(44,960)
	<u>\$ 4,987,019</u>	<u>\$ 4,565,871</u>

Knoxville Utilities Board Water Division
Notes to Financial Statements
June 30, 2015 and 2014

5. Accounts Payable and Accruals

Accounts payable and accruals were composed of the following:

	2015	2014
Trade accounts	\$ 1,832,317	\$ 1,511,988
Salaries and wages	265,669	243,592
Self-insurance liabilities	220,793	204,465
Other current liabilities	-	820,872
	<u>\$ 2,318,779</u>	<u>\$ 2,780,917</u>

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
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	<u>\$ 123,385,000</u>	<u>\$ 51,005,000</u>	<u>\$ 3,765,000</u>	<u>\$ 22,225,000</u>	<u>\$ 148,400,000</u>	<u>\$ 4,410,000</u>
Unamortized Premium	1,518,734	1,493,612	102,471	42,985	2,866,890	-
Total long term debt	<u>\$ 124,903,734</u>	<u>\$ 52,498,612</u>	<u>\$ 3,867,471</u>	<u>\$ 22,267,985</u>	<u>\$ 151,266,890</u>	<u>\$ 4,410,000</u>

	Balance June 30, 2013	Additions	Payments	Defeased	Balance June 30, 2014	Amounts Due Within One Year
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>

Knoxville Utilities Board Water Division
Notes to Financial Statements
June 30, 2015 and 2014

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

Fiscal Year	Principal	Total Interest	Grand Total
2016	\$ 4,410,000	\$ 5,377,406	\$ 9,787,406
2017	4,560,000	5,502,077	10,062,077
2018	4,710,000	5,308,927	10,018,927
2019	4,870,000	5,127,527	9,997,527
2020	5,100,000	4,923,477	10,023,477
2021 - 2025	28,500,000	21,716,537	50,216,537
2026 - 2030	34,310,000	16,181,136	50,491,136
2031 - 2035	28,865,000	9,980,888	38,845,888
2036 - 2040	21,300,000	5,258,187	26,558,187
2041 - 2045	11,775,000	1,416,250	13,191,250
Total	<u>\$ 148,400,000</u>	<u>\$ 80,792,412</u>	<u>\$ 229,192,412</u>

The Division has pledged sufficient revenue, after deduction of all current operating expenses (exclusive of tax equivalents), to meet bond principal and interest payments when due. The requirements for the bonds are being met through monthly deposits to the Water Bond Fund, as required by the bond covenants. As of June 30, 2015, these bond covenants had been satisfied.

During fiscal year 2006, KUB's Water Division 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 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.

Knoxville Utilities Board Water Division

Notes to Financial Statements

June 30, 2015 and 2014

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.

Other liabilities consist of the following:

	Balance June 30, 2014	Increase	Decrease	Balance June 30, 2015
Accrued compensated absences	\$ 1,491,316	\$ 2,264,335	\$ (2,231,162)	\$ 1,524,489
Other	32,821	193,749	(116,271)	110,299
	<u>\$ 1,524,137</u>	<u>\$ 2,458,084</u>	<u>\$ (2,347,433)</u>	<u>\$ 1,634,788</u>

7. Lease Commitments

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

2016	\$ 5,961
2017	3,569
2018	1,622
2019	1,065
2020	1,065
Total operating minimum lease payments	<u>\$ 13,282</u>

Knoxville Utilities Board Water Division
Notes to Financial Statements
June 30, 2015 and 2014

8. Capital Assets

Capital asset activity was as follows:

	Beginning 6/30/2014	Increase	Decrease	Ending 6/30/2015
Production Plant	\$ 727,863	\$ -	\$ -	727,863
Pumping & Treatment Plant	65,538,290	229,177	(241,860)	65,525,607
Distribution Plant				
Distribution Mains	145,877,358	10,657,161	(419,952)	156,114,567
Transmission Mains	27,261,415	84,477	(7,827)	27,338,065
Services & Meters	29,841,733	882,602	(1,001,964)	29,722,371
Other	21,679,780	690,660	(150,058)	22,220,382
Total Distribution Plant	<u>\$ 224,660,286</u>	<u>\$ 12,314,900</u>	<u>\$ (1,579,801)</u>	<u>\$ 235,395,385</u>
Total General Plant	<u>22,552,206</u>	<u>1,612,164</u>	<u>(226,291)</u>	<u>23,938,079</u>
Total Water Plant	<u>\$ 313,478,645</u>	<u>\$ 14,156,241</u>	<u>\$ (2,047,952)</u>	<u>\$ 325,586,934</u>
Less Accumulated Depreciation	<u>(97,290,740)</u>	<u>(8,049,680)</u>	<u>2,263,093</u>	<u>(103,077,327)</u>
Net Plant Assets	<u>\$ 216,187,905</u>	<u>\$ 6,106,561</u>	<u>\$ 215,141</u>	<u>\$ 222,509,607</u>
Work In Progress	<u>23,517,782</u>	<u>26,268,395</u>	<u>(14,157,025)</u>	<u>35,629,152</u>
Total Net Plant	<u><u>\$ 239,705,687</u></u>	<u><u>\$ 32,374,956</u></u>	<u><u>\$ (13,941,884)</u></u>	<u><u>\$ 258,138,759</u></u>

	Beginning 6/30/2013	Increase	Decrease	Ending 6/30/2014
Production Plant	\$ 727,863	\$ -	\$ -	727,863
Pumping & Treatment Plant	64,374,463	1,453,930	(290,103)	65,538,290
Distribution Plant				
Distribution Mains	129,748,438	17,316,663	(1,187,743)	145,877,358
Transmission Mains	26,795,413	509,435	(43,433)	27,261,415
Services & Meters	28,644,956	1,986,014	(789,237)	29,841,733
Other Accounts	20,857,760	955,085	(133,065)	21,679,780
Total Distribution Plant	<u>\$ 206,046,567</u>	<u>\$ 20,767,197</u>	<u>\$ (2,153,478)</u>	<u>\$ 224,660,286</u>
Total General Plant	<u>21,158,646</u>	<u>1,631,977</u>	<u>(238,417)</u>	<u>22,552,206</u>
Total Water Plant	<u>\$ 292,307,539</u>	<u>\$ 23,853,104</u>	<u>\$ (2,681,998)</u>	<u>\$ 313,478,645</u>
Less Accumulated Depreciation	<u>(92,986,123)</u>	<u>(6,924,520)</u>	<u>2,619,903</u>	<u>(97,290,740)</u>
Net Plant Assets	<u>\$ 199,321,416</u>	<u>\$ 16,928,584</u>	<u>\$ (62,095)</u>	<u>\$ 216,187,905</u>
Work In Progress	<u>26,700,469</u>	<u>20,587,700</u>	<u>(23,770,387)</u>	<u>23,517,782</u>
Total Net Plant	<u><u>\$ 226,021,885</u></u>	<u><u>\$ 37,516,284</u></u>	<u><u>\$ (23,832,482)</u></u>	<u><u>\$ 239,705,687</u></u>

Knoxville Utilities Board Water Division
Notes to Financial Statements
June 30, 2015 and 2014

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 \$220,793 resulting from the following changes:

	2015	2014
Balance, beginning of year	\$ 204,465	\$ 225,417
Current year claims and changes in estimates	1,840,260	1,602,477
Claims payments	<u>(1,823,932)</u>	<u>(1,623,429)</u>
Balance, end of year	<u>\$ 220,793</u>	<u>\$ 204,465</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. For purposes of this disclosure, presentation is on a consolidated basis unless division's share is specified.

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:

	2014	2013
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>

Knoxville Utilities Board Water Division

Notes to Financial Statements

June 30, 2015 and 2014

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 percent of the first \$4,800 of annual earnings and 5 percent 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.

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

Knoxville Utilities Board Water Division

Notes to Financial Statements

June 30, 2015 and 2014

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. Of these amounts, \$820,872 and \$715,348 are attributable to the Water Division. 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. The Water Division's portion of this contribution is \$737,019.

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. The Water Division's portion of this contribution is \$625,809. 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. The division's share of the net pension asset is \$782,812.

Knoxville Utilities Board Water Division
Notes to Financial Statements
June 30, 2015 and 2014

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

	2014	2013
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 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

Knoxville Utilities Board Water Division
Notes to Financial Statements
June 30, 2015 and 2014

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>	Long Term Expected
	<u>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:

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

Knoxville Utilities Board Water Division
Notes to Financial Statements
June 30, 2015 and 2014

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 (Division's share \$357,488).

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 (Division's share \$829,180). 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 (Division's share \$410,436) 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	-

Knoxville Utilities Board Water Division

Notes to Financial Statements

June 30, 2015 and 2014

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. Based on the funding level of the Pension Plan, effective July 1, 2011, KUB began to reimburse the Pension Plan for the current matching contributions. The match and nonelective contributions for employees hired on or after January 1, 2011 are paid directly by KUB. KUB funded 401(k) matching contributions and nonelective contributions of \$1,593,350 (Division's share \$207,135) and \$1,463,184 (Division's share \$190,214), 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

Knoxville Utilities Board Water Division
Notes to Financial Statements
June 30, 2015 and 2014

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)	3,500,284	3,319,013
f) Employer Contributions	3,497,372	4,057,091
g) Net OPEB Obligation/(Asset) at end of fiscal year (a+e-f)	\$ (174,410)	\$ (177,322)

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:

Schedule of Employer Contributions					
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 (Division's share \$454,658). 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 (Division's share \$454,658). As of June 30, 2015, the employer's OPEB obligation has been exceeded by \$174,410 (Division's share \$22,673).

Knoxville Utilities Board Water Division

Notes to Financial Statements

June 30, 2015 and 2014

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 (Division's share \$123,919).

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 (Division's share \$6,206,933). The actuarial value of the Plan's assets was \$47,705,478 (Division's share \$6,201,712). As a result, the Plan's unfunded actuarial accrued liability was \$40,162 (Division's share \$5,221). 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 (Division's share \$80,602). 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.

Knoxville Utilities Board Water Division
Notes to Financial Statements
June 30, 2015 and 2014

13. Related Party Transactions

The Division, in the normal course of operations, is involved in transactions with the City of Knoxville and with other divisions of KUB. Such transactions for the years ended June 30, 2015 and 2014, are summarized as follows:

	2015	2014
City of Knoxville		
Amounts billed by the Division for utilities and related services	\$ 3,894,557	\$ 3,229,509
Payments by the Division in lieu of property tax	2,943,719	2,377,350
Payments by the Division for services provided	507,095	696,190
Other divisions of KUB		
Amounts billed to other divisions for utilities and related services provided	327,109	358,304
Interdivisional rental expense	214,469	197,536
Interdivisional rental income	92,415	80,427
Amounts billed to the Division by other divisions for utilities services provided	2,964,224	3,120,332

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

	2015	2014
Accounts receivable	\$ 295,804	\$ 62,221

14. Other Commitments and Contingencies

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

Knoxville Utilities Board Water Division
Required Supplementary Information – Schedule of Funding Progress
June 30, 2015
(Unaudited)

Other Post-Employment Benefits (OPEB)

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

Required Supplementary Information – Schedule of Changes in Net Pension Liability and Related Ratios

June 30, 2015

(Unaudited)

	2014
Total pension liability	
Service cost	\$ 4,092,808
Interest	14,698,657
Benefit payments, including refunds of member contributions	(15,533,167)
Net change in total pension liability	3,258,298
Total pension liability - beginning	199,515,466
Total pension liability - ending (a)	\$ 202,773,764
Plan fiduciary net position	
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	(128,000)
Net change in plan fiduciary net position**	12,795,245
Plan fiduciary net position - beginning**	196,000,149
Plan fiduciary net position - ending (b)**	\$ 208,795,394
Plan's net pension liability - ending (a) - (b)	\$ (6,021,630)
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 Water Division
Required Supplementary Information – Schedule of Employer Pension Contributions
June 30, 2015
(Unaudited)

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

Notes to Schedule:

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:

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 Water Division
Supplemental Information - Schedule of Insurance in Force
June 30, 2015
(Unaudited)

Schedule 1

Insurance coverage is for KUB as a consolidated entity.

Crime

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

Directors' and Officers' Liability Insurance

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

Employment Practices Liability

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

Fiduciary

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

Pollution Legal Liability

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

Property Insurance

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

Travel Accident

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

Excess Insurance for General Liability

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

Excess Insurance for Workers' Compensation

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

Employee Health Plan Stop Loss Coverage

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

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Water Division
Supplemental Information - Schedule of Debt Maturities by Fiscal Year
June 30, 2015
(Unaudited)

Schedule 2

Continued on Next Page

FY	S-2005		T-2007		U-2009		W-2011		X-2012		Y-2013	
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest
15-16	\$ 440,000	\$ 289,521	\$ 700,000	\$ 79,750	\$ 825,000	\$ 964,625	\$ 550,000	\$ 882,750	\$ 485,000	\$ 370,000	\$ 265,000	\$ 290,150
16-17	465,000	267,521	750,000	41,250	875,000	931,625	550,000	871,750	515,000	345,750	280,000	282,200
17-18	485,000	244,271			925,000	896,625	550,000	844,250	535,000	320,000	300,000	273,800
18-19	500,000	224,871			950,000	859,625	550,000	827,750	565,000	293,250	320,000	261,800
19-20	520,000	204,871			1,000,000	821,625	550,000	805,750	590,000	265,000	340,000	249,000
20-21	545,000	183,421			1,050,000	781,625	550,000	789,250	625,000	235,500	350,000	235,400
21-22	570,000	160,940			1,125,000	739,625	550,000	772,750	655,000	204,250	375,000	221,400
22-23	590,000	137,428			1,175,000	694,625	500,000	756,250	670,000	184,600	400,000	210,150
23-24	615,000	112,353			1,225,000	647,625	500,000	741,250	690,000	164,500	415,000	198,150
24-25	640,000	86,215			1,300,000	598,625	500,000	726,250	710,000	143,800	435,000	185,700
25-26	665,000	58,695			1,350,000	546,625	500,000	710,625	735,000	120,725	450,000	172,650
26-27	700,000	30,100			1,425,000	492,625	500,000	693,125	765,000	95,000	470,000	159,150
27-28					1,500,000	435,625	500,000	673,125	790,000	64,400	1,250,000	145,050
28-29					1,575,000	375,625	500,000	655,625	820,000	32,800	1,300,000	107,550
29-30					1,650,000	308,688	500,000	635,625			2,285,000	68,550
30-31					1,750,000	238,563	500,000	617,500				
31-32					1,825,000	164,188	500,000	598,750				
32-33					1,925,000	86,625	500,000	580,000				
33-34							2,000,000	560,000				
34-35							2,000,000	480,000				
35-36							2,000,000	400,000				
36-37							2,000,000	320,000				
37-38							2,000,000	240,000				
38-39							2,000,000	160,000				
39-40							2,000,000	80,000				
40-41												
41-42												
42-43												
43-44												
44-45												
	<u>\$ 6,735,000</u>	<u>\$ 2,000,207</u>	<u>\$ 1,450,000</u>	<u>\$ 121,000</u>	<u>\$ 23,450,000</u>	<u>\$ 10,584,814</u>	<u>\$ 23,350,000</u>	<u>\$ 15,422,375</u>	<u>\$ 9,150,000</u>	<u>\$ 2,839,575</u>	<u>\$ 9,235,000</u>	<u>\$ 3,060,700</u>

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Water Division
Supplemental Information - Schedule of Debt Maturities by Fiscal Year
June 30, 2015
(Unaudited)

Schedule 2

Continued from Previous Page

FY	Z-2013		AA-2014		BB-2015		CC-2015		TOTAL		Grand
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Total
15-16	\$ 475,000	\$ 1,014,125	\$ 150,000	\$ 264,750	\$ 170,000	\$ 666,833	\$ 350,000	\$ 554,902	\$ 4,410,000	\$ 5,377,406	\$ 9,787,406
16-17	500,000	1,004,625	150,000	261,750	100,000	791,700	375,000	703,906	4,560,000	\$ 5,502,077	10,062,077
17-18	500,000	989,625	150,000	257,250	865,000	786,700	400,000	696,406	4,710,000	\$ 5,308,927	10,018,927
18-19	525,000	979,625	150,000	252,750	885,000	743,450	425,000	684,406	4,870,000	\$ 5,127,527	9,997,527
19-20	550,000	963,875	175,000	246,750	950,000	699,200	425,000	667,406	5,100,000	\$ 4,923,477	10,023,477
20-21	575,000	947,375	175,000	243,250	960,000	680,200	450,000	650,406	5,280,000	\$ 4,746,427	10,026,427
21-22	600,000	930,125	175,000	238,000	1,000,000	661,000	475,000	632,406	5,525,000	\$ 4,560,496	10,085,496
22-23	625,000	912,125	200,000	231,000	1,050,000	611,000	475,000	613,406	5,685,000	\$ 4,350,584	10,035,584
23-24	625,000	893,375	200,000	223,000	1,110,000	558,500	500,000	599,156	5,880,000	\$ 4,137,909	10,017,909
24-25	650,000	874,625	200,000	215,000	1,170,000	503,000	525,000	587,906	6,130,000	\$ 3,921,121	10,051,121
25-26	675,000	852,688	225,000	209,000	1,210,000	467,900	550,000	574,782	6,360,000	\$ 3,713,690	10,073,690
26-27	700,000	828,219	225,000	202,250	1,245,000	428,575	550,000	560,344	6,580,000	\$ 3,489,388	10,069,388
27-28	750,000	800,219	225,000	195,500	1,260,000	385,000	575,000	543,844	6,850,000	\$ 3,242,763	10,092,763
28-29	775,000	770,219	250,000	188,750	1,275,000	340,900	600,000	526,594	7,095,000	\$ 2,998,063	10,093,063
29-30	800,000	738,250	250,000	181,250	1,315,000	296,275	625,000	508,594	7,425,000	\$ 2,737,232	10,162,232
30-31	825,000	704,250	275,000	173,438	2,740,000	256,825	650,000	489,060	6,740,000	\$ 2,479,636	9,219,636
31-32	850,000	669,188	275,000	164,844	2,800,000	174,625	675,000	467,938	6,925,000	\$ 2,239,533	9,164,533
32-33	900,000	632,000	300,000	155,906	2,900,000	90,625	700,000	446,000	7,225,000	\$ 1,991,156	9,216,156
33-34	925,000	591,500	300,000	146,156			725,000	418,000	3,950,000	\$ 1,715,656	5,665,656
34-35	950,000	549,875	325,000	136,032			750,000	389,000	4,025,000	\$ 1,554,907	5,579,907
35-36	1,000,000	507,125	325,000	124,656			775,000	359,000	4,100,000	\$ 1,390,781	5,490,781
36-37	1,025,000	460,875	350,000	113,282			800,000	330,906	4,175,000	\$ 1,225,063	5,400,063
37-38	1,075,000	413,469	350,000	101,031			825,000	301,906	4,250,000	\$ 1,056,406	5,306,406
38-39	1,100,000	363,750	375,000	88,781			875,000	272,000	4,350,000	\$ 884,531	5,234,531
39-40	1,150,000	308,750	375,000	75,656			900,000	237,000	4,425,000	\$ 701,406	5,126,406
40-41	1,200,000	251,250	400,000	62,531			925,000	201,000	2,525,000	\$ 514,781	3,039,781
41-42	1,225,000	191,250	425,000	48,031			975,000	164,000	2,625,000	\$ 403,281	3,028,281
42-43	1,275,000	130,000	450,000	32,625			1,000,000	125,000	2,725,000	\$ 287,625	3,012,625
43-44	1,325,000	66,250	450,000	16,313			1,050,000	85,000	2,825,000	\$ 167,563	2,992,563
44-45							1,075,000	43,000	1,075,000	\$ 43,000	1,118,000
	<u>\$ 24,150,000</u>	<u>\$ 19,338,627</u>	<u>\$ 7,875,000</u>	<u>\$ 4,849,532</u>	<u>\$ 23,005,000</u>	<u>\$ 9,142,308</u>	<u>\$ 20,000,000</u>	<u>\$ 13,433,274</u>	<u>\$ 148,400,000</u>	<u>\$ 80,792,412</u>	<u>\$ 229,192,412</u>

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Water Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2015
(Unaudited)

Schedule 3

Rate Class	Base Charge	Number of Customers
Residential Inside City rate	For water furnished to premises entirely within the corporate limits of the City of Knoxville:	55,093
Commodity Charge		
	First 2 100 Cubic Feet Per Month at \$0.25 Per 100 Cubic Feet	
	Over 2 100 Cubic Feet Per Month at \$2.65 Per 100 Cubic Feet	
Additional Monthly Customer Charge		
	For 5/8" meter \$ 13.00	
	For 1" meter 27.10	
	For 1 1/2" meter 39.00	
	For 2" meter 55.00	
Residential Outside City rate	For water furnished to premises upon which any water faucet or other outlet is outside the corporate limits of the City of Knoxville:	13,148
Commodity Charge		
	First 2 100 Cubic Feet Per Month at \$0.30 Per 100 Cubic Feet	
	Over 2 100 Cubic Feet Per Month at \$3.20 Per 100 Cubic Feet	
Additional Monthly Customer Charge		
	For 5/8" meter \$ 14.40	
	For 1" meter 31.40	
	For 1 1/2" meter 45.40	
	For 2" meter 64.40	

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Water Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2015
(Unaudited)

Schedule 3

Rate Class	Base Charge	Number of Customers
Non-Residential Inside City rate/ Industrial Park rate	For water furnished to premises entirely within the corporate limits of the City of Knoxville or within the boundaries of an area recognized as an industrial park by the Tennessee Department of Economic and Community Development:	9,613
Commodity Charge		
First	2 100 Cubic Feet Per Month at \$1.45 Per 100 Cubic Feet	
Next	8 100 Cubic Feet Per Month at \$3.25 Per 100 Cubic Feet	
Next	90 100 Cubic Feet Per Month at \$3.95 Per 100 Cubic Feet	
Next	300 100 Cubic Feet Per Month at \$2.75 Per 100 Cubic Feet	
Next	4,600 100 Cubic Feet Per Month at \$1.90 Per 100 Cubic Feet	
Next	5,000 100 Cubic Feet Per Month at \$1.00 Per 100 Cubic Feet	
Additional Monthly Customer Charge		
For	5/8" meter	\$ 13.00
For	1" meter	27.10
For	1 1/2" meter	39.00
For	2" meter	55.00
For	3" meter	121.00
For	4" meter	200.00
For	6" meter	438.00
For	8" meter	770.00
For	10" meter	1,173.00
For	12" meter	1,736.00
Non-Residential Outside City rate	For water furnished to premises upon which any water faucet or other outlet is outside the corporate limits of the City of Knoxville, excluding premises within the boundaries of an area recognized as an industrial park by the Tennessee Department of Economic and Community Development:	699
Commodity Charge		
First	2 100 Cubic Feet Per Month at \$1.70 Per 100 Cubic Feet	
Next	8 100 Cubic Feet Per Month at \$3.80 Per 100 Cubic Feet	
Next	90 100 Cubic Feet Per Month at \$4.75 Per 100 Cubic Feet	
Next	300 100 Cubic Feet Per Month at \$3.30 Per 100 Cubic Feet	
Next	4,600 100 Cubic Feet Per Month at \$2.30 Per 100 Cubic Feet	
Next	5,000 100 Cubic Feet Per Month at \$1.20 Per 100 Cubic Feet	
Additional Monthly Customer Charge		
For	5/8" meter	\$ 14.40
For	1" meter	31.40
For	1 1/2" meter	45.40
For	2" meter	64.40
For	3" meter	144.00
For	4" meter	241.00
For	6" meter	526.00
For	8" meter	924.00
For	10" meter	1,407.00
For	12" meter	2,085.00

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Water Division
Supplemental Information - Schedule of Unaccounted for Water
June 30, 2015
(Unaudited)

Schedule 4

The following unaudited Schedule of Unaccounted for Water is attached as required by the Tennessee Code Annotated. For reports submitted January 1, 2013 and later, the American Water Works Association (AWWA) water loss reporting model must be used. For fiscal year 2014, water utilities are required to have a Validity Score greater than 65 and maintain non-revenue water as a percent by cost of operating system of less than 30%. For fiscal year 2015, water utilities are required to have a Validity Score greater than 70 and maintain non-revenue water as a percent by cost of operating system of less than 25%. For fiscal year 2014, KUB reported a Validity Score of 85 and non-revenue water as a percent by cost of operating system of 11.3%. For fiscal year 2015, KUB reported a Validity Score of 94 and non-revenue water as a percent by cost of operating system of 10.2%. See Supplemental Information Schedule 4 for the AWWA Reporting Worksheet.

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Water Division

Supplemental Information - Schedule of Unaccounted for Water

June 30, 2015
(Unaudited)

Schedule 4

AWWA Free Water Audit Software: Reporting Worksheet

WAS v5.0
American Water Works Association.
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? Click to access definition

+ Click to add a comment

Water Audit Report for: Knoxville Utilities Board
Reporting Year: 2015 7/2014 - 6/2015

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

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

WATER SUPPLIED

<----- Enter grading in column 'E' and 'J' ----->

Volume from own sources:	+ ? 10	11,669.000	MG/Yr	+ ? 5	
Water imported:	+ ?	0.000	MG/Yr	+ ?	
Water exported:	+ ? 10	279.391	MG/Yr	+ ?	

WATER SUPPLIED:
11,265.334 MG/Yr

Master Meter and Supply Error Adjustments

Pcnt:	Value:			MG/Yr
+ ?	124.275	124.275		MG/Yr
+ ?				MG/Yr
+ ?				MG/Yr

Enter negative % or value for under-registration
Enter positive % or value for over-registration

AUTHORIZED CONSUMPTION

Billed metered:	+ ? 10	7,665.155	MG/Yr	+ ? 5	
Billed unmetered:	+ ? 10	41.513	MG/Yr	+ ?	
Unbilled metered:	+ ? 10	181.310	MG/Yr	+ ?	
Unbilled unmetered:	+ ?	140.817	MG/Yr	+ ?	

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

AUTHORIZED CONSUMPTION:
8,028.795 MG/Yr

Click here: ?
for help using option
buttons below

Pcnt: Value: MG/Yr

1.25% 124.275

Use buttons to select
percentage of water
supplied
OR
value

Pcnt: Value: MG/Yr

0.25% 16.898

2.04% 16.898

WATER LOSSES (Water Supplied - Authorized Consumption)

3,236.539 MG/Yr

Apparent Losses

Unauthorized consumption: + ? 28.163 MG/Yr

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

Customer metering inaccuracies:	+ ? 9	163.401	MG/Yr	+ ? 5	
Systematic data handling errors:	+ ? 7	16.898	MG/Yr	+ ?	

Apparent Losses:
208.463 MG/Yr

Real Losses (Current Annual Real Losses or CARL)

Real Losses = Water Losses - Apparent Losses:
3,028.077 MG/Yr

WATER LOSSES:
3,236.539 MG/Yr

Pcnt: Value: MG/Yr

0.25% 16.898

2.04% 16.898

NON-REVENUE WATER

NON-REVENUE WATER:
3,558.666 MG/Yr

= Water Losses + Unbilled Metered + Unbilled Unmetered

SYSTEM DATA

Length of mains:	+ ? 10	1,407.1	miles	+ ? 10	
Number of active AND inactive service connections:	+ ?	91,786	conn/mile main	+ ?	
Service connection density:	+ ?	65	conn/mile main	+ ?	

Are customer meters typically located at the curbstop or property line? Yes (length of service line, beyond the property boundary, that is the responsibility of the utility)

Average length of customer service line: + ?

Average length of customer service line has been set to zero and a data grading score of 10 has been applied

Average operating pressure: + ? 10 79.0 psi

COST DATA

Total annual cost of operating water system:	+ ? 10	\$31,588,964	\$/Year	+ ? 8	
Customer retail unit cost (applied to Apparent Losses):	+ ?	\$7.77	\$/100 cubic feet (ccf)	+ ?	
Variable production cost (applied to Real Losses):	+ ? 10	\$314.51	\$/Million gallons	+ ?	

Use Customer Retail Unit Cost to value real losses

*** YOUR SCORE IS: 94 out of 100 ***

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

PRIORITY AREAS FOR ATTENTION:

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

1: Unauthorized consumption

2: Systematic data handling errors

3: Customer retail unit cost (applied to Apparent Losses)

See accompanying Report of Independent Auditors on Supplemental Information.

59

Knoxville Utilities Board Water Division
Supplemental Information - Schedule of Unaccounted for Water
June 30, 2015
(Unaudited)

Schedule 4

AWWA Free Water Audit Software: System Attributes and Performance Indicators		WAS v5.0 American Water Works Association Copyright © 2014, All Rights Reserved.
Water Audit Report for: Knoxville Utilities Board		
Reporting Year: 2015 7/2014 - 6/2015		
*** YOUR WATER AUDIT DATA VALIDITY SCORE IS: 94 out of 100 ***		
<u>System Attributes:</u>		
	Apparent Losses:	208.463 MG/Yr
+	Real Losses:	3,028.077 MG/Yr
=	Water Losses:	3,236.539 MG/Yr
?	Unavoidable Annual Real Losses (UARL):	616.50 MG/Yr
	Annual cost of Apparent Losses:	\$2,165,297
	Annual cost of Real Losses:	\$952,360 Valued at Variable Production Cost Return to Reporting Worksheet to change this assumption
<u>Performance Indicators:</u>		
Financial:	Non-revenue water as percent by volume of Water Supplied:	31.6%
	Non-revenue water as percent by cost of operating system:	10.2% Real Losses valued at Variable Production Cost
Operational Efficiency:	Apparent Losses per service connection per day:	6.22 gallons/connection/day
	Real Losses per service connection per day:	90.39 gallons/connection/day
	Real Losses per length of main per day*:	N/A
	Real Losses per service connection per day per psi pressure:	1.14 gallons/connection/day/psi
	From Above, Real Losses = Current Annual Real Losses (CARL):	3,028.08 million gallons/year
?	Infrastructure Leakage Index (ILI) [CARL/UARL]:	4.91

* This performance indicator applies for systems with a low service connection density of less than 32 service connections/mile of pipeline

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
Water Division of the Knoxville Utilities Board
Knoxville, Tennessee

Report on the Financial Statements

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 Water Division (the Division) of the Knoxville Utilities Board, 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 the Division'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 the Division'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 the Division's internal control. Accordingly, we do not express an opinion on the effectiveness of the Division'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 the Division'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
Water Division of the Knoxville Utilities Board
Knoxville, Tennessee

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Division'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 the Division's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Division's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Coulter & Justus, P.C.

Knoxville, Tennessee
October 16, 2015

Knoxville Utilities Board
Wastewater Division
Financial Statements and Supplemental
Information
June 30, 2015 and 2014

Knoxville Utilities Board Wastewater Division

Index

June 30, 2015 and 2014

	Page(s)
Independent Auditors' Report	1-2
Management's Discussion and Analysis	3-24
Financial Statements	
Statements of Net Position.....	25-26
Statements of Revenues, Expenses and Changes in Net Position.....	27
Statements of Cash Flows	28
Notes to Financial Statements	29-50
Required Supplementary Information – Schedule of Funding Progress	51
Required Supplementary Information – Schedule of Changes in Net Pension Liability and Related Ratios	52
Required Supplementary Information – Schedule of Employer Pension Contributions.....	53
Supplemental Information:	
Schedule 1 – Schedule of Insurance in Force	54
Schedule 2 – Schedule of Debt Maturities by Fiscal Year	55-56
Schedule 3 – Schedule of Current Rates in Force.....	57-60
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 <i>Government Auditing Standards</i>	61-62



Report of Independent Auditors

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

We have audited the accompanying financial statements of the Wastewater Division (the Division) 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 the Division'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 Division's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Division's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Wastewater Division of the Knoxville Utilities Board 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, the Division adopted new accounting guidance, Governmental Accounting Standards Board Statement No. 68, *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27* in 2015. Our opinion is not modified with respect to that matter.

Board of Commissioners
The Wastewater Division of the Knoxville Utilities Board
Knoxville, Tennessee

Other Matters

Prior Period Financial Statements

The financial statements of the Division 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.

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 24 and the required supplementary information on pages 51 through 53 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 the Division's basic financial statements. The supplemental information is presented for purposes of additional analysis and is not a required part of the basic financial statements. The supplemental information 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 the Division's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Division's internal control over financial reporting and compliance.

Coulter & Justus, P.C.

Knoxville, Tennessee
October 16, 2015

Knoxville Utilities Board Wastewater Division

Management's Discussion and Analysis

June 30, 2015 and 2014

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. The Wastewater Division (Division) provides services to certain customers in Knox County and in two surrounding counties in East Tennessee. The Division's accounts are maintained in conformity with the Uniform System of Accounts of the National Association of Regulatory Utility Commissioners (NARUC) and the Governmental Accounting Standards Board (GASB), as applicable. The financial statements present only the Wastewater Division and do not purport to, and do not, present fairly the consolidated financial position of Knoxville Utilities Board at June 30, 2015 and 2014, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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

The Division's Management Discussion and Analysis ("MD&A") focuses on the fiscal year ending June 30, 2015 activities, resulting changes and current known facts, and should be read in conjunction with the Division's financial statements.

Wastewater Division Highlights

System Highlights

The wastewater service area covers 245 square miles and includes 69,847 wastewater customers. KUB maintains 1,315 miles of services mains, 75 pump stations, and 4 treatment plants to treat 13.3 billion gallons of wastewater on an annual basis. The average daily flow is 36.5 million gallons.

The wastewater system added 234 customers during fiscal year 2015.

The typical residential wastewater customer's monthly wastewater bill was \$50.50 during as of June 30, 2015, representing an increase of \$3 compared to June 30, 2014. The increase in the monthly bill reflects a rate increase effective October 2014.

In August 2014, KUB issued \$30 million in wastewater system revenue bonds. In April 2015, KUB issued \$30 million in wastewater system revenue bonds. The proceeds of these bond issues were used to fund wastewater system capital improvements. KUB also sold \$129.8 million in wastewater system revenue refunding bonds in April 2015 to refinance certain outstanding bond at lower interest rates. The refunding will provide debt service savings of \$13.4 over the life of the bonds.

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 treatment 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 treatment plant was awarded Platinum.

Knoxville Utilities Board Wastewater Division

Management's Discussion and Analysis

June 30, 2015 and 2014

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 the 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.

In 2013, the Board extended the funding approach for Century II to include the wastewater system, although the Wastewater Division had maintained a ten-year funding plan since the inception of the Federal Consent Decree (see below). The Board formally endorsed and adopted by resolution, a ten year funding plan for the Wastewater Division, which includes a combination of rate increases and debt issues to fully fund the wastewater system's Century II program.

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 the Wastewater Division. The first rate increase went into effect in October 2014. The wastewater rate increases will each produce an additional \$4.7 million of annual sales revenues.

KUB rehabilitated or replaced 30.4 miles of wastewater system main, exceeding the target level of 25 miles, while staying within the Division's total capital budget during fiscal year 2015.

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.

Knoxville Utilities Board Wastewater Division

Management's Discussion and Analysis

June 30, 2015 and 2014

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 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

The Division's net position during the year increased \$7.8 million compared to a \$5.7 million increase last fiscal year. 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 \$0.2 million during fiscal year 2015. This change resulted in a net increase of \$7.6 million or 3 percent in the Division's net position.

Operating revenue increased \$4.2 million or 5.5 percent, the result of additional revenue generated during the fiscal year from the rate increase effective October 2014, along with a 0.9 percent increase in wastewater sales volumes.

Operating expenses increased \$2.5 million or 5 percent. Operating and maintenance (O&M) expenditures increased \$1.2 million or 4.2 percent. Depreciation expense rose \$1 million or 6.5 percent. Taxes and tax equivalents increased \$0.2 million or 5.1 percent.

Interest income was consistent with the prior fiscal year. Interest expense increased \$0.1 million or less than 1 percent reflecting additional interest expense on \$60 million in revenue bonds sold in fiscal year 2015. Other income (net) was \$0.4 million higher.

Capital contributions increased \$0.1 million, the result of an increase in donated assets from developers compared to the previous fiscal year.

Knoxville Utilities Board Wastewater Division

Management's Discussion and Analysis

June 30, 2015 and 2014

Total plant assets (net) increased \$21.9 million or 3.4 percent since the end of last fiscal year.

KUB sold two series of wastewater system revenue bonds during fiscal year 2015 for the purpose of funding wastewater system capital improvements totaling \$60 million. The \$30 million bond issue in April 2015 was accelerated to take advantage of the low interest rate environment which impacted the Division's debt rate and debt service coverage levels for fiscal year 2015. Long-term debt represented 65.8 percent of the Division's capital structure as of June 30, 2015, as compared to 63.9 percent last year. The increase is the net result of the issuance of revenue bonds in August 2014 and April 2015 offset the scheduled repayment of debt during the fiscal year. Capital structure equals long-term debt (which includes the current and long-term portion of revenue bonds and notes) plus net position.

The Division's bond covenants require a debt service coverage ratio of at least 1.2 times the maximum principal and interest payments over the life of the Division's outstanding bonds. Current year debt coverage for the fiscal year was 1.65. Maximum debt service coverage was 1.55.

Fiscal Year 2014 Compared to Fiscal Year 2013

The Division's net position increased \$5.7 million or 2.3 percent, compared to an \$8.8 million increase in fiscal year 2013.

Operating revenue increased \$0.5 million or 0.6 percent, the net result of additional revenue generated during the fiscal year from the 12 percent rate increase effective October 2012, offset by a 1.9 percent decline in wastewater billed sales volumes.

Operating expenses increased \$3.7 million or 8 percent. Operating and maintenance (O&M) expenditures increased \$1.9 million or 6.6 percent. Depreciation expense rose \$1.6 million or 11.3 percent. Taxes and tax equivalents increased \$0.2 million or 6.1 percent.

Non-operating revenues were consistent with the prior year. Interest income was \$0.1 million less than the prior fiscal year. Interest expense decreased \$0.6 million or 2.9 percent, the net effect of a March 2013 revenue bond refunding and \$65 million revenue bond issuance in the prior fiscal year. Other income (net) was \$0.5 million lower, reflecting a loss on disposition of wastewater system assets.

Capital contributions increased \$0.1 million, the result of an increase in donated assets from developers compared to the previous fiscal year.

Total plant assets (net) increased \$24.2 million or 3.9 percent since the end of last fiscal year.

Long-term debt represented 63.9 percent of the Division's capital structure as of June 30, 2014, as compared to 64.9 percent at June 30, 2013. The decrease is attributable to the scheduled repayment of debt during the fiscal year. Capital structure equals long-term debt (which includes the current portion of revenue bonds and notes, as applicable, due to be retired the next fiscal year) plus net position.

The Division's bond covenants require a debt service coverage ratio of at least 1.2 times the maximum principal and interest payments over the life of the Division's outstanding bonds. Debt coverage for the fiscal year ending June 30, 2014 was 1.61. Maximum debt service coverage was 1.59.

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Knoxville Utilities Board Wastewater Division

Management's Discussion and Analysis

June 30, 2015 and 2014

Division Cash Budget Appropriations

KUB's Board of Commissioners adopted a Wastewater Division budget of \$107.4 million for fiscal year 2015. At year end, the Division was \$2.6 million under budget. O&M spending was \$2 million under budget. Operating efficiencies resulted in a savings in utility costs of \$0.6 million, while outside contractors and KUB labor related expenses were a combined \$1.2 million under budget. Capital spending was \$0.8 million under budget, reflecting timing of planned projects. Cash operating receipts were \$1.9 million below budget due to lower than projected sales revenue. The Division's general fund balance was \$16.3 million higher in fiscal year 2015 than budgeted, primarily due to the acceleration of a \$30 million bond issue to take advantage of the low interest rate environment. The chart below depicts KUB's original budget compared to actual results and is presented on a cash basis.

Wastewater Division Cash Report As of June 30, 2015

<i>(in thousands of dollars)</i>	FY 2015 Budget	FY 2015 Actual FYTD	Dollar Variance*	Percent Variance
Beginning Balance General Fund	\$ 15,414	\$ 15,414		
Operating Receipts	81,495	79,606	(1,889)	-2.3%
Disbursements				
Operation & Maintenance Expense	33,715	31,743	1,972	5.8%
Capital Expenditures	40,444	39,652	792	2.0%
Debt Service	28,928	29,106	(178)	-0.6%
Taxes & Tax Equivalents	4,351	4,326	25	0.6%
Total Disbursements	107,438	104,827	2,611	2.4%
Bond Proceeds	29,700	45,073	15,373	51.8%
Net Flow-throughs and Transfers	(2,667)	(2,413)	254	9.5%
Ending General Fund Balance	<u>\$ 16,504</u>	<u>\$ 32,853</u>	<u>\$ 16,349</u>	<u>99.1%</u>

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

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Knoxville Utilities Board Wastewater Division

Management's Discussion and Analysis

June 30, 2015 and 2014

Knoxville Utilities Board Wastewater Division - Financial Statements

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

Statement of Net Position

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

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

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

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

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

Statement of Revenues, Expenses and Changes in Net Position

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

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

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

Statement of Cash Flows

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

The statement indicates the Division's beginning cash balance and ending cash balance and 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 Wastewater Division
Management's Discussion and Analysis
June 30, 2015 and 2014

Condensed Financial Statements

Statement of Net Position

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

Statements of Net Position
As of June 30

<i>(in thousands of dollars)</i>	2015	2014	2013
Current, restricted and other assets	\$ 104,099	\$ 66,802	\$ 95,925
Capital assets, net	664,178	642,302	618,134
Deferred outflows of resources	18,593	10,064	10,533
Total assets and deferred outflows of resources	<u>786,870</u>	<u>719,168</u>	<u>724,592</u>
Current and other liabilities	19,981	19,979	26,217
Long-term debt outstanding	503,955	445,190	450,050
Deferred inflows of resources	1,339	-	-
Total liabilities and deferred inflows of resources	<u>525,275</u>	<u>465,169</u>	<u>476,267</u>
Net position			
Net investment in capital assets	172,144	201,947	169,625
Restricted	2,624	2,263	2,148
Unrestricted	86,827	49,789	76,552
Total net position	<u>\$ 261,595</u>	<u>\$ 253,999</u>	<u>\$ 248,325</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 Wastewater Division

Management's Discussion and Analysis

June 30, 2015 and 2014

Impacts and Analysis

Current, Restricted and Other Assets

Fiscal Year 2015 Compared to Fiscal Year 2014

Current, restricted and other assets increased \$37.3 million or 55.8 percent, reflecting a \$17.4 million increase in the general fund balance and \$15.6 million in unused bond proceeds. Operating contingency reserves increased \$2.4 million and accounts receivable increased \$0.6 million.

Fiscal Year 2014 Compared to Fiscal Year 2013

Current, restricted and other assets decreased \$29.1 million or 30.4 percent. General fund cash decreased \$32.5 million, due to the use of general fund cash to fund capital expenditures during the year. Accounts receivable decreased \$0.8 million and operating contingency reserves increased \$1.1 million.

Capital Assets

Fiscal Year 2015 Compared to Fiscal Year 2014

Capital assets increased \$21.9 million or 3.4 percent, the result of capital expenditures, net of depreciation. Major capital expenditures during the year included \$25.3 million for major system improvements related to Century II (previously reported as PACE 10 expenditures), \$7 million for general system improvements and \$1.8 million for information system upgrades.

Fiscal Year 2014 Compared to Fiscal Year 2013

Capital assets increased \$24.2 million or 3.9 percent, the result of capital expenditures, net of depreciation. Major capital expenditures during the year included \$34 million for major system improvements related to PACE 10 and \$3 million for Composite Correction Plan projects.

Deferred Outflows of Resources

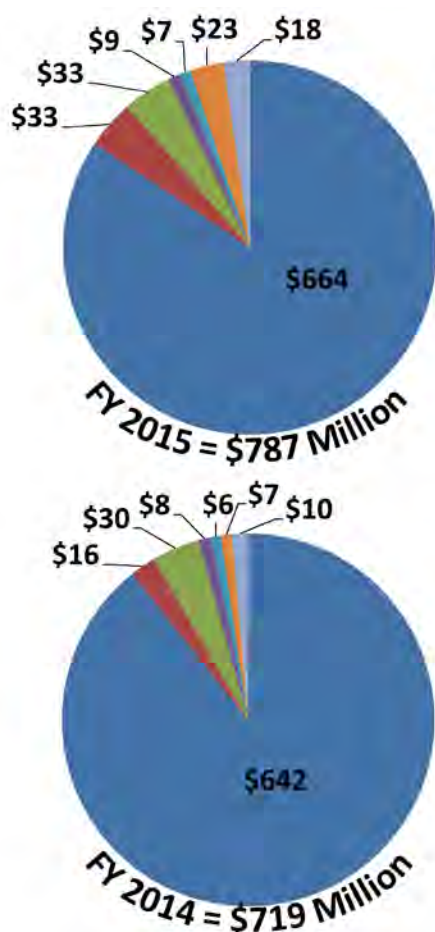
Fiscal Year 2015 Compared to Fiscal Year 2014

Deferred outflows increased \$8.5 million compared to the prior year, reflecting \$7.9 million in unamortized bond refunding costs from fiscal year 2015 bond refinancing.

Fiscal Year 2014 Compared to Fiscal Year 2013

Deferred outflows of resources total \$10 million, which was a decline of \$0.5 million or 4.5 percent compared to fiscal year 2013. This reflects the amortization of deferred losses on bonds refunded in prior periods.

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



Wastewater Division Total Assets and Deferred Outflows of Resources (in Millions)

	<u>FY15</u>	<u>FY14</u>
Plant	85%	89%
General Fund	4%	2%
Contingency Fund	4%	4%
Accounts Receivable	1%	1%
Other Assets	1%	1%
Restricted Assets	3%	1%
Deferred Outflows of Resources	2%	2%

Current and Other Liabilities

Fiscal Year 2015 Compared to Fiscal Year 2014

Current and other liabilities were consistent with the prior fiscal year.

Fiscal Year 2014 Compared to Fiscal Year 2013

Current and other liabilities decreased \$6.2 million, which was the net result of a \$5.6 million decline in accounts payable and a \$0.5 million increase in the current portion of revenue bonds.

Knoxville Utilities Board Wastewater Division

Management's Discussion and Analysis

June 30, 2015 and 2014

Long-Term Debt

Fiscal Year 2015 Compared to Fiscal Year 2014

The Division's outstanding long-term debt increased \$58.8 million or 13.2 percent. The Division issued \$30 million in revenue bonds both in August 2014 and in April 2015. The increase was partially offset by the scheduled repayment of bond debt.

Fiscal Year 2014 Compared to Fiscal Year 2013

The Division's outstanding long-term debt decreased \$4.9 million or 1.1 percent due to scheduled debt repayments.

Deferred Inflows of Resources

Fiscal Year 2015 Compared to Fiscal Year 2014

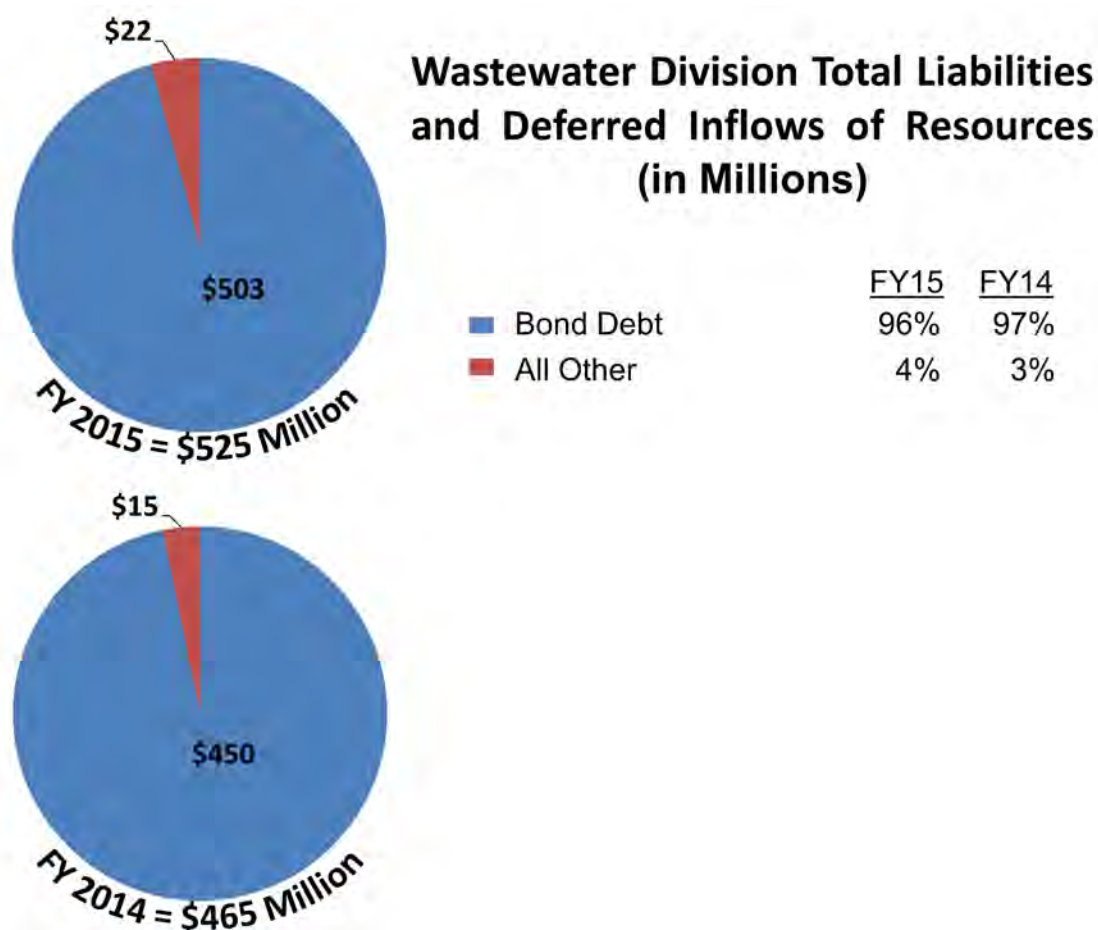
Deferred inflows of resources were \$1.3 million higher than the prior fiscal year due to the addition of pension inflow. For further explanation, see Notes to the Financial Statements.

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 Wastewater Division
Management's Discussion and Analysis
June 30, 2015 and 2014



Net Position

Fiscal Year 2015 Compared to Fiscal Year 2014

Net investment in capital assets decreased \$29.8 million or 14.8 percent. The increase was the result of \$21.9 million of net plant additions and an increase in current and long term debt of \$53.2 million. Unrestricted assets increased \$37 million primarily due to the \$37.3 million increase in current and other assets compared to the prior year. Restricted net position was \$0.4 million higher than the previous fiscal year, based on increases in debt service.

Fiscal Year 2014 Compared to Fiscal Year 2013

Net investment in capital assets increased \$32.3 million or 19.1 percent. The increase was the result of \$24.2 million of net plant additions and a decrease in current and long term debt of \$8.5 million. Unrestricted assets decreased \$26.8 million primarily due to a \$32.5 million decrease in general fund cash compared with the prior year. Restricted net position was \$0.1 million higher than the previous fiscal year, based on increases in debt service.

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

Statement of Revenues, Expenses and Changes in Net Position

The following table reflects the condensed Statement of Revenues, Expenses and Changes in Net Position for the Wastewater Division compared to the prior year 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>	2015	2014	2013
Operating revenues	\$ 79,206	\$ 75,042	\$ 74,579
Operating expenses			
Treatment	11,597	10,769	10,402
Collection	8,609	7,795	7,266
Customer service	2,837	2,605	2,458
Administrative and general	7,846	8,484	7,697
Depreciation	17,131	16,086	14,455
Taxes and tax equivalents	4,301	4,092	3,856
Total operating expenses	<u>52,321</u>	<u>49,831</u>	<u>46,134</u>
Operating income	<u>26,885</u>	<u>25,211</u>	<u>28,445</u>
Interest income	301	292	373
Interest expense	(19,355)	(19,264)	(19,841)
Other income/(expense)	<u>(433)</u>	<u>(837)</u>	<u>(351)</u>
Change in net position before capital contributions	<u>7,398</u>	<u>5,402</u>	<u>8,626</u>
Capital contributions	<u>358</u>	<u>272</u>	<u>144</u>
Change in net position	<u>\$ 7,756</u>	<u>\$ 5,674</u>	<u>\$ 8,770</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 primarily determined by the amount of water usage billed during the fiscal year. The Division has certain commercial and industrial customers whose wastewater usage is metered separately from their water usage. Any change (increase/decrease) in wastewater rates would also cause a change in operating revenue.
- Operating expenses (treatment, collection system expense, customer service, administrative and general) are normally impacted by changes in areas including, but not limited to, labor cost (staffing, wage rates), active employee and retiree health insurance costs, chemicals, and wastewater system maintenance.
- Depreciation expense is impacted by plant additions and retirements during the fiscal year.
- Taxes & tax equivalents are impacted by plant additions/retirements and changes in property tax rates.
- Interest income is impacted by the level of interest rates and investments.

Knoxville Utilities Board Wastewater Division

Management's Discussion and Analysis

June 30, 2015 and 2014

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

Impacts and Analysis

Margin from Sales

Fiscal Year 2015 Compared to Fiscal Year 2014

The Division's net position during the year increased \$7.8 million compared to a \$5.7 million increase last fiscal year. 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 \$0.2 million during fiscal year 2015. This change resulted in a net increase of \$7.6 million or 3 percent in the Division's net position.

Operating revenue increased \$4.2 million or 5.5 percent for the fiscal year ending June 30, 2015, the result of additional revenue generated during the fiscal year from the rate increase effective October 2014 and a 0.9 percent increase in wastewater sales volumes. Rebates on bond interest payments from the federal government for federally taxable Build America Bonds (BABs) are reported as revenue in accordance with GASB. KUB recognized \$2.7 million in revenue for BABs rebates in fiscal year 2015.

FY 2015 Total Wastewater Customers = 69,847 FY 2015 Wastewater Sales = 6.5 Billion Gallons



Residential customers accounted for 89 percent of wastewater customers and 41 percent of total billed sales for the year. Commercial customers accounted for the largest portion of total sales for the year.

KUB's ten largest wastewater customers accounted for 9.1 percent of KUB's billed wastewater volumes. Those ten customers represent five industrial and five commercial customers, including four governmental customers.

The Division has added 664 customers over the past three years, representing annual growth of less than 1 percent. Billed wastewater volumes have slowed in recent years, reflecting declining water usage due to more efficient appliances and conservation efforts.

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

Fiscal Year 2014 Compared to Fiscal Year 2013

The Division's net position increased \$5.7 million in fiscal year 2014 compared to earnings of \$8.8 million in fiscal year 2013.

Operating revenue increased \$0.5 million or 0.6 percent for the fiscal year ending June 30, 2014, the net result of additional revenue generated during the fiscal year from the 12 percent rate increase effective October 2012 and a 1.9 percent decline in wastewater billed sales volumes. Rebates on bond interest payments from the federal government for federally taxable Build America Bonds (BABs) are reported as revenue in accordance with GASB. KUB recognized \$1.8 million in revenue for BABs rebates in fiscal year 2014.

FY 2014 Total Wastewater Customers = 69,613 FY 2014 Wastewater Sales = 6.4 Billion Gallons



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

KUB's ten largest wastewater customers accounted for 8.9 percent of KUB's billed wastewater volumes. Those ten customers represent five industrial and five commercial customers, including four governmental customers.

The Division has added 875 customers over the past three years, representing annual growth of less than 1 percent. Billed wastewater volumes have declined steadily over the past three years, reflecting declining water usage due to more efficient appliances and conservation efforts.

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Knoxville Utilities Board Wastewater Division

Management's Discussion and Analysis

June 30, 2015 and 2014

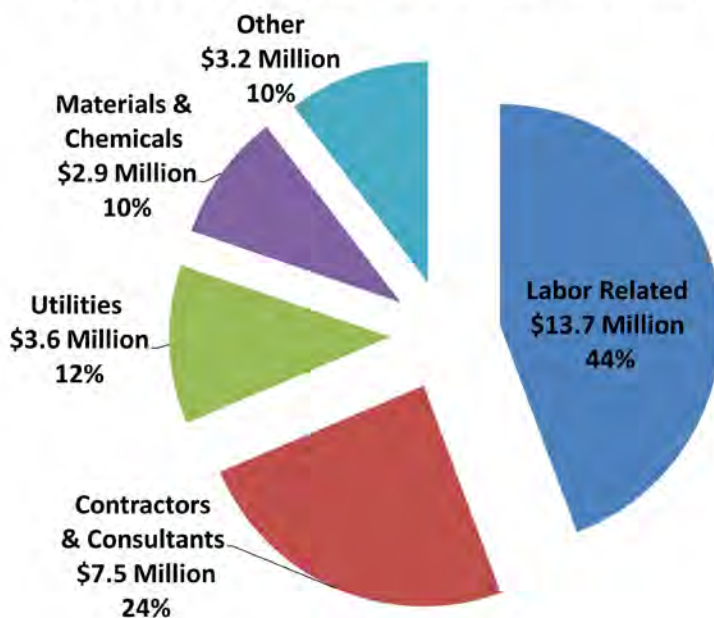
Operating Expenses

Fiscal Year 2015 Compared to Fiscal Year 2014

Operating expenses increased \$2.5 million or 5 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, collection, customer service and administrative and general.

- Treatment expenses were up \$0.8 million, primarily due to higher consulting and contracting expenses.
- Collection system expenses increased \$0.8 million, reflecting higher labor related expenses, outside contractor expenses for lift station maintenance and repairs, and outside consultant expenses for blockage abatement.
- Customer service expenses increased \$0.2 million, reflecting the Division's share of expenses for software licenses.
- Administrative and general expenses decreased \$0.6 million, due to a decrease in pension expense.

FY 2015 Wastewater O&M Expense = \$30.9 Million



- Depreciation expense increased \$1 million or 6.5 percent, the result of a full year of depreciation on \$72.3 million of wastewater system assets placed in service during fiscal year 2014, and a partial year of depreciation on \$16.2 million placed in service during fiscal year 2015. \$3.4 million of wastewater system assets were retired during the fiscal year.
- Taxes and tax equivalents increased \$0.2 million. The City of Knoxville's property tax rate increased this year and higher plant in service levels contributed to the growth in tax equivalent payments.

Knoxville Utilities Board Wastewater Division

Management's Discussion and Analysis

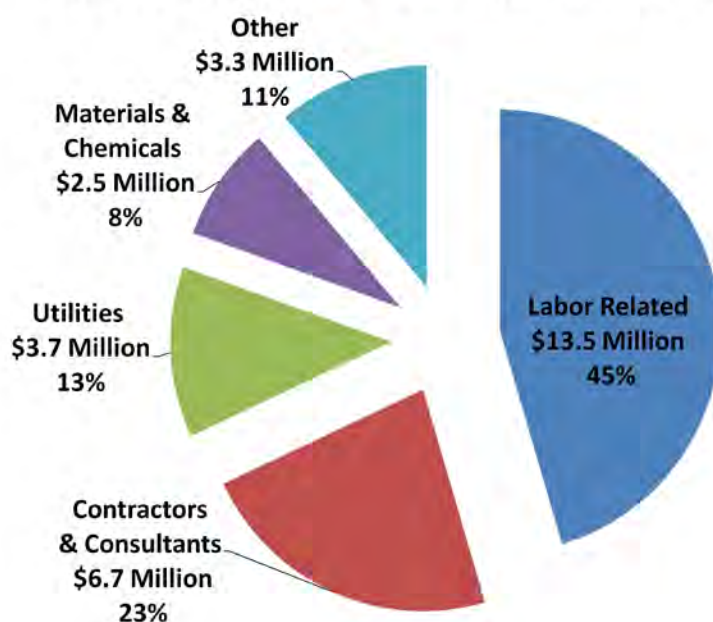
June 30, 2015 and 2014

Fiscal Year 2014 Compared to Fiscal Year 2013

Operating expenses increased \$3.7 million or 8 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, collection, customer service and administrative and general.

- Treatment expenses were up \$0.4 million, the result of higher labor-related expenses.
- Collection system expenses increased \$0.5 million, driven by contractor expense and utility service.
- Customer service expenses increased \$0.1 million, reflecting the Division's share of meter reading, telephone, software, and labor-related expenses.
- Administrative and general expenses were up \$0.8 million, reflecting an allocation of shared costs among utility systems.

FY 2014 Wastewater O&M Expense = \$29.7 Million

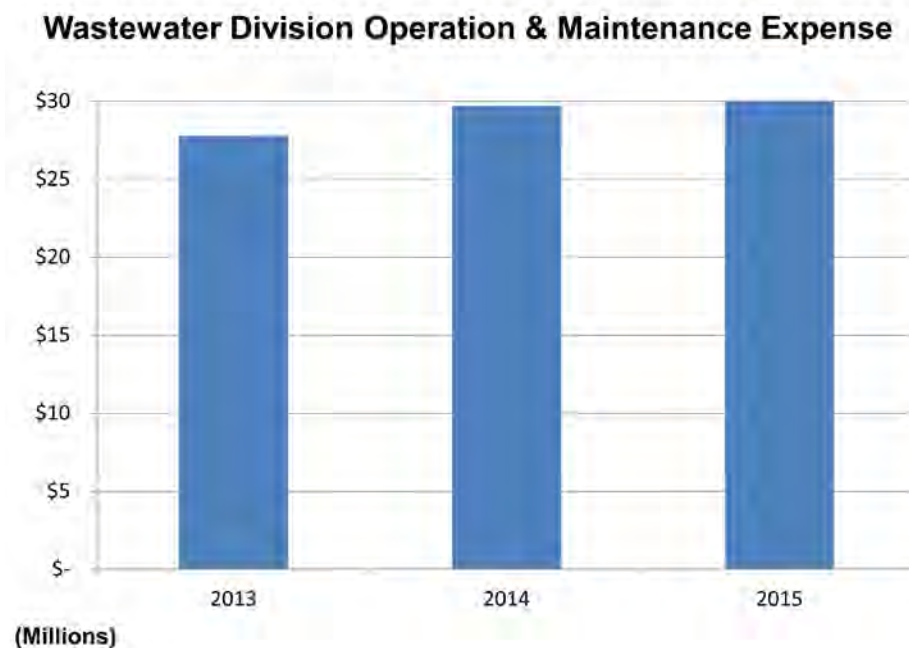


- Depreciation expense increased \$1.6 million or 11.3 percent, the result of a full year of depreciation on \$61 million of wastewater system assets placed in service during fiscal year 2013, and a partial year of depreciation on \$72.3 million placed in service during fiscal year 2014. \$14.3 million of wastewater assets were retired during fiscal year 2014.
- Taxes and tax equivalents increased \$0.2 million, due to increased wastewater plant in service values.

Knoxville Utilities Board Wastewater Division

Management's Discussion and Analysis

June 30, 2015 and 2014



Other Income and Expense

Fiscal Year 2015 Compared to Fiscal Year 2014

Interest income was consistent with the prior fiscal year.

Interest expense increased \$0.1 million or less than 1 percent, the net effect of additional interest expense associated with \$60 million in new bonds offset by debt interest savings from bond refinancing.

Other income (net) was \$0.4 million higher primarily due to a prior year loss on disposition of wastewater system assets.

Capital contributions increased \$0.1 million compared to last fiscal year as a result of additional assets received from developers and other governmental entities.

Fiscal Year 2014 Compared to Fiscal Year 2013

Interest income was \$0.1 million less than the prior fiscal year.

Interest expense decreased \$0.6 million or 2.9 percent, the net effect of additional interest from \$65 million in bonds sold in fiscal year 2013 offset by interest savings from bond refinancing that occurred in March 2013.

Other income (net) was \$0.5 million lower primarily due to a \$0.3 million increase in loss on disposition of wastewater system assets and \$0.3 million increase in amortization of debt costs.

Capital contributions increased \$0.1 million compared to last fiscal year as a result of additional assets received from developers and other governmental entities.

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

Capital Assets

	Capital Assets As of June 30 (Net of Depreciation)		
<i>(in thousands of dollars)</i>	2015	2014	2013
Pumping & Treatment Plant	\$ 135,248	\$ 136,055	\$ 112,438
Collection Plant			
Mains and Metering	390,454	389,515	359,166
Other	71,708	72,884	70,857
Total Collection Plant	<u>462,162</u>	<u>462,399</u>	<u>430,023</u>
Total General Plant	<u>8,101</u>	<u>8,070</u>	<u>7,853</u>
Total Wastewater Plant	<u>605,511</u>	<u>606,524</u>	<u>550,314</u>
Work In Progress	58,667	35,778	67,820
Total Net Plant	<u>\$ 664,178</u>	<u>\$ 642,302</u>	<u>\$ 618,134</u>

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Knoxville Utilities Board Wastewater Division

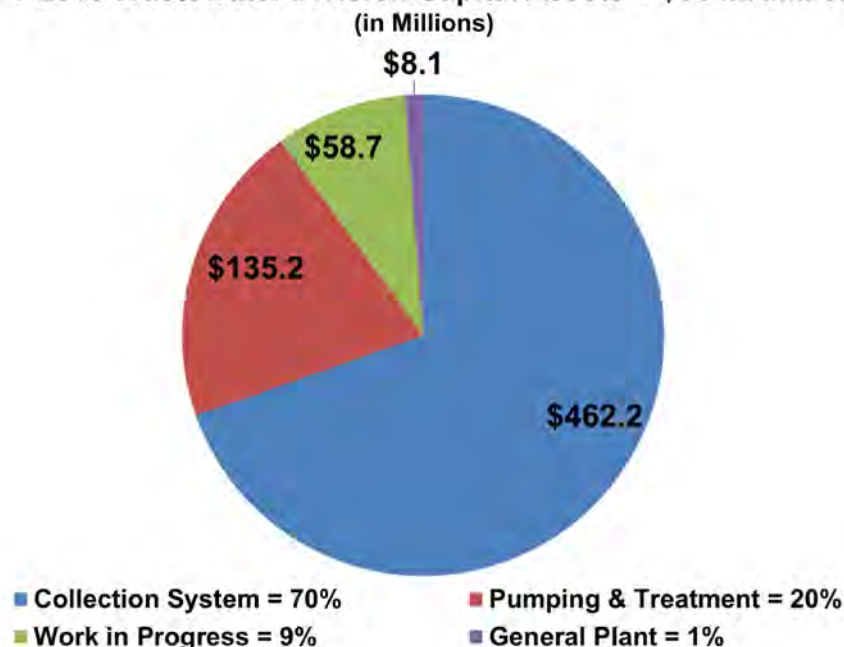
Management's Discussion and Analysis

June 30, 2015 and 2014

Fiscal Year 2015 Compared to Fiscal Year 2014

As of June 30, 2015, the Division had \$664.2 million invested in a variety of capital assets, as reflected in the schedule of capital assets, which represents a net increase (including additions, retirements, and depreciation) of \$21.9 million or 3.4 percent over the end of the last fiscal year.

FY 2015 Wastewater Division Capital Assets = \$664.2 Million



Major capital asset expenditures during the year were as follows:

- \$25.3 million related to 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
- \$7 million for system improvements
- \$1.8 million for information system upgrades

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Knoxville Utilities Board Wastewater Division

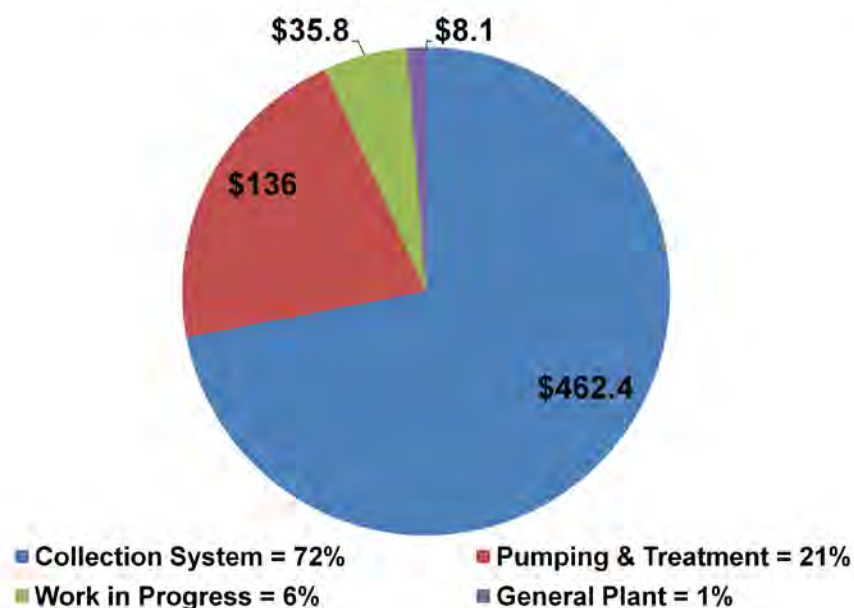
Management's Discussion and Analysis

June 30, 2015 and 2014

Fiscal Year 2014 Compared to Fiscal Year 2013

As of June 30, 2014, the Division had \$642.3 million invested in a variety of capital assets, as reflected in the schedule of capital assets, which represents a net increase (including additions, retirements, and depreciation) of \$24.2 million or 3.9 percent over the end of the last fiscal year.

FY 2014 Wastewater Division Capital Assets = \$642.3 Million
(in Millions)



Major capital asset expenditures during the year were as follows:

- \$34 million related to PACE 10 projects
 - \$26 million for sewer mini-basin rehabilitation and replacement
 - \$3.7 million for pump station design and construction
 - \$2.2 million for sewer trunk line replacement and rehabilitation
- \$3 million for Composite Correction Plan projects

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Knoxville Utilities Board Wastewater Division

Management's Discussion and Analysis

June 30, 2015 and 2014

Debt Administration

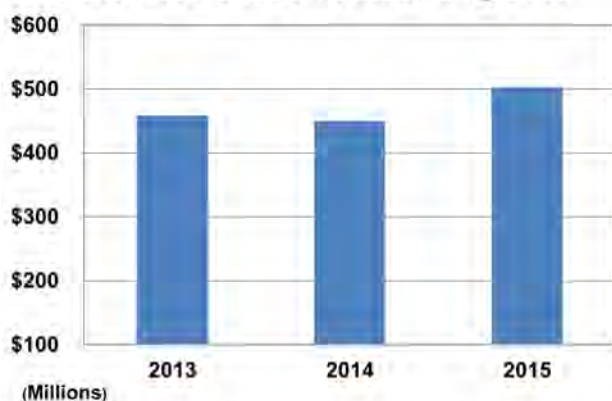
The Division's outstanding debt rose in fiscal year 2015 to \$503.3 million due to \$60 million in new bonds sold during the fiscal year. As part of the Century II Infrastructure Program, as well as PACE 10 in previous years, bond proceeds were used to fund capital improvements for the wastewater system. The bonds are secured solely by revenues of the Wastewater Division. Debt as a percentage of the Division's capital structure was 65.8 percent in 2015, 63.9 percent in 2014 and 64.9 percent at the end of fiscal year 2013. KUB's Debt Management Policy limits the Division's debt ratio to 70 percent or less.

Outstanding Debt As of June 30

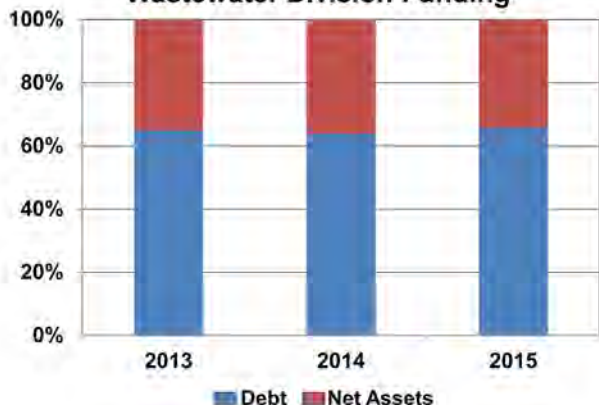
(in thousands of dollars)

	2015	2014	2013
Revenue bonds	\$ 503,260	\$ 450,050	\$ 458,595
Total outstanding debt	\$ 503,260	\$ 450,050	\$ 458,595

Wastewater Division Outstanding Debt



Wastewater Division Funding



The Division will pay \$127.3 million in principal payments over the next ten years, representing 25.3 percent of the outstanding bonds. KUB's Debt Management Policy requires a minimum of 20 percent of wastewater debt principal be repaid over the next ten years.

Fiscal Year 2015 Compared to Fiscal Year 2014

As of June 30, 2015, the Division had \$503.3 million in outstanding debt (including the current portion of revenue bonds), compared to \$450.1 million last year, representing an increase of \$53.2 million or 11.8 percent. The Division's weighted average cost of debt as of June 30, 2015 was 4.03 percent.

The increase is attributable to the issuance of revenue bonds during the fiscal year of \$30 million in August 2014 and \$30 million in April 2015. The increase was partially offset by scheduled repayments of bond debt.

In April 2015, KUB sold \$129.8 million of revenue refunding bonds. The refunding of certain bonds at lower interest rates will provide debt service savings of \$13.4 over the life of the bonds.

Knoxville Utilities Board Wastewater Division

Management's Discussion and Analysis

June 30, 2015 and 2014

The Division's outstanding debt is rated by Standard & Poor's and Moody's Investors Service. As of June 30, 2015, the Division's revenue bonds were rated AA+ by Standard & Poor's and Aa2 by Moody's Investors Service.

Fiscal Year 2014 Compared to Fiscal Year 2013

As of June 30, 2014, the Division had \$450.1 million in outstanding debt (including the current portion of revenue bonds), compared to \$458.6 million last year, representing a decrease of \$8.5 million or 1.9 percent. The Division's weighted average cost of debt as of June 30, 2014 was 4.23 percent.

The decrease in debt was attributable to the scheduled repayment of bond debt during the fiscal year.

The Division's outstanding debt is rated by Standard & Poor's and Moody's Investors Service. As of June 30, 2014, the Division's revenue bonds were rated AA+ by Standard & Poor's and Aa2 by Moody's Investors Service.

Impacts on Future Financial Position

KUB anticipates adding 150 wastewater customers in 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 first of the three rate increases was effective October 2014. 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.

KUB long-term debt includes \$95.8 million of Wastewater Division 2010 Build America Bonds (BABs) in which the U.S. Treasury provides a rebate to KUB for a portion of the interest. The interest rebates were subject to federal sequestration during the fiscal year and were reduced by 7.3 percent. Any future actions by Congress may also affect the anticipated rebates for future fiscal years.

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 the Division's financial position or results of operations during fiscal year 2015.

Financial Contact

The Division's financial statements are designed to present users (citizens, customers, investors, and creditors) with a general overview of the Division's financial position and results of operations for the fiscal years ending June 30, 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 Wastewater Division
Statements of Net Position
June 30, 2015 and 2014

	2015	2014
Assets and Deferred Outflows of Resources		
Current assets:		
Cash and cash equivalents	\$ 32,853,270	\$ 15,413,919
Short-term contingency fund investments	456,174	13,875,114
Other current assets	45,356	61,432
Accrued interest receivable	7,154	2,866
Accounts receivable, less allowance of uncollectible accounts of \$88,128 in 2015 and \$89,248 in 2014	8,848,535	8,200,763
Inventories	248,831	200,763
Prepaid expenses	64,592	75,673
Total current assets	<u>42,523,912</u>	<u>37,830,530</u>
Restricted assets:		
Wastewater bond fund	7,097,019	7,014,496
Other funds	9,218	9,213
Unused bond proceeds	15,605,921	-
Total restricted assets	<u>22,712,158</u>	<u>7,023,709</u>
Wastewater plant in service	770,902,707	758,132,261
Less accumulated depreciation	<u>(165,391,520)</u>	<u>(151,608,595)</u>
	605,511,187	606,523,666
Retirement in progress	187,702	194,255
Construction in progress	58,479,696	35,583,696
Net plant in service	<u>664,178,585</u>	<u>642,301,617</u>
Other assets:		
Net pension asset	1,264,542	-
Long-term contingency fund investments	32,373,560	16,523,370
Other	5,224,902	5,424,100
Total other assets	<u>38,863,004</u>	<u>21,947,470</u>
Total assets	<u>768,277,659</u>	<u>709,103,326</u>
Deferred outflows of resources:		
Pension outflow	663,012	-
Unamortized bond refunding costs	17,929,691	10,064,386
Total deferred outflows of resources	<u>18,592,703</u>	<u>10,064,386</u>
Total assets and deferred outflows of resources	<u>\$ 786,870,362</u>	<u>\$ 719,167,712</u>

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

Knoxville Utilities Board Wastewater Division
Statements of Net Position
June 30, 2015 and 2014

	2015	2014
Liabilities, Deferred Inflows, and Net Position		
Current liabilities:		
Current portion of revenue bonds	\$ 10,930,000	\$ 9,015,000
Accounts payable	899,476	1,303,779
Accrued expenses	579,027	1,842,381
Customer deposits plus accrued interest	1,037,256	1,018,250
Accrued interest on revenue bonds	4,482,373	4,760,646
Total current liabilities	<u>17,928,132</u>	<u>17,940,056</u>
Other liabilities:		
Accrued compensated absences	1,661,822	1,643,542
Customer advances for construction	306,000	312,000
Other	85,069	83,376
Total other liabilities	<u>2,052,891</u>	<u>2,038,918</u>
Long-term debt:		
Wastewater revenue bonds	492,330,000	441,035,000
Unamortized premiums/discounts	11,625,190	4,154,408
Total long-term debt	<u>503,955,190</u>	<u>445,189,408</u>
Total liabilities	<u>523,936,213</u>	<u>465,168,382</u>
Deferred inflows of resources:		
Pension inflow	1,339,445	-
Total deferred inflows of resources	<u>1,339,445</u>	<u>-</u>
Total liabilities and deferred inflows of resources	<u>525,275,658</u>	<u>465,168,382</u>
Net position		
Net investment in capital assets	172,143,725	201,947,494
Restricted for:		
Debt service	2,614,646	2,253,850
Other	9,218	9,213
Unrestricted	86,827,115	49,788,773
Total net position	<u>261,594,704</u>	<u>253,999,330</u>
Total liabilities, deferred inflows, and net position	<u>\$ 786,870,362</u>	<u>\$ 719,167,712</u>

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

Knoxville Utilities Board Wastewater Division
Statements of Revenues, Expenses and Changes in Net Position
Years Ended June 30, 2015 and 2014

	2015	2014
Operating revenues	\$ 79,206,028	\$ 75,041,645
Operating expenses		
Treatment	11,596,638	10,768,467
Collection	8,608,980	7,794,582
Customer service	2,837,597	2,605,271
Administrative and general	7,845,973	8,483,808
Provision for depreciation	17,130,721	16,086,344
Taxes and tax equivalents	4,300,666	4,092,366
Total operating expenses	<u>52,320,575</u>	<u>49,830,838</u>
Operating income	<u>26,885,453</u>	<u>25,210,807</u>
Non-operating revenues (expenses)		
Contributions in aid of construction	394,551	916,996
Interest and dividend income	301,292	291,711
Interest expense	(19,355,169)	(19,263,722)
Amortization of debt costs	(405,039)	(399,903)
Write-down of plant for costs recovered through contributions	(394,551)	(916,996)
Other	(27,974)	(436,533)
Total non-operating revenues (expenses)	<u>(19,486,890)</u>	<u>(19,808,447)</u>
Change in net position before capital contributions	7,398,563	5,402,360
Capital contributions	357,246	271,650
Change in net position	7,755,809	5,674,010
Net position, beginning of year, as previously reported	253,999,330	248,325,320
Change in method of accounting for pension	(160,435)	-
Net position, beginning of year, as restated	253,838,895	248,325,320
Net position, end of year	<u>\$ 261,594,704</u>	<u>\$ 253,999,330</u>

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

Knoxville Utilities Board Wastewater Division

Statements of Cash Flows

Years Ended June 30, 2015 and 2014

	2015	2014
Cash flows from operating activities:		
Cash receipts from customers	\$ 76,288,189	\$ 73,613,445
Cash (payments to) receipts from other operations	1,399,282	1,500,788
Cash payments to suppliers of goods or services	(21,331,092)	(24,746,416)
Cash payments to employees for services	(10,185,046)	(10,158,275)
Payment in lieu of taxes	(3,575,461)	(3,373,076)
Net cash provided by operating activities	<u>42,595,872</u>	<u>36,836,466</u>
Cash flows from capital and related financing activities:		
Net proceeds from bond issuance	60,671,698	-
Principal paid on revenue bonds and notes payable	(9,390,000)	(8,545,000)
(Increase) decrease in unused bond proceeds	(15,605,921)	206
Interest paid on revenue bonds and notes payable	(19,633,440)	(19,496,968)
Acquisition and construction of wastewater plant	(39,310,006)	(41,385,195)
Changes in wastewater bond fund, restricted	(82,523)	115,746
Customer advances for construction	(6,000)	(9,000)
Proceeds received on disposal of plant	-	4,848
Cash received from developers and individuals for capital purposes	394,551	916,996
Net cash used in capital and related financing activities	<u>(22,961,641)</u>	<u>(68,398,367)</u>
Cash flows from investing activities:		
Purchase of investment securities	(7,241,807)	(1,294,156)
Maturities of investment securities	4,810,557	15,231,335
Interest received	297,004	311,437
Other property and investments	(60,634)	(184,162)
Net cash provided by (used in) investing activities	<u>(2,194,880)</u>	<u>14,064,454</u>
Net increase (decrease) in cash and cash equivalents	17,439,351	(17,497,447)
Cash and cash equivalents, beginning of year	15,413,919	32,911,366
Cash and cash equivalents, end of year	<u>\$ 32,853,270</u>	<u>\$ 15,413,919</u>
Reconciliation of operating income to net cash provided by operating activities		
Operating income	\$ 26,885,453	\$ 25,210,807
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization expenses	17,336,391	16,314,629
Changes in operating assets and liabilities:		
Accounts receivable	(647,772)	776,663
Inventories	(48,067)	(26,285)
Prepaid expenses	11,080	(1,257)
Other assets	(559,797)	(222,628)
Accounts payable and accrued expenses	(402,115)	(5,324,427)
Customer deposits plus accrued interest	19,006	50,920
Other liabilities	1,693	58,044
Net cash provided by operating activities	<u>\$ 42,595,872</u>	<u>\$ 36,836,466</u>
Noncash capital activities:		
Acquisition of plant assets through developer contributions	\$ 357,246	\$ 271,650

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

Knoxville Utilities Board Wastewater Division

Notes to Financial Statements

June 30, 2015 and 2014

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. The Wastewater Division (Division) provides services to certain customers in Knox County and in two surrounding counties in East Tennessee. The Division's accounts are maintained in conformity with the Uniform System of Accounts of the National Association of Regulatory Utility Commissioners (NARUC) and the Governmental Accounting Standards Board (GASB), as applicable. The financial statements present only the Wastewater Division and do not purport to, and do not, present fairly the consolidated financial position of Knoxville Utilities Board at June 30, 2015 and 2014, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

2. Significant Accounting Policies

Basis of Accounting

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 financial statements are prepared on the accrual basis of accounting, whereby revenues are recognized when earned and expenses are recognized when incurred. The accounting and financial reporting treatment applied to the Division is determined by measurement focus. The transactions of the Division are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operations are included on the Statement of Net Position. Net position (i.e., total assets and deferred outflows of resources net of total liabilities and deferred inflows of resources) 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

Knoxville Utilities Board Wastewater Division

Notes to Financial Statements

June 30, 2015 and 2014

accounting and financial reporting requirement 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.

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.

Wastewater Plant

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

The provision for depreciation of wastewater plant in service is based on the estimated useful lives of the assets, which range from three to fifty years, and is computed using the straight-line method. Pursuant to NARUC, the caption "Provision for depreciation" in the Statements of Revenue, Expenses and Change in Net Position does not include depreciation for transportation equipment of \$205,670 in fiscal year 2015 and \$228,285 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 the KUB Wastewater Division. Operating revenue is recorded when the service is rendered, on a cycle basis, and includes an estimate of unbilled revenue. Revenues are reported net of bad debt expense of \$213,886 in fiscal year 2015 and \$209,288 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 net assets available, it is KUB's policy to apply those expenses to restricted net assets to the extent such are available and then to unrestricted net assets.

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 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

Knoxville Utilities Board Wastewater Division

Notes to Financial Statements

June 30, 2015 and 2014

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 (Division's share \$160,435) to increase the net pension liability by \$3,515,317 (Division's share \$738,216) based on revised actuarial assumptions to conform with GASB 68 and to reclassify 2014 expenses of \$2,751,341 (Division's share \$577,782) 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 prior twelve months. Therefore, KUB's measurements as of June 30, 2015 are based on December 31, 2014 measurement date.

Knoxville Utilities Board Wastewater Division

Notes to Financial Statements

June 30, 2015 and 2014

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 utility plant construction and debt repayment. Certain additional assets are designated by management for contingency purposes and economic development.

Cash Equivalents

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

Deferred Outflows and Inflows of Resources

Deferred outflows of resources are items previously reported as assets related to the acquisition of assets or related debt which are amortized over the life of the asset or debt. Deferred inflows of resources are items previously reported as liabilities related to the acquisition of assets or related debt which are amortized over the life of the asset or debt. 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 Wastewater Division

Notes to Financial Statements

June 30, 2015 and 2014

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. 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.

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 fiscal year 2014 balances to conform to fiscal year 2015 presentation.

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 Wastewater Division

Notes to Financial Statements

June 30, 2015 and 2014

KUB has not elected early implementation of these standards and has not completed the process of evaluating the impact of these statements on its financial statements.

3. Deposits and Investments

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 Wastewater Division
Notes to Financial Statements
June 30, 2015 and 2014

Classification of deposits and investments per Statement of Net Position:

	2015	2014
Current assets		
Cash and cash equivalents	\$ 32,853,270	\$ 15,413,919
Short-term contingency fund investments	456,174	13,875,114
Other assets		
Long-term contingency fund investments	32,306,048	16,432,478
Restricted assets		
Unused bond proceeds	15,605,874	-
Wastewater bond fund	7,097,019	7,014,496
Other funds	9,218	9,213
	<u>\$ 88,327,603</u>	<u>\$ 52,745,220</u>

The above amounts do not include accrued interest of \$67,559 in fiscal year 2015 and \$90,892 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:

Deposit and Investment Maturities (in Years)			
	Fair Value	Less Than 1	1-5
Supersweep NOW and Other Deposits	\$ 29,567,939	\$ 29,567,939	\$ -
State Treasurer's Investment Pool	15,305,874	15,305,874	-
Agency Bonds	36,649,897	456,174	36,193,723
Certificates of Deposits	8,479,394	7,397,019	1,082,375
	<u>\$ 90,003,104</u>	<u>\$ 52,727,006</u>	<u>\$ 37,276,098</u>

4. Accounts Receivable

Accounts receivable consists of the following:

	2015	2014
Wholesale and retail customers		
Billed services	\$ 4,886,812	\$ 4,383,501
Unbilled services	3,206,393	3,166,391
Other	843,458	740,119
Allowance for uncollectible accounts	(88,128)	(89,248)
	<u>\$ 8,848,535</u>	<u>\$ 8,200,763</u>

Knoxville Utilities Board Wastewater Division
Notes to Financial Statements
June 30, 2015 and 2014

5. Accounts Payable and Accruals

Accounts payable and accruals were composed of the following:

	2015	2014
Trade accounts	\$ 899,476	\$ 1,303,779
Salaries and wages	222,361	186,069
Self-insurance liabilities	356,666	330,289
Other current liabilities	-	1,326,023
	<u>\$ 1,478,503</u>	<u>\$ 3,146,160</u>

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
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	<u>\$ 450,050,000</u>	<u>\$ 189,825,000</u>	<u>\$ 9,390,000</u>	<u>\$ 127,225,000</u>	<u>\$ 503,260,000</u>	<u>\$ 10,930,000</u>
Unamortized Premium	4,154,409	8,539,211	312,636	755,794	11,625,190	-
Total long term debt	<u>\$ 454,204,409</u>	<u>\$ 198,364,211</u>	<u>\$ 9,702,636</u>	<u>\$ 127,980,794</u>	<u>\$ 514,885,190</u>	<u>\$ 10,930,000</u>

	Balance June 30, 2013	Additions	Payments	Defeased	Balance June 30, 2014	Amounts Due Within One Year
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>

Knoxville Utilities Board Wastewater Division

Notes to Financial Statements

June 30, 2015 and 2014

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

Fiscal Year	Principal	Total Interest	Grand Total
2016	\$ 10,930,000	\$ 19,687,582	\$ 30,617,582
2017	10,930,000	19,855,137	30,785,137
2018	11,380,000	19,439,779	30,819,779
2019	11,810,000	18,969,000	30,779,000
2020	12,320,000	18,473,025	30,793,025
2021-2025	69,935,000	83,813,054	153,748,054
2026-2030	73,215,000	70,002,922	143,217,922
2031-2035	88,320,000	55,379,944	143,699,944
2036-2040	105,265,000	37,105,089	142,370,089
2041-2045	88,505,000	16,049,044	104,554,044
2046-2050	20,650,000	1,813,275	22,463,275
Total	<u>\$ 503,260,000</u>	<u>\$ 360,587,851</u>	<u>\$ 863,847,851</u>

The Division has pledged sufficient revenue, after deduction of all current operating expenses (exclusive of tax equivalents), to meet bond principal and interest payments when due. The bond covenants relating to the Wastewater Revenue Bonds require the establishment of a Wastewater Bond Fund for the payment of principal and interest requirements. As of June 30, 2015, those bond covenants had been satisfied.

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.

During fiscal year 2011, KUB's Wastewater Division issued Series 2010C bonds to fund wastewater system capital improvements. These bonds were issued as federally taxable Build America Bonds with a 35 percent interest payment rebate to be received from the United States Government for each interest payment. Effective 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.

Knoxville Utilities Board Wastewater Division

Notes to Financial Statements

June 30, 2015 and 2014

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.

Other liabilities consist of the following:

	Balance June 30, 2014	Increase	Decrease	Balance June 30, 2015
Accrued compensated absences	\$ 1,643,542	\$ 2,897,791	\$ (2,879,511)	\$ 1,661,822
Customer advances for construction	312,000	-	(6,000)	306,000
Other	83,376	186,094	(184,401)	85,069
	<u>\$ 2,038,918</u>	<u>\$ 3,083,885</u>	<u>\$ (3,069,912)</u>	<u>\$ 2,052,891</u>

7. Lease Commitments

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

2016	\$ 10,089
2017	6,041
2018	2,660
2019	1,719
2020	1,719
Total operating minimum lease payments	<u>\$ 22,228</u>

Knoxville Utilities Board Wastewater Division
Notes to Financial Statements
June 30, 2015 and 2014

8. Capital Assets

Capital asset activity was as follows:

	Beginning 6/30/2014	Increase	Decrease	Ending 6/30/2015
Pumping & Treatment Plant	\$ 202,877,753	\$ 4,119,355	\$ (366,704)	\$ 206,630,404
Collection Plant				
Mains and Metering	450,538,908	9,876,536	(2,639,025)	457,776,419
Other	80,411,724	197,288	(61,017)	80,547,995
Total Collection Plant	\$ 530,950,632	\$ 10,073,824	\$ (2,700,042)	\$ 538,324,414
Total General Plant	24,303,876	1,974,951	(330,938)	25,947,889
Total Wastewater Plant	\$ 758,132,261	\$ 16,168,130	\$ (3,397,684)	\$ 770,902,707
Less accumulated depreciation	(151,608,595)	(17,196,280)	3,413,355	(165,391,520)
Net Plant Assets	\$ 606,523,666	\$ (1,028,150)	\$ 15,671	\$ 605,511,187
Work In Progress	35,777,951	39,146,048	(16,256,601)	58,667,398
Total Net Plant	\$ 642,301,617	\$ 38,117,898	\$ (16,240,930)	\$ 664,178,585

	Beginning 6/30/2013	Increase	Decrease	Ending 6/30/2014
Pumping & Treatment Plant	\$ 176,026,267	\$ 28,044,422	\$ (1,192,936)	\$ 202,877,753
Collection Plant				
Mains and Metering	424,450,701	38,900,383	(12,812,176)	450,538,908
Other Accounts	77,035,027	3,397,197	(20,500)	80,411,724
Total Collection Plant	\$ 501,485,728	\$ 42,297,580	\$ (12,832,676)	\$ 530,950,632
Total General Plant	22,621,810	1,986,923	(304,857)	24,303,876
Total Wastewater Plant	\$ 700,133,805	\$ 72,328,925	\$ (14,330,469)	\$ 758,132,261
Less accumulated depreciation	(149,819,959)	(15,995,754)	14,207,118	(151,608,595)
Net Plant Assets	\$ 550,313,846	\$ 56,333,171	\$ (123,351)	\$ 606,523,666
Work In Progress	67,819,773	40,309,184	(72,351,006)	35,777,951
Total Net Plant	\$ 618,133,619	\$ 96,642,355	\$ (72,474,357)	\$ 642,301,617

9. Risk Management

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

Knoxville Utilities Board Wastewater Division

Notes to Financial Statements

June 30, 2015 and 2014

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 \$356,666 resulting from the following changes:

	2015	2014
Balance, beginning of year	\$ 330,289	\$ 360,281
Current year claims and changes in estimates	2,971,832	2,524,750
Claims payments	(2,945,455)	(2,554,742)
Balance, end of year	<u>\$ 356,666</u>	<u>\$ 330,289</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. For purposes of this disclosure, presentation is on a consolidated basis unless division's share is specified.

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:

	2014	2013
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>

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"

Knoxville Utilities Board Wastewater Division

Notes to Financial Statements

June 30, 2015 and 2014

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 percent of the first \$4,800 of annual earnings and 5 percent 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.

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:

Knoxville Utilities Board Wastewater Division
Notes to Financial Statements
June 30, 2015 and 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. Of these amounts, \$1,326,024 and \$1,155,562 are attributable to the Wastewater Division. 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. The Wastewater Division's portion of this contribution is \$1,190,570.

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. The Wastewater Division's portion of this contribution is \$1,059,061. 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. The division's share of the net pension asset is \$1,264,542.

Knoxville Utilities Board Wastewater Division
Notes to Financial Statements
June 30, 2015 and 2014

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

		2014	2013
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

Knoxville Utilities Board Wastewater Division

Notes to Financial Statements

June 30, 2015 and 2014

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:

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

Knoxville Utilities Board Wastewater Division
Notes to Financial Statements
June 30, 2015 and 2014

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 (Division's share \$577,480).

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 (Division's share \$1,339,445). 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 (Division's share \$663,012) 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		-

Knoxville Utilities Board Wastewater Division

Notes to Financial Statements

June 30, 2015 and 2014

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 (Division's share \$334,604) and \$1,463,184 (Division's share \$307,269), 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 Wastewater Division

Notes to Financial Statements

June 30, 2015 and 2014

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 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)	3,500,284	3,319,013
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>

Knoxville Utilities Board Wastewater Division

Notes to Financial Statements

June 30, 2015 and 2014

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:

Schedule of Employer Contributions					
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 (Division's share \$734,448). 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 (Division's share \$734,448). As of June 30, 2015, the employer's OPEB obligation has been exceeded by \$174,410 (Division's share \$36,626).

The annual required contribution for the fiscal year ending June 30, 2016, as determined by the Plan's actuarial valuation for the year ended December 31, 2014 is \$953,221 (Division's share \$209,708).

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 (Division's share \$10,026,585). The actuarial value of the Plan's assets was \$47,705,478 (Division's share \$10,018,151). As a result, the Plan's unfunded actuarial accrued liability was \$40,162 (Division's share \$8,434). 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 (Division's share \$136,403). 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.

Knoxville Utilities Board Wastewater Division

Notes to Financial Statements

June 30, 2015 and 2014

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.

13. Related Party Transactions

The Division, in the normal course of operations, is involved in transactions with the City of Knoxville and with other divisions of KUB. Such transactions for the years ended June 30, 2015 and 2014 are summarized as follows:

	2015	2014
City of Knoxville		
Amounts billed by the Division for utilities and related services	\$ 1,013,354	\$ 816,084
Payments by the Division in lieu of property tax	3,575,461	3,373,076
Payments by the Division for services provided	1,147,555	1,024,176
Other divisions of KUB		
Amounts billed to other divisions for utilities and related services provided	285,944	365,806
Interdivisional rental expense	306,769	283,101
Interdivisional rental income	96,075	86,602
Amounts billed to the Division by other divisions for utilities services provided	3,002,595	3,125,483

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

	2015	2014
Accounts receivable	\$ 29,056	\$ 40,190

Knoxville Utilities Board Wastewater Division

Notes to Financial Statements

June 30, 2015 and 2014

14. Other Commitments and Contingencies

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

In February 2005, a Consent Decree was entered into federal court regarding the operation of KUB's wastewater system. Under the terms of the Consent Decree, the remediation of identified sanitary sewer overflows ("SSOs") on KUB's wastewater system must be completed by June 30, 2016. 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 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.

Knoxville Utilities Board Wastewater Division
Required Supplementary Information – Schedule of Funding Progress
June 30, 2015
(Unaudited)

Other Post-Employment Benefits (OPEB)

Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded Actuarial Accrued Liability (UAAL) (b-a)	Funded Ratio (a)/(b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll [(b)-(a)]/(c)
January 1, 2008	\$ -	\$ 108,329,141	\$ 108,329,141	0%	\$ 31,234,509	346.8%
January 1, 2009	14,593,487	100,726,738	86,133,251	14%	31,846,091	270.5%
January 1, 2010	21,275,643	58,475,364	37,199,721	36%	30,069,028	123.7%
January 1, 2011	40,749,815	64,289,254	23,539,439	63%	28,878,791	81.5%
January 1, 2012	37,907,357	61,603,466	23,696,109	62%	28,269,123	83.8%
January 1, 2013	38,571,803	63,341,531	24,769,728	61%	27,566,340	89.9%
* 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 Wastewater Division
Required Supplementary Information – Schedule of Changes in Net Pension
Liability and Related Ratios
June 30, 2015
(Unaudited)

	2014
Total pension liability	
Service cost	\$ 4,092,808
Interest	14,698,657
Benefit payments, including refunds of member contributions	(15,533,167)
Net change in total pension liability	3,258,298
Total pension liability - beginning	199,515,466
Total pension liability - ending (a)	\$ 202,773,764
Plan fiduciary net position	
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	(128,000)
Net change in plan fiduciary net position**	12,795,245
Plan fiduciary net position - beginning**	196,000,149
Plan fiduciary net position - ending (b)**	\$ 208,795,394
Plan's net pension liability - ending (a) - (b)	\$ (6,021,630)
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 Wastewater Division
Required Supplementary Information – Schedule of Employer Pension
Contributions
June 30, 2015
(Unaudited)

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

Notes to Schedule:

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:

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 Wastewater Division
Supplemental Information - Schedule of Insurance in Force
June 30, 2015
(Unaudited)

Schedule 1

Insurance coverage is for KUB as a consolidated entity.

Crime

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

Directors' and Officers' Liability Insurance

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

Employment Practices Liability

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

Fiduciary

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

Pollution Legal Liability

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

Property Insurance

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

Travel Accident

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

Excess Insurance for General Liability

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

Excess Insurance for Workers' Compensation

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

Employee Health Plan Stop Loss Coverage

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

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Wastewater Division
Supplemental Information – Schedule of Debt Maturities by Fiscal Year
June 30, 2015
(Unaudited)

Schedule 2
Continued on Next Page

FY	2005B		2008		2010		2010C		2012A			
	Principal	Interest	Principal	Interest	Principal	Interest	Rebate*	Principal	Interest	Rebate*	Principal	Interest
15-16	\$ 1,410,000	\$ 676,585	\$ 4,450,000	\$ 550,000	\$ 1,910,000	\$ 668,500	\$ 1,250,000	\$ 3,673,920	\$ 1,285,872	\$ 820,000	\$ 571,925	
16-17	1,470,000	620,185	4,600,000	327,500	1,910,000	668,500	1,400,000	3,634,545	1,272,090	840,000	551,425	
17-18	1,525,000	561,385	1,950,000	97,500	1,910,000	668,500	1,500,000	3,584,425	1,254,548	985,000	528,325	
18-19	1,595,000	498,860			1,910,000	668,500	1,550,000	3,525,625	1,233,968	970,000	498,775	
19-20	1,655,000	433,066			1,910,000	668,500	1,600,000	3,460,990	1,211,346	950,000	467,250	
20-21	1,725,000	363,556			1,910,000	668,500	1,650,000	3,394,270	1,187,994	1,085,000	434,000	
21-22	1,800,000	290,244			1,910,000	668,500	1,700,000	3,325,465	1,163,912	1,175,000	390,600	
22-23	1,880,000	212,844			1,910,000	668,500	1,750,000	3,246,925	1,136,424	1,165,000	343,600	
23-24	695,000	130,594			1,910,000	668,500	1,850,000	3,162,575	1,106,902	1,250,000	297,000	
24-25	730,000	100,188			1,910,000	668,500	1,950,000	3,065,450	1,072,908	1,140,000	247,000	
25-26	765,000	68,250			1,910,000	668,500	2,375,000	2,961,125	1,036,394	1,190,000	201,400	
26-27	795,000	34,781			1,910,000	668,500	2,500,000	2,830,738	990,758	1,235,000	153,800	
27-28					1,910,000	668,500	2,600,000	2,688,488	940,970	1,280,000	104,400	
28-29					1,910,000	668,500	2,725,000	2,536,388	887,736	1,330,000	53,200	
29-30					1,910,000	668,500	2,850,000	2,376,975	831,942			
30-31					1,910,000	668,500	2,975,000	2,210,250	773,588			
31-32					1,910,000	668,500	3,100,000	2,031,750	711,112			
32-33					1,910,000	668,500	3,250,000	1,845,750	646,012			
33-34					1,910,000	668,500	3,375,000	1,650,750	577,762			
34-35					1,910,000	668,500	3,550,000	1,448,250	506,882			
35-36					1,910,000	668,500	3,700,000	1,235,250	432,338			
36-37					1,910,000	668,500	3,875,000	1,009,550	353,342			
37-38					1,910,000	668,500	4,050,000	773,175	270,612			
38-39					1,910,000	668,500	4,225,000	526,125	184,144			
39-40					1,910,000	668,500	4,400,000	268,400	93,940			
40-41					1,910,000	668,500						
41-42					1,910,000	668,500						
42-43					10,000,000	1,910,000	668,500					
43-44					10,000,000	1,260,000	441,000					
44-45					10,000,000	630,000	220,500					
45-46												
46-47												
47-48												
48-49												
49-50												
Total	\$ 16,045,000	\$ 3,990,538	\$ 11,000,000	\$ 975,000	\$ 30,000,000	\$ 55,370,000	\$ 19,379,500	\$ 65,750,000	\$ 60,467,154	\$ 21,163,496	\$ 15,415,000	\$ 4,842,700

*Series 2010 and 2010c bonds were issued as federally taxable Build America Bonds. KUB will receive a 35 percent interest rebate payment from the United States Government for each interest payment. Effective 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.

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Wastewater Division
Supplemental Information – Schedule of Debt Maturities by Fiscal Year
June 30, 2015
(Unaudited)

Schedule 2

Continued from Previous Page

FY	2012B		2013A		2014A		2015A		2015B		TOTALS		Grand Total	Grand Total
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	(P + I)	(Less Rebates)
15-16	\$ 925,000	\$ 1,935,063	\$ 610,000	\$ 3,563,300	\$ 425,000	\$ 1,094,619	\$ 465,000	\$ 4,710,761	\$ 575,000	\$ 1,001,409	\$ 10,930,000	\$ 19,687,582	\$ 30,617,582	\$ 28,663,210
16-17	975,000	1,916,563	620,000	3,551,100	450,000	1,086,119	125,000	5,115,762	450,000	1,141,938	10,930,000	19,855,137	30,785,137	28,844,547
17-18	1,000,000	1,904,375	635,000	3,538,700	475,000	1,077,119	2,835,000	5,109,512	475,000	1,128,438	11,380,000	19,439,779	30,819,779	28,896,731
18-19	1,050,000	1,891,871	660,000	3,513,300	475,000	1,058,119	5,010,000	4,967,762	500,000	1,104,688	11,810,000	18,969,000	30,779,000	28,876,532
19-20	1,100,000	1,878,750	685,000	3,486,900	500,000	1,039,119	5,305,000	4,717,262	525,000	1,079,688	12,320,000	18,473,025	30,793,025	28,913,179
20-21	1,150,000	1,862,250	710,000	3,459,500	525,000	1,019,119	5,460,000	4,452,012	525,000	1,063,938	12,830,000	17,958,645	30,788,645	28,932,151
21-22	1,200,000	1,804,750	740,000	3,431,100	550,000	998,119	5,675,000	4,179,012	550,000	1,042,938	13,390,000	17,372,228	30,762,228	28,929,816
22-23	1,250,000	1,744,750	770,000	3,401,500	575,000	981,619	6,005,000	3,895,262	575,000	1,020,936	13,970,000	16,757,436	30,727,436	28,922,512
23-24	1,300,000	1,694,750	4,600,000	3,370,700	600,000	964,369	3,720,000	3,595,012	600,000	997,938	14,615,000	16,122,938	30,737,938	28,962,536
24-25	1,375,000	1,642,750	4,900,000	3,232,700	625,000	946,369	3,785,000	3,483,412	625,000	973,938	15,130,000	15,601,807	30,731,807	28,990,399
25-26	1,425,000	1,587,750	5,040,000	3,085,700	650,000	927,619	1,425,000	3,369,864	650,000	955,188	13,520,000	15,066,896	28,586,896	26,882,002
26-27	1,500,000	1,530,750	5,200,000	2,934,500	700,000	908,119	1,490,000	3,323,550	675,000	935,688	14,095,000	14,561,926	28,656,926	26,997,668
27-28	1,575,000	1,470,750	6,305,000	2,778,500	725,000	880,119	1,405,000	3,271,400	700,000	915,438	14,590,000	14,019,095	28,609,095	26,999,625
28-29	1,625,000	1,423,500	6,535,000	2,573,588	750,000	851,119	1,450,000	3,222,226	725,000	887,438	15,140,000	13,457,459	28,597,459	27,041,223
29-30	1,700,000	1,374,750	8,315,000	2,377,538	775,000	821,119	1,455,000	3,178,726	775,000	858,438	15,870,000	12,897,546	28,767,546	27,267,104
30-31	1,775,000	1,323,750	8,550,000	2,128,088	825,000	790,119	1,515,000	3,135,076	800,000	827,436	16,440,000	12,324,719	28,764,719	27,322,631
31-32	1,875,000	1,270,500	8,840,000	1,871,588	850,000	757,119	1,520,000	3,089,626	825,000	795,436	17,010,000	11,726,019	28,736,019	27,356,407
32-33	1,950,000	1,214,250	9,120,000	1,606,388	900,000	723,119	1,580,000	3,042,125	850,000	762,436	17,650,000	11,104,068	28,754,068	27,439,556
33-34	2,025,000	1,155,750	9,390,000	1,332,788	925,000	687,119	1,635,000	2,992,750	900,000	733,750	18,250,000	10,462,907	28,712,907	27,466,645
34-35	2,125,000	1,095,000	9,705,000	1,015,875	975,000	650,119	1,690,000	2,939,612	925,000	703,375	18,970,000	9,762,231	28,732,231	27,556,849
35-36	2,225,000	1,031,250	10,025,000	688,331	1,025,000	611,119	1,750,000	2,884,688	975,000	671,000	19,700,000	9,031,638	28,731,638	27,630,800
36-37	2,325,000	964,500	10,370,000	349,988	1,075,000	570,119	1,825,000	2,827,812	1,000,000	632,000	20,470,000	8,263,969	28,733,969	27,712,127
37-38	2,425,000	894,750			500,000	527,119	13,420,000	2,768,500	500,000	592,000	20,895,000	7,465,544	28,360,544	27,421,432
38-39	2,550,000	822,000			500,000	507,119	13,895,000	2,298,800	500,000	572,000	21,670,000	6,636,044	28,306,044	27,453,400
39-40	2,650,000	745,500			500,000	488,994	14,480,000	1,743,000	500,000	552,000	22,530,000	5,707,894	28,237,894	27,475,454
40-41	2,775,000	666,000			1,175,000	470,869	15,130,000	1,236,200	1,100,000	532,000	20,180,000	4,815,069	24,995,069	24,326,569
41-42	2,900,000	582,750			1,225,000	428,275		631,000	1,150,000	488,000	21,050,000	4,040,025	25,090,025	24,421,525
42-43	3,025,000	495,750			1,300,000	382,950			1,200,000	442,000	15,525,000	3,230,700	18,755,700	18,087,200
43-44	3,150,000	405,000			1,350,000	334,850			1,250,000	394,000	15,750,000	2,393,850	18,143,850	17,702,850
44-45	3,300,000	310,500			1,400,000	284,900			1,300,000	344,000	16,000,000	1,569,400	17,569,400	17,348,900
45-46	3,450,000	211,500			1,475,000	233,100			1,350,000	292,000	6,275,000	736,600	7,011,600	7,011,600
46-47	3,600,000	108,000			1,550,000	178,525			1,400,000	238,000	6,550,000	524,525	7,074,525	7,074,525
47-48					1,600,000	121,175			1,450,000	182,000	3,050,000	303,175	3,353,175	3,353,175
48-49					1,675,000	61,975			1,525,000	124,000	3,200,000	185,975	3,385,975	3,385,975
49-50									1,575,000	63,000	1,575,000	63,000	1,638,000	1,638,000
Total	\$ 63,275,000	\$ 38,960,122	\$ 112,325,000	\$ 57,291,672	\$ 29,625,000	\$ 23,461,469	\$ 129,825,000	\$ 90,180,724	\$ 30,000,000	\$ 25,048,472	\$ 503,260,000	\$ 360,587,851	\$ 863,847,851	\$ 823,304,855

*Series 2010 and 2010c bonds were issued as federally taxable Build America Bonds. KUB will receive a 35 percent interest rebate payment from the United States Government for each interest payment. Effective 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.

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Wastewater Division
Supplemental Information – Schedule of Current Rates in Force
June 30, 2015
(Unaudited)

Schedule 3

Rate Class	Base Charge	Number of Customers
Residential Inside City rate	For wastewater service furnished to premises entirely within the corporate limits of the City of Knoxville:	54,488
	Commodity Charge	
	First 2 100 Cubic Feet Per Month at \$0.70 Per 100 Cubic Feet	
	Over 2 100 Cubic Feet Per Month at \$8.70 Per 100 Cubic Feet	
	Additional Monthly Customer Charge	
	5/8" meter \$ 23.00	
	1" meter 38.00	
	1 1/2" meter 50.00	
	2" meter 70.00	
Non-Residential Inside City rate	For wastewater service furnished to premises entirely within the corporate limits of the City of Knoxville:	8,594
	Commodity Charge	
	First 2 100 Cubic Feet Per Month at \$0.75 Per 100 Cubic Feet	
	Next 8 100 Cubic Feet Per Month at \$9.85 Per 100 Cubic Feet	
	Next 90 100 Cubic Feet Per Month at \$8.80 Per 100 Cubic Feet	
	Next 300 100 Cubic Feet Per Month at \$7.55 Per 100 Cubic Feet	
	Next 4,600 100 Cubic Feet Per Month at \$6.15 Per 100 Cubic Feet	
	Next 5,000 100 Cubic Feet Per Month at \$4.30 Per 100 Cubic Feet	

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Wastewater Division
Supplemental Information – Schedule of Current Rates in Force
June 30, 2015
(Unaudited)

Schedule 3

Additional Monthly Customer Charge

5/8" meter	\$	23.00
1" meter		38.00
1 1/2" meter		50.00
2" meter		70.00
3" meter		123.00
4" meter		200.00
6" meter		427.00
8" meter		742.00
10" meter		1,125.00
12" meter		1,658.00

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Wastewater Division
Supplemental Information – Schedule of Current Rates in Force
June 30, 2015
(Unaudited)

Schedule 3

Rate Class	Base Charge	Number of Customers
Residential Outside City rate	For wastewater service furnished to premises entirely or partly outside the corporate limits of the City of Knoxville:	7,557
	Commodity Charge	
	First 2 100 Cubic Feet Per Month at \$0.85 Per 100 Cubic Feet	
	Over 2 100 Cubic Feet Per Month at \$9.30 Per 100 Cubic Feet	
	Additional Monthly Customer Charge	
	5/8" meter \$ 27.00	
	1" meter 41.00	
	1 1/2" meter 58.00	
	2" meter 78.00	
Non-Residential Outside City rate	For wastewater service furnished to premises entirely or partly outside the corporate limits of the City of Knoxville:	513
	Commodity Charge	
	First 2 100 Cubic Feet Per Month at \$0.90 Per 100 Cubic Feet	
	Next 8 100 Cubic Feet Per Month at \$10.90 Per 100 Cubic Feet	
	Next 90 100 Cubic Feet Per Month at \$9.65 Per 100 Cubic Feet	
	Next 300 100 Cubic Feet Per Month at \$8.25 Per 100 Cubic Feet	
	Next 4,600 100 Cubic Feet Per Month at \$6.90 Per 100 Cubic Feet	
	Next 5,000 100 Cubic Feet Per Month at \$4.80 Per 100 Cubic Feet	

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Wastewater Division
Supplemental Information – Schedule of Current Rates in Force
June 30, 2015
(Unaudited)

Schedule 3

Additional Monthly Customer Charge

5/8" meter	\$ 27.00
1" meter	41.00
1 1/2" meter	58.00
2" meter	78.00
3" meter	139.00
4" meter	222.00
6" meter	469.00
8" meter	817.00
10" meter	1,234.00
12" meter	1,821.00

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
Wastewater Division of the Knoxville Utilities Board
Knoxville, Tennessee

Report on the Financial Statements

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 Wastewater Division (the Division) of the Knoxville Utilities Board, 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 the Division'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 the Division'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 the Division's internal control. Accordingly, we do not express an opinion on the effectiveness of the Division'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 the Division'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
Wastewater Division of the Knoxville Utilities Board
Knoxville, Tennessee

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Division'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 the Division's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Division's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Coulter & Justus, P.C.

Knoxville, Tennessee
October 16, 2015