Knoxville Utilities Board

Consolidated Financial Statements and Supplemental Information
June 30, 2012 and 2011

Knoxville Utilities Board
Index
June 30, 2012 and 2011

Page(s)

Independent Auditors' Report 1-2

Management's Discussion and Analysis 3-19

Financial Statements

Consolidated Statements of Net Assets 20-21

Consolidated Statements of Revenues, Expenses and Changes in Net Assets 22

Consolidated Statements of Cash Flows 23

Notes to Consolidated Financial Statements 24-42

Required Supplementary Information – Schedule of Funding Progress 43

Supplemental Information

Schedule 1 – Schedule of Expenditures of Federal Awards 44

Schedule 2 – Schedule of Findings and Questioned Costs 45

Schedule 3 – Schedule of Insurance in Force 46

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* 47-48

Report of Independent Auditors Report on Compliance with Requirements that could have a Direct Material Effect on each Major Program and on Internal Control over Compliance in Accordance with *OMB Circular A-133* 49-50

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Independent Auditors' Report

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

We have audited the accompanying consolidated financial statements of the Knoxville Utilities Board, an independent agency and reported as a component unit for financial reporting purposes only by the City of Knoxville, Tennessee, as of and for the years ended June 30, 2012 and 2011. These financial statements are the responsibility of Knoxville Utilities Board's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Knoxville Utilities Board, as of June 30, 2012 and 2011, and the respective changes in financial position, and cash flows, for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 18, 2012, on our consideration of the Knoxville Utilities Board'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* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 19 and Schedule of Funding Progress on page 43 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.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Knoxville Utilities Board's financial statements as a whole. The supplemental schedule on page 46 is presented for the purpose of additional analysis and is not a required part of the financial statements. The accompanying schedule of expenditures of federal awards on page 44 is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit*

Organizations, and is also not a required part of the financial statements. The schedule of expenditures of federal awards is the responsibility of management and was derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole. The supplemental schedule 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 them.

In accordance with *Government Auditing Standards*, the report on our consideration of the Board's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters dated October 18, 2012, has been reissued due to the omission of two federal program contracts on the schedule of expenditures of federal, state and other awards. Since program CFDA 97.036 was considered major, additional audit procedures were performed. The changes to the previously issued report dated October 18, 2012 encompasses the addition of program CFDA 97.036 contract number 34101-0000009205 and contract number 34101-0000009832 to the schedule of expenditures of federal, state and other awards and to the schedule of findings and questioned costs.

Rodefer Moss & Co, PLLC

Knoxville, Tennessee
October 18, 2012
(Except as noted in the last paragraph above,
as to which the date is October 22, 2013)

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

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

The Management Discussion and Analysis ("MD&A") focuses on the fiscal year ending June 30, 2012 activities, resulting changes and current known facts, and should be read in conjunction with KUB's consolidated financial statements.

Consolidated Highlights

Financial Highlights

Net assets increased $26.3 million or 3.3 percent in fiscal year 2012, compared to a $27.7 million increase last fiscal year.

Operating revenue decreased $28.9 million or 4 percent, the net result of a decline in sales volumes for all four utility systems, the flow through of higher wholesale power rates to KUB's retail electric customers, additional revenue from electric, water, and wastewater rate increases, and the flow through of lower wholesale natural gas rates to KUB's gas customers. Purchased energy expense (power and natural gas) decreased $27.2 million or 5.6 percent. Margin from sales (operating revenue less purchased energy expense) was down $1.7 million or 0.7 percent compared with the prior fiscal year.

Operating expenses (excluding purchased power and purchased gas expense) decreased $1.5 million, or 0.8 percent. Operating and maintenance (O&M) expenses declined $4.1 million or 3.6 percent. Depreciation and amortization expense increased $2 million or 4.4 percent. Taxes and tax equivalents increased $0.6 million or 2.5 percent.

Lower interest rates on contingency reserve investments resulted in a $0.4 million decrease in interest income. Interest expense increased $1.8 million or 5.7 percent, due to the issuance of $25 million in water revenue bonds during the fiscal year and a full year of interest on $112 million of debt issued the previous year. These items contributed to a net decrease in non-operating revenues (expenses) of $2.1 million compared to the prior year.

Capital contributions increased $0.9 million, the result of growth in contributed assets from developers due to new construction in the water and wastewater service areas.

Total plant assets (net) increased $97.6 million or 7.7 percent over the last fiscal year.

In December 2011, the Water Division issued $25 million of new long-term debt to fund capital system improvements.

In April 2012, $94.6 million of outstanding debt was refunded, which will result in a cost savings of $15.4 million over the term of the debt ($12.3 million on a net present value basis). As a result of the refunding, the principal owed was reduced by $5.7 million.

Long-term debt represented 47 percent of KUB's capital structure, compared to 47.9 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 assets.

Other Highlights

As of June 30, 2012, KUB served 442,500 customers. During the year, 2,700 new customers were added, representing growth of less than 1 percent.

A historically mild winter had a significant impact on energy sales for fiscal year 2012. The winter was 23 percent warmer than normal and, as a result, electric sales volumes were 4.6 percent lower than the prior fiscal year and natural gas sales volumes were 13.3 percent lower.

KUB refunded $94.6 million in outstanding bonds at lower interest rates, which will provide debt service savings of $15.4 million over the life of the bonds.

KUB achieved its goal of reducing full-time staffing to 875 full-time employees by June 30, 2012. KUB's full-time staffing level as of fiscal year-end was 872. The staffing goal was a key component of KUB's recession response plan, which was initiated in January 2009. Prior to setting this goal, KUB's long-term staffing plan anticipated 980 full-time employees by June 2012. Achieving the goal will provide approximately $5 million in annual savings.

Two historic storm events, with combined restoration costs of $8.4 million, impacted the KUB electric system during fiscal year 2011. KUB received $4.2 million in reimbursements from the Federal Emergency Management Agency (FEMA) during fiscal year 2012. KUB anticipates an additional $2.1 million in reimbursements from FEMA in fiscal year 2013.

KUB was awarded a grant from the Department of Energy in October 2009 through the DOE's Smart Grid Investment Grant Program. The grant, which totals $3.58 million, will be used to help fund a smart grid pilot project in the University of Tennessee and surrounding areas. The pilot includes the installation of over 6,000 digital electronic smart meters and an advanced metering infrastructure (AMI) communications backbone, which will provide coverage for KUB's entire service territory. The communications infrastructure will enable KUB to remotely read meters, and also provide remote service connection/disconnection capabilities. The term of the pilot is approximately three years. During fiscal year 2012, KUB installed the AMI communication backbone. The grant funded $2.1 million of pilot expenditures for fiscal year 2012.

Each of KUB's four wastewater treatment plants received an award from the National Association of Clean Water Agencies for outstanding permit compliance in 2011. KUB also received a National Biosolids Partnership certification in December 2011 following an independent review and audit (Biosolids are nutrient-rich organic matter produced by wastewater treatment that can be recycled as fertilizer).

Century II Infrastructure Program

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

In September 2011, the Board adopted a resolution, which endorsed the Century II electric and water programs and the associated ten-year funding plans. The resolution also adopted the initial three electric and water rate increases, the first of which were effective October 1, 2011, and January 1, 2012, respectively. Each of the electric rate increases will generate an additional $5 million in annual electric sales revenue. For residential electric customers this will result in an increase of $1 in their monthly electric bills for each of the rate increases. Each of the water rate increases will generate an additional $1.7 million in annual water sales revenue. For residential water customers this will result in an increase of $1 in their monthly water bills for each of the rate increases.

With Board approval, KUB immediately began implementing the accelerated pace of infrastructure replacement for the electric and water systems. For the fiscal year ended June 30, 2012, KUB exceeded its target replacement levels for all of its Century II programs, while maintaining its overall capital budget. For the electric system, 2,800 poles were replaced, exceeding the target level of 2,300; 17.5 miles of underground electric cable were replaced, exceeding the target level of 12.5 miles. For the water system, 11.5 miles of galvanized water main were replaced, exceeding the target level of 10 miles; 4.1 miles of cast iron water main were replaced, exceeding the target level of 3.5 miles. For the natural gas system, 9.75 miles of cast iron/ductile iron gas main were replaced, exceeding the target level of 8 miles. For the wastewater system, 29 miles of wastewater system main were rehabilitated or replaced, exceeding the target level of 25 miles.

Consent Decree

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

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

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

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

KUB's funding plan for the Consent Decree includes approximately $680 million in bond issues through June 2021 plus 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, 2012, the Wastewater Division had issued $360 million in bonds to fund system capital improvements since the inception of the Consent Decree. The KUB Board of Commissioners approved two 50 percent rate increases, which went into effect in April 2005 and January 2007, respectively. The Board also approved an 8 percent rate increase, which was effective in September 2008, and a 12 percent rate increase, which was effective in April 2011. The Board also adopted a 12 percent rate increase to be effective October 2012. KUB anticipates additional bond issues and rate increases over the next decade to help fund PACE 10.

KUB continues to be in compliance with Consent Decree requirements. In August 2004, KUB launched PACE 10, an accelerated ten-year program to help improve Knoxville's waterways, the quality of life, and the economic well being of the community. 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 203 miles of collection system pipe. KUB also continues to maintain a proactive operations and maintenance plan for the wastewater collection system including inspection, cleaning, grease control, and private lateral enforcement. The result of the PACE 10 program has been a substantial reduction in sanitary sewer overflows.

During fiscal year 2012, the Wastewater Division incurred $60.5 million in total expenditures related to Consent Decree requirements, including $3.7 million for operating costs and $56.8 million in capital improvements. During the fiscal year, $20.4 million was spent on sewer mini-basin rehab and replacement. Trunk line replacement and rehabilitation accounted for $17 million of capital expenditures during the fiscal year. Upgrades currently in progress at the Kuwahee and Fourth Creek Treatment Facilities accounted for $11.8 million of fiscal year 2012 capital expenditures. As of June 30, 2012, the Wastewater Division had spent $371.5 million in capital investments to meet the requirements of the Consent Decree.

Cash Budget Appropriations

KUB's Board of Commissioners adopted a total cash budget of $869.4 million for fiscal year 2012. At fiscal year-end, cash expenditures were $56.5 million under budget primarily due to a $53.2 million decrease in purchased energy expense as a result of lower than expected purchases due to milder winter weather and lower than projected wholesale energy rates. Operating receipts were down $59.4 million compared to budget as a result of lower than expected sales and the flow through of lower than anticipated energy costs. O&M expenditures were $3.4 million under budget, reflecting labor-related savings. Capital expenditures were on budget. $59.1 million in bond proceeds were transferred to the general fund to pay for capital during fiscal year 2012, $16.7 million more than expected, which was due to the timing of capital projects during fiscal year 2011. KUB's general fund balance was $11.3 million higher than anticipated at year-end. The numbers below are presented on a cash basis.

KUB Consolidated Cash Report
As of June 30, 2012

(in thousands of dollars)	**FY 2012 Budget**	**FY 2012 Actual FYTD**	**Dollar Variance***	**Percent Variance**
Beginning Balance General Fund	$139,547	$139,547		
Operating Receipts	776,160	714,808	(61,352)	-7.9%
Disbursements				
Purchased Energy Expense	521,808	468,596	53,212	-10.2%
Operation & Maintenance Expense	115,460	112,086	3,374	-2.9%
Capital Expenditures	152,711	152,387	324	-0.2%
Debt Service & Taxes	79,388	79,776	(388)	0.5%
Total Disbursements	869,367	812,845	56,522	-6.5%
Bond Proceeds	42,424	59,096	16,672	39.3%
Net Flow-throughs and Transfers	317	(248)	(565)	-100%
Ending General Fund Balance	$ 89,081	$ 100,358	$ 11,277	12.7%

**(-) indicates a decrease to cash*

KUB Consolidated Financial Statements

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

Statement of Net Assets

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

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

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

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

Statement of Revenues, Expenses and Changes in Net Assets

KUB reports its revenues and expenses (both operating and non-operating) on the Statement of Revenues, Expenses and Changes in Net Assets. 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 assets for the reporting period. Net assets at the beginning of the period is increased or decreased, as applicable, by the change in net assets for the reporting period.

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

Statement of Cash Flows

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

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

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

Condensed Financial Statements

Statement of Net Assets

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

Statements of Net Assets
As of June 30

(in thousands of dollars)	2012	2011
Current and other assets	$ 338,631	$ 409,140
Capital assets, net	1,367,479	1,269,924
Total assets	1,706,110	1,679,064
Current and other liabilities	150,228	147,156
Long-term debt outstanding	720,575	722,940
Total liabilities	870,803	870,096
Net assets		
Invested in capital assets, net of related debt	621,993	529,826
Restricted	11,228	10,426
Unrestricted	202,086	268,716
Total net assets	$ 835,307	$ 808,968

Normal Impacts on Statement of Net Assets

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

- Change in net assets (from Statement of Revenues, Expenses and Changes in Net Assets): impacts (increase/decrease) current and other assets and/or capital assets and unrestricted net assets.
- Issuing debt for capital: increases current and other assets 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 assets and increases invested in capital assets, net of related debt.
- Principal payment on debt: (a) reduces current and other assets and reduces long-term debt and (b) reduces unrestricted net assets and increases invested in capital assets, net of related debt.
- Reduction of capital assets through depreciation: reduces capital assets and invested in capital assets, net of related debt.

Current Year Impacts and Analysis

Current and Other Assets

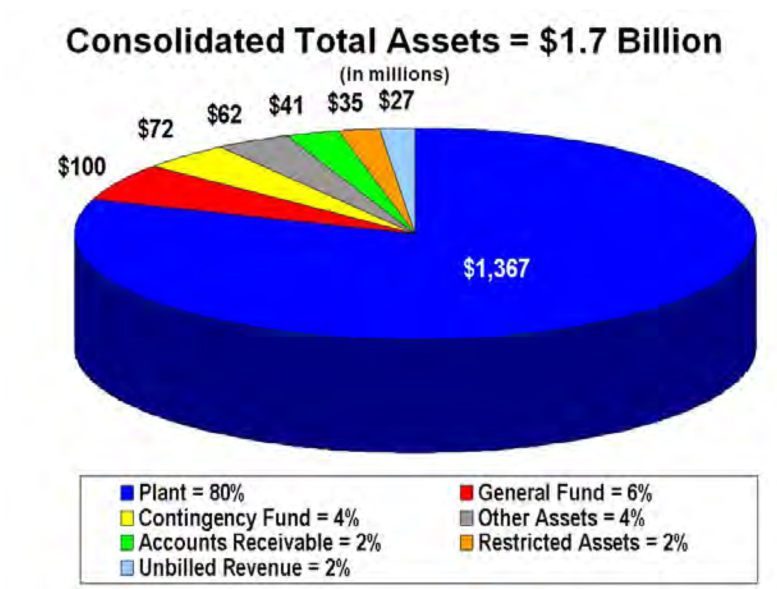
Current and other assets decreased $70.5 million or 17.2 percent. General fund cash (including cash and cash equivalents, short-term investments, and long-term investments) decreased $39.2 million or 28.1 percent, due to the use of general fund cash to fund a portion of the year's capital improvements. Accounts receivable was $9 million or 17.8 percent lower than last year, partially due to lower June sales in all divisions compared to the prior year. The cost of gas in storage rose $3 million or 27.2 percent, due to an increase in the volume of stored gas compared to last year. The total of unused bond proceeds, $13.8 million, represented the remainder of $25 million in water bonds issued in December 2011. During fiscal year 2012, $47.8 million of unused proceeds available at the end of the prior year were expended to fund capital system improvements in the Electric, Gas, and Wastewater Divisions. This amount contributed to the overall decrease in restricted assets.

In the previous fiscal year, KUB instituted a deferred accounting component to its Purchased Power Adjustment to ensure appropriate cost recovery over the long-term. As of June 30, 2012, KUB had under recovered $17.7 million in wholesale power costs, which reflected a $1.7 million increase in net assets compared to the prior year. This under recovery of wholesale power costs will be recovered from KUB's electric customers through future adjustments to electric rates via the Purchased Power Adjustment.

The Gas Division under recovered $3.9 million in wholesale gas costs from its customers in fiscal year 2012, as compared to a $1.1 million over recovery in fiscal year 2011. This under recovery of costs will be flowed back to gas customers next fiscal year through adjustments to natural gas rates via the Purchased Gas Adjustment. The net effect was a $2.8 million addition in assets.

Capital Assets

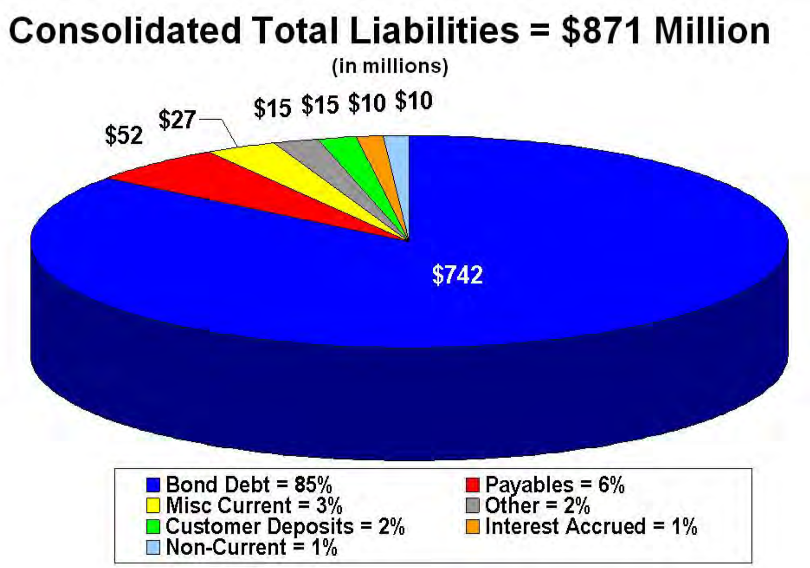
Capital assets (net) increased $97.6 million or 7.7 percent. Major plant additions (reflected in both plant additions and work in progress) during fiscal year 2012 included $45 million for PACE 10 projects for the wastewater collection system, $11.8 million for Composite Correction Plan projects for the wastewater system, $22.7 million for electric distribution system improvements, $17.3 million for cast iron gas main replacement and construction of new gas mains, $7 million for water main replacement, $6.8 million for pole replacements for the electric system, $4.5 million for water plant and system improvements, and $2.8 million for smart grid infrastructure.



Current and Other Liabilities
Current and other liabilities increased $3.1 million. The net unamortized cost of debt increased $5 million primarily reflecting premiums received in the refunding of $94.6 million of outstanding debt in April 2012. In addition, the liability for the current portion of debt related to bonds rose $1.9 million compared to the prior year. These increases were partially reduced by a $3.5 million decrease in liability for the funding of post employment medical benefits.

Long-term Debt

Long-term debt decreased $2.4 million or 0.3 percent. In December 2011, the Water Division issued $25 million in long-term bonds. In April 2012, KUB refunded $94.6 million in debt, resulting in a net reduction in outstanding debt of $5.7 million. During the fiscal year, $19.8 million of bond debt was repaid which contributed to the overall decrease in debt.



Net Assets
Investments in capital assets, net of debt increased $92.2 million or 17.4 percent, primarily due to the $26.3 million increase in net assets (as reported on the Statement of Revenue, Expenses and Changes in Net Assets), the expending of $59 million in proceeds from prior and current year bond issues on capital infrastructure during the year, and a $2.4 million decrease in long-term debt. Restricted net assets increased $0.8 million compared to the prior year. Unrestricted net assets decreased $66.6 million or 24.8 percent, reflecting the reduced balances of unused bond proceeds and general fund cash at fiscal year end.

Statement of Revenues, Expenses and Changes in Net Assets

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

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

(in thousands of dollars)	**2012**	**2011**
Operating revenues	$ 693,531	$ 722,442
Less: Purchased power expense	456,038	483,253
Margin from sales	237,493	239,189
Operating expenses		
Treatment	12,624	13,000
Distribution and collection	53,940	56,559
Customer service	11,100	11,755
Administrative and general	31,066	31,492
Depreciation and amortization	47,613	45,603
Taxes and tax equivalents	24,552	23,950
Total operating expenses	180,895	182,359
Operating income	56,598	56,830
Interest income	1,504	1,876
Interest expense	(34,077)	(32,245)
Other income/(expense)	(767)	(910)
Change in net assets before capital contributions	23,258	25,551
Capital contributions	3,081	2,181
Change in net assets	$ 26,339	$ 27,732

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

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

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

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

- Interest expense on debt is impacted by level of outstanding debt and the interest rate(s) on the outstanding debt.

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

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

Current Year Impacts and Analysis

Net assets increased $26.3 million, compared to a $27.7 million increase last fiscal year.

Operating revenue declined $28.9 million or 4 percent for the fiscal year ending June 30, 2012. Electric Division operating revenue decreased $15.5 million, the net result of a 4.6 percent decline in sales volumes, additional revenue from a one percent electric margin rate increase, and the flow through of higher wholesale power rates. Gas Division revenue decreased $19.5 million or 18.4 percent for the fiscal year, the result of lower wholesale gas prices, which flowed through to KUB's gas customers, and a 13.3 percent decline in natural gas sales volumes. Water Division revenue increased $1.1 million or 2.9 percent, the result of additional revenue from a five percent rate increase, which was effective January 2012. Wastewater Division revenue was $4.7 million higher than the previous year, reflecting a full year of revenue from a twelve percent rate increase effective April 2011.

Wholesale energy expense decreased $27.2 million or 5.6 percent. Both purchased power and natural gas volumes were significantly impacted by the mildest winter in KUB's service territory in 25 years. Purchased power expense decreased $14.6 million compared to last year, the net result of higher wholesale power rates and lower sales volumes. Purchased gas cost fell $13 million, the combined result of a decline in sales volumes and lower wholesale natural gas prices.

Margin from sales (operating revenue less purchased energy expense) declined $1.7 million compared to the previous year, the net result of lower billed sales volumes in all divisions, a full year of margin from the prior year wastewater rate increase, and a partial year's revenue from the electric and water rate increases.

Operating Expenses

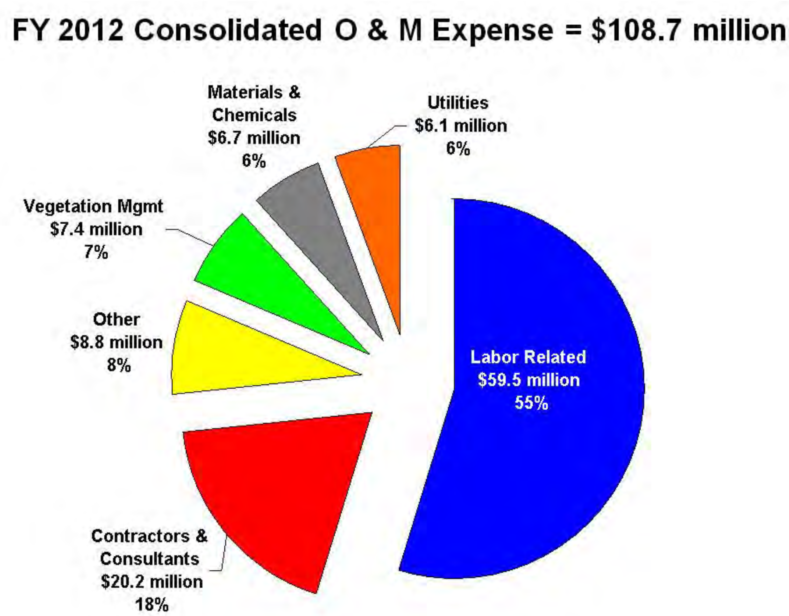
Operating expenses (excluding wholesale purchased energy expense) decreased $1.5 million or 0.8 percent compared to last fiscal year.

- Treatment expenses were $0.4 million or 2.9 percent lower than the prior year, reflecting a decrease in labor-related expenses.

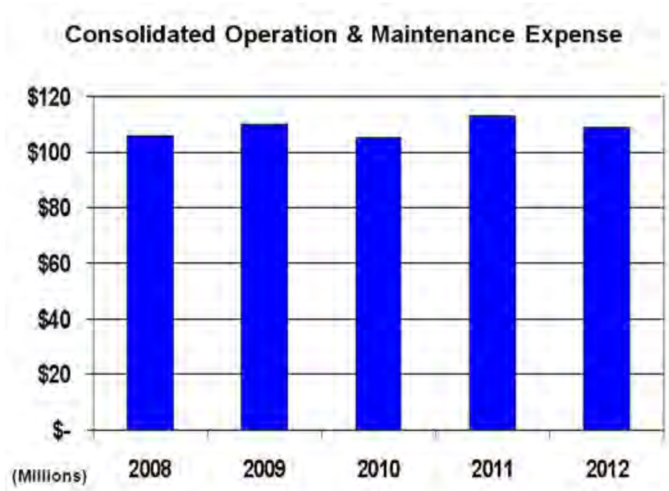
- Distribution and collection expenses decreased $2.6 million or 4.6 percent. Prior year expenditures of $3.7 million for the gas saddle inspection and replacement program and $1.7 million for electric system storm restoration for the April and June 2011 storm events (net of accrued FEMA reimbursement) offset current year increases, including higher vegetation management and facilities maintenance costs.

- Customer service expenses declined $0.7 million or 5.6 percent, due to a $1.1 million decline in labor-related expenses compared with the prior year.

- Administrative and general expenses decreased $0.4 million or 1.4 percent, due to a $0.3 million decline in labor-related expenses compared with the prior year.



Operation and Maintenance (O&M) expenses have increased at an annual rate of 0.7 percent over the past five years, reflecting cost management initiatives implemented by KUB, including a reduction in full-time staffing from 967 full-time employees in 2008 to 872 by June 30, 2012.



- Depreciation and amortization expense increased $2 million or 4.4 percent. $110.7 million in assets were added during fiscal year 2011. KUB recorded a full year of depreciation expense on these capital investments during fiscal year 2012.

- Taxes and tax equivalents increased $0.6 million or 2.5 percent. Tax equivalent payments to taxing jurisdictions in which KUB's utility systems are located are based on a combination of net plant values and margin from sales. This increase was primarily due to the rise in KUB's plant values and margin from sales in fiscal year 2011.

Interest income decreased $0.4 million or 19.8 percent due to less interest earned on investments, the result of lower interest rates.

Interest expense increased $1.8 million or 5.7 percent, reflecting interest expense on $112 million in bonds sold in December 2010 and $25 million in bonds sold in December 2011.

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

Capital contributions were $0.9 million higher than last fiscal year. Capital contributions for the water and wastewater systems each increased $0.6 million, while electric system contributions were down $0.3 million.

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Capital Assets and Debt Administration

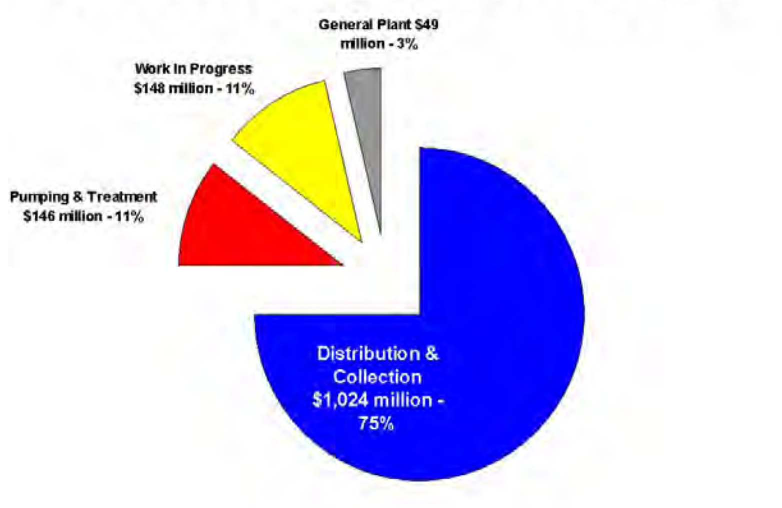
Capital Assets

As of June 30, 2012, KUB had $1.4 billion invested in capital assets, as reflected in the schedule below, which represents a net increase (including additions, retirements, and depreciation) of $97.6 million or 7.7 percent over the end of the last fiscal year.

Capital Assets
As of June 30
(Net of Depreciation)

(in thousands of dollars)	2012	2011
Production plant	$ 103	$ 117
Pumping & treatment plant	145,983	133,271
Distribution & collection plant:		
Mains	563,475	552,666
Services and meters	81,478	81,652
Electric station equipment	25,181	28,492
Poles, towers and fixtures	63,621	58,819
Overhead conductors	69,161	66,520
Line transformers	48,486	48,245
Others	172,735	149,147
Total distribution & collection plant	1,024,137	985,541
General plant	49,208	43,143
Total plant	1,219,431	1,162,072
Work in progress	148,048	107,852
Total net plant	$ 1,367,479	$ 1,269,924

Consolidated Capital Assets = $1.4 Billion



Major capital asset additions during the year were as follows:

- $45 million related to PACE 10 projects.
  - $20.4 million for sewer mini-basin rehabilitation and replacement
  - $17 million for sewer trunk line replacement and rehabilitation
  - $3.2 million for pump station design and construction
  - $2.7 million for storage tank design and construction

- $11.8 million for Composite Correction Plan projects.
  - $9.3 million for upgrades to the Kuwahee Wastewater Treatment Plant
  - $2.5 million for upgrades at the Fourth Creek Wastewater Treatment Facility

- $22.7 million for electric distribution system improvements.

- $17.3 million for gas main replacement and construction of new mains for the gas system.

- $7 million for pipe replacement for the water system.

- $6.8 million for pole replacements for the electric system.

- $4.5 million for water plant and system improvements.

- $2.8 million for smart grid infrastructure.

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Debt Outstanding

As of June 30, 2012, KUB had $742.2 million in outstanding debt (including the current portion of revenue bonds) compared to $742.7 million last year, a decrease of $0.5 million. KUB's weighted average cost of debt as of June 30, 2012 was 4.5 percent (the effective weighted average cost of debt is 4.14 percent, which reflects the Build America Bond rebate for a portion of the outstanding debt).

During fiscal year 2012, $19.8 million in bonds were repaid, reducing outstanding debt levels.

During the fiscal year, $25 million in long-term bonds were issued to finance capital improvements for the water system.

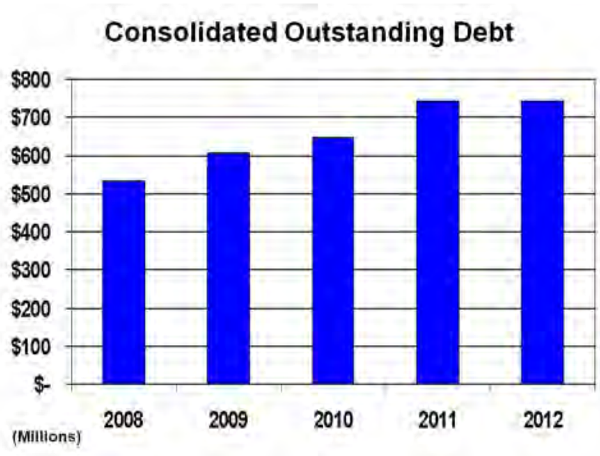
KUB issued $88.9 million in refunding bonds for the purpose of refunding outstanding bonds for all four divisions at lower interest rates. The bonds refunded were issued in 2004. The proceeds of the bonds, when combined with $7.8 million in premiums paid by underwriters, refunded $94.6 million in outstanding bonds and paid all costs of issuance. KUB will realize a total debt service savings of $15.4 million over the life of the bonds.

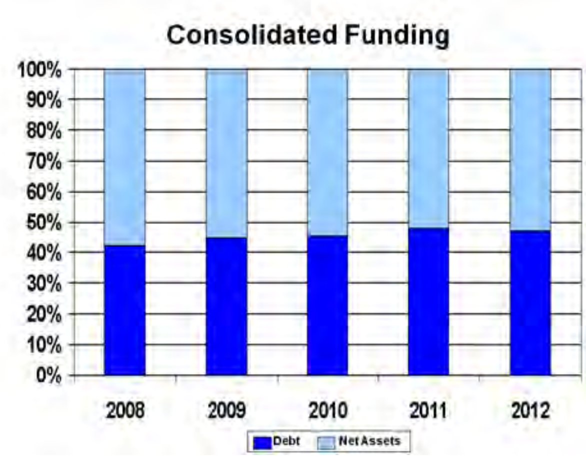
KUB's outstanding debt is rated by Standard & Poor's and Moody's Investors Service. As of June 30, 2012, Standard & Poor's rated the revenue bonds of the Electric, Water, and Wastewater Divisions AA+ and the revenue bonds of the Gas Division AA. Moody's Investors Service rated the bonds of all four divisions Aa2.

The following is a schedule of KUB's outstanding debt as of June 30, 2012.

Outstanding Debt
As of June 30

(in thousands of dollars)		2012		2011
Revenue bonds	$	742,210	$	742,690





Since fiscal year 2008, KUB's outstanding debt has increased from $532 million to its current level of $742.2 million. The majority of the growth is attributed to new debt in the Wastewater Division to fund capital projects to meet the requirements of the Consent Decree.

Impacts on Future Financial Position

KUB anticipates net customer growth of 500 customers over the course of the next fiscal year.

KUB expects to issue $120 million in long-term bonds during the next fiscal year to fund electric, gas, and wastewater system capital projects.

In July 2012, the Gas Division issued a short-term revenue anticipation note (line of credit) for $20 million for the purpose of managing seasonal cash flow during the winter heating season.

A previously adopted one percent electric rate increase, to help fund Century II electric system improvements, will be effective October 1, 2012.

A previously adopted five percent water rate increase, designed to help fund Century II water system improvements, will be effective January 1, 2013.

The KUB Board of Commissioners adopted a 12 percent wastewater rate increase to be effective October 1, 2012. The rate increase will raise the typical residential wastewater customer's monthly bill $5.20.

In fiscal year 2013, KUB will enter into the third year of a three-year smart grid pilot project partially funded by a grant from the Department of Energy. Looking forward to the final year of the project in fiscal year 2013, KUB will deploy conservation voltage reduction equipment on select circuits in and around the core project area. The core project area spans the University of Tennessee and Fort Sanders area. Also, KUB will deploy smart metering technology on its largest commercial and industrial customers through-out the KUB service territory.

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 2013.

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, 2012 and 2011. 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 Assets
June 30, 2012 and 2011

	2012	2011
Assets		
Current assets:		
Cash and cash equivalents	$ 69,858,112	$ 124,547,268
Short-term investments	30,500,000	15,000,000
Short-term contingency fund investments	30,795,149	26,845,286
Other current assets	2,775,000	3,641,718
Accrued interest receivable	115,080	61,661
Accounts receivable, less allowance of uncollectible accounts of $955,065 in 2012 and $1,106,488 in 2011	68,491,633	76,343,051
Inventories	7,642,232	5,222,294
Prepaid expenses	745,139	750,090
Prepaid gas purchases	13,789,493	10,836,632
Total current assets	224,711,838	263,248,000
Restricted assets:		
Bond funds	21,354,636	21,481,119
Other funds	23,769	128,582
Unused bond proceeds	13,803,726	47,847,090
Total restricted assets	35,182,131	69,456,791
Plant in service	1,866,937,094	1,772,751,320
Less accumulated depreciation	(647,505,932)	(610,679,323)
	1,219,431,162	1,162,071,997
Retirement in progress	1,305,720	285,292
Construction in progress	146,742,096	107,567,070
Net plant in service	1,367,478,978	1,269,924,359
Other assets:		
Long-term contingency fund investments	41,602,818	42,829,469
TVA conservation program receivable	9,552,209	8,549,048
Unrecovered purchased power cost	17,654,719	15,926,383
Under recovered purchased gas cost	2,825,163	-
Deferred loss on refunding bonds	3,586,800	4,579,121
Supplemental environmental project	-	150,000
Other	3,514,951	4,401,266
Total other assets	78,736,660	76,435,287
Total assets	$ 1,706,109,607	$ 1,679,064,437

Knoxville Utilities Board
Consolidated Statements of Net Assets
June 30, 2012 and 2011

	2012	2011
Capitalization and Liabilities		
Current liabilities:		
Current portion of revenue bonds and revenue notes	$ 21,635,000	$ 19,750,000
Sales tax collections payable	1,145,588	1,107,542
Accounts payable	51,127,955	51,264,087
Accrued expenses	26,741,204	29,246,593
Customer deposits plus accrued interest	14,720,397	13,653,431
Over recovered gas costs	-	1,067,074
Accrued interest on revenue bonds	10,150,676	11,182,299
Total current liabilities	125,520,820	127,271,026
Other liabilities:		
TVA conservation program	9,335,409	8,199,059
Accrued compensated absences	8,237,657	8,219,683
Customer advances for construction	1,283,627	1,451,870
Supplemental environmental project	-	150,000
Other	5,850,719	1,864,017
Total other liabilities	24,707,412	19,884,629
Long-term debt:		
Revenue bonds	720,575,000	722,940,000
Total long-term debt	720,575,000	722,940,000
Total liabilities	870,803,232	870,095,655
Net assets		
Invested in capital assets, net of related debt	621,992,896	529,825,848
Restricted for:		
Debt service	11,203,959	10,298,820
Other	23,768	128,583
Unrestricted	202,085,752	268,715,531
Total net assets	835,306,375	808,968,782
Total liabilities and net assets	$ 1,706,109,607	$ 1,679,064,437

Knoxville Utilities Board
Consolidated Statements of Revenues, Expenses and Changes in Net Assets
June 30, 2012 and 2011

	2012	2011
Operating revenues		
Electric	$ 500,812,890	$ 515,421,181
Gas	85,526,548	105,621,034
Water	37,091,445	36,028,958
Wastewater	70,099,897	65,370,778
Total operating revenues	693,530,780	722,441,951
Operating expenses		
Purchased power	405,767,449	419,672,545
Purchased gas	50,270,966	63,580,197
Treatment	12,624,245	12,999,930
Distribution and collection	53,940,051	56,559,153
Customer service	11,099,777	11,755,170
Administrative and general	31,065,524	31,491,994
Provision for depreciation and amortization	47,613,323	45,602,624
Taxes and tax equivalents	24,552,314	23,950,299
Total operating expenses	636,933,649	665,611,912
Operating income	56,597,131	56,830,039
Non-operating revenues (expenses)		
Contributions in aid of construction	5,729,916	4,807,594
Interest and dividend income	1,503,523	1,875,952
Interest expense	(34,077,313)	(32,244,801)
Write-down of plant for costs recovered through contributions	(5,729,916)	(4,807,594)
Other	(767,199)	(910,633)
Total non-operating revenues (expenses)	(33,340,989)	(31,279,482)
Change in net assets before capital contributions	23,256,142	25,550,557
Capital contributions	3,081,451	2,181,080
Change in net assets	26,337,593	27,731,637
Net assets, beginning of year	808,968,782	781,237,145
Net assets, end of year	$ 835,306,375	$ 808,968,782

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

Knoxville Utilities Board
Consolidated Statements of Cash Flows
June 30, 2012 and 2011

	2012	2011
Cash flows from operating activities:		
Cash receipts from customers	$ 695,320,206	$ 724,421,360
Cash receipts from other operations	16,434,833	(3,563,858)
Cash payments to suppliers of goods or services	(539,558,030)	(559,723,038)
Cash payments to employees for services	(48,822,557)	(38,256,333)
Payment in lieu of taxes	(21,252,243)	(20,469,450)
Cash receipts from collections of TVA conservation loan program participants	2,286,470	2,067,095
Cash payments for TVA Conservation loan program	(2,094,050)	(2,206,781)
Net cash provided by operating activities	102,314,629	102,268,995
Cash flows from capital and related financing activities:		
Net proceeds from bond issuance	24,978,728	111,150,965
Principal paid on revenue bonds and notes payable	(19,750,000)	(16,370,000)
Decrease (increase) in unused bond proceeds	34,004,216	(33,563,208)
Interest paid on revenue bonds and notes payable	(35,108,938)	(30,643,085)
Acquisition and construction of plant	(149,920,294)	(110,952,327)
Changes in bond funds, restricted	126,482	(3,757,829)
Customer advances for construction	(168,243)	363,065
Proceeds received on disposal of plant	73,054	48,870
Cash received from developers and individuals for capital purposes	5,729,917	4,807,594
Net cash used in capital and related financing activities	(140,035,078)	(78,915,955)
Cash flows from investing activities:		
Purchase of investment securities	(19,063,289)	(20,230,052)
Maturities of investment securities	840,078	1,173,778
Interest received	1,503,523	1,875,952
Other property and investments	(249,019)	(916,150)
Net cash (used in) investing activities	(16,968,707)	(18,096,472)
Net (decrease) increase in cash and cash equivalents	(54,689,156)	5,256,569
Cash and cash equivalents, beginning of year	124,547,268	119,290,700
Cash and cash equivalents, end of year	$ 69,858,112	$ 124,547,268
Reconciliation of operating income to net cash provided by operating activities		
Operating income	$ 56,597,131	$ 56,830,039
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization expenses	49,492,211	47,638,267
Changes in operating assets and liabilities:		
Accounts receivable	7,833,203	(2,992,818)
Inventories	(2,419,939)	1,035,221
Prepaid expenses	(2,947,910)	554,848
TVA conservation program receivable	(1,003,161)	(1,975,025)
Other assets	846,269	(26,746)
Sales tax collections payable	38,046	38,255
Accounts payable and accrued expenses	(2,773,549)	16,675,384
TVA conservation program payable	1,136,351	1,767,193
Unrecovered purchased power cost	(1,728,336)	(15,926,383)
Underrecovered gas costs	(3,892,237)	(2,450,026)
Customer deposits plus accrued interest	1,066,966	1,095,368
Other liabilities	69,584	5,418
Net cash provided by operating activities	$ 102,314,629	$ 102,268,995
Noncash capital activities:		
Acquisition of plant assets through developer contributions	$ 3,081,451	$ 2,181,080

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

1. Description of Business:

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

2. Significant Accounting Policies:

Basis of Accounting

KUB follows the provisions of Statement No. 34 (Statement 34) of the Governmental Accounting Standards Board *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments.* Statement 34 established standards for external financial reporting for all state and local governmental entities, which includes a statement of net assets; a statement of revenues, expenses and changes in net assets; and a statement of cash flows. It requires the classification of net assets into three components – invested in capital assets, net of related debt; restricted; and unrestricted. These classifications are defined as follows:

- Invested in capital assets, net of related debt – This component of net assets 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. 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 invested in capital assets, net of related debt. Rather, that portion of the debt is included in the same net assets component as the unspent proceeds.

- Restricted – This component of net assets consists of restrictions placed on net asset use through external constraints imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or restrictions imposed by law through constitutional provisions or enabling legislation.

- Unrestricted net assets – This component of net assets consists of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt."

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.

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 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 consolidated statement of net assets. Net assets (i.e., total assets net of total liabilities) are segregated into invested in capital assets, net of related debt; restricted for capital activity and debt service; and unrestricted components.

As allowed by the Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, KUB's policy is to apply only those Financial Accounting Standards Board statements, related interpretations, Accounting Principles Board opinions and accounting research bulletins issued on or prior to November 30, 1989 that do not conflict with Governmental Accounting Standards.

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 assets does not include depreciation for transportation equipment of $1,878,888 in 2012 and $2,035,642 in 2011. Interest costs are expensed as incurred.

Operating Revenue

Operating revenue consists primarily of charges for services provided by the principal operations of KUB. Operating revenue is recorded when the service is rendered, on a cycle basis, and includes an estimate of unbilled revenue. Revenues are reported net of bad debt expense of $1,599,128 in 2012 and $2,958,582 in 2011.

Non-operating Revenue

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

Expense

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

Contributions in Aid of Construction and Capital Contributions

Contributions in aid of construction are cash collections from customers or others for a particular purpose, generally the construction of new facilities to serve new customers in excess of the investment KUB is willing to make for a particular incremental revenue source. KUB reduces the plant account balances to which contributions relate by the actual amount of the contribution and recognizes the contributions as non operating revenue in accordance with FAS 71, *"Accounting for the Effects of Certain Types of Regulation"*.

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 33, *"Accounting and Financial Reporting for Nonexchange Transactions"*, such contributions are recognized as revenues and capital assets upon receipt.

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

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

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

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

Purchased Gas Adjustment
In November 1990, the Division implemented a deferred Purchased Gas (Cost) Adjustment (PGA) mechanism, which allows the Division to flow changes in purchased gas costs through to its customers. These changes in gas costs are reflected as adjustments to the base gas rates established by KUB's Board of Commissioners. The rate-setting authority vested in the KUB Board by the City Charter meets the "self-regulated" provisions of SFAS No. 71, *"Accounting for the Effects of Certain Types of Regulation,"* and KUB meets the remaining criteria of SFAS No. 71. The PGA is intended to assure that KUB recovers the total cost of natural gas purchased, transported and/or reserved for delivery to its sales and transportation customers on an equitable basis. The PGA is also intended to assure that no excess or deficient cost recovery from KUB's customers occurs.

Under the PGA mechanism, the Division tracks the actual over/under recovered amount in the Over/Under recovered Purchased Gas Costs accounts. These accounts are rolled into the PGA rate adjustment on June 30 of each year thereby assuring that any (under)/over recovered amounts are passed on to the Division's customers. The amount of (under)/over recovered cost was ($2,825,163) at June 30, 2012 and $1,067,074 at June 30, 2011.

Purchased Power Adjustment
In October 2002, the Board adopted a Purchased Power Adjustment (PPA) to address changes in wholesale power costs. The PPA was established in response to an amendment to KUB's power supply contract under which, among other things, TVA relinquished its regulatory authority over KUB retail electric rates. The PPA allows KUB to promptly adjust retail electric rates in response to wholesale rate changes or adjustments, thus ensuring that KUB will recover the costs incurred for purchased power. These changes in electric costs are reflected as adjustments to the base electric rates established by KUB's Board of Commissioners. The rate-setting authority vested in the KUB Board by the City Charter meets the "self-regulated" provisions of SFAS No. 71, *"Accounting for the Effects of Certain Types of Regulation,"* and KUB meets the remaining criteria of SFAS No. 71.

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

Estimates

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

Restricted and Designated Assets

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

Cash Equivalents

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

Environmental Cleanup Matters

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

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 18, 2012, the date these financial statements were issued, for items that should potentially be recognized or disclosed.

Reclassifications

Certain reclassifications have been made to the 2011 balances to conform to the 2012 presentation.

3. Deposits and Investments

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

Information related to the carrying value and bank balances of deposits, and the carrying value and fair value of investments, at June 30, 2012 is as follows:

	Carrying Value	Bank Balance
Deposits		
Deposits in financial institutions	$ 69,881,881	$ 93,832,283
Investments		
Certificates of Deposits	92,121,114	92,121,114
State Treasurer's Investment Pool	3,017,701	3,017,701
Agency Bonds	42,683,415	42,683,415
	$ 207,704,111	$ 231,654,513

Classification of deposits and investments:

Depository Account	Bank Balance
Insured	$ 286,903
Collateralized:	
Collateral held by pledging bank's trust department in KUB's name	42,683,415
Collateral held by pledging bank's trust department not in KUB's name*	188,684,195
Total deposits and investments	$ 231,654,513

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

Classification of deposits and investments per statement of net assets:

		2012
Current assets		
Cash and cash equivalents	$	69,858,112
Short-term investments		30,500,000
Short-term contingency fund investments		30,775,170
Other assets		
Long-term contingency fund investments		41,403,246
Restricted assets		
Unused bond proceeds		13,789,178
Bond fund		21,354,636
Other funds		23,769
	$	207,704,111

The above amounts do not include accrued interest of $234,101.

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

	Deposit and Investment Maturities (in Years)		
	Fair Value	Less Than 1	1-5
Supersweep NOW and Other Deposits	$ 93,832,283	$ 93,832,283	$ -
State Treasurer's Investment Pool	3,017,701	3,017,701	-
Agency Bonds	42,683,415	9,100,149	33,583,266
Certificates of Deposits	92,121,114	84,321,115	7,799,999
	$ 231,654,513	$ 190,271,248	$ 41,383,265

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

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

4. Accounts Receivable

Accounts receivable consists of the following:

		2012		2011
Wholesale and retail customers				
Billed services	$	37,731,872	$	43,288,182
Unbilled services		27,180,833		26,058,787
Other		4,533,993		8,102,570
Allowance for uncollectible accounts		(955,065)		(1,106,488)
	$	68,491,633	$	76,343,051

5. Accounts Payable and Accruals

Accounts payable and accruals consist of the following:

		2012		2011
Trade accounts	$	51,127,955	$	51,264,087
Salaries and wages		871,022		614,703
Advances on pole rental		1,119,017		1,047,294
Self-insurance liabilities		1,827,920		2,175,294
Other current liabilities		22,923,245		25,409,302
	$	77,869,159	$	80,510,680

6. Long-Term Obligations

Long-term debt consists of the following:

	Balance June 30, 2011	Additions	Payments	Balance June 30, 2012	Amounts Due Within One Year
Electric					
V-2004 - 2.0 - 4.75%	$ 41,800,000	$ -	$ 40,785,000	$ 1,015,000	$ 1,015,000
W-2005 - 3.0 - 4.5%	38,115,000	-	1,595,000	36,520,000	1,660,000
X-2006 - 4.0 - 5.0%	18,350,000	-	1,500,000	16,850,000	1,550,000
Y-2009 - 2.5 - 5.0%	40,000,000	-	1,300,000	38,700,000	1,350,000
Z-2010 - 1.45 - 6.35%	30,000,000	-	1,030,000	28,970,000	1,245,000
AA-2012 - 3.0 - 5.0%	-	36,815,000	-	36,815,000	100,000
Total debt	$ 168,265,000	$ 36,815,000	$ 46,210,000	$ 158,870,000	$ 6,920,000
Gas					
K-2004 - 2.0 - 4.75%	$ 26,160,000	$ -	$ 26,160,000	$ -	$ -
L-2005 - 3.0 - 4.75%	13,245,000	-	600,000	12,645,000	620,000
M-2006 - 4.0 - 5.0%	19,025,000	-	3,400,000	15,625,000	3,550,000
N-2007 - 4.0 - 5.0%	12,000,000	-	-	12,000,000	-
O-2010 - 2.0 - 3.0%	10,295,000	-	125,000	10,170,000	120,000
P-2010 - 3.3 - 6.2%	12,000,000	-	-	12,000,000	-
Q-2012 - 2.0 - 4.0%	-	24,920,000	-	24,920,000	225,000
Total debt	$ 92,725,000	$ 24,920,000	$ 30,285,000	$ 87,360,000	$ 4,515,000
Water					
Q-2004 - 2.0 - 5.0%	$ 11,990,000	$ -	$ 11,990,000	$ -	$ -
R-2005 - 3.5 - 5.0%	10,000,000	-	-	10,000,000	-
S-2005 - 3.5 - 5.0%	8,345,000	-	380,000	7,965,000	390,000
T-2007 - 4.0 - 5.5%	25,000,000	-	-	25,000,000	-
U-2009 - 3.0 - 4.5%	25,000,000	-	-	25,000,000	-
V-2010 - 2.0 - 2.5%	2,960,000	-	740,000	2,220,000	2,220,000
W-2011 - 2.0 - 4.0%	-	25,000,000	-	25,000,000	550,000
X-2012 - 3.0 - 5.0%	-	10,050,000	-	10,050,000	-
Total debt	$ 83,295,000	$ 35,050,000	$ 13,110,000	$ 105,235,000	$ 3,160,000
Wastewater					
2004 A - 4.0 - 4.75%	$ 18,000,000	$ -	$ 18,000,000	$ -	$ -
2005 A - 4.0 - 5.0%	140,000,000	-	-	140,000,000	-
2005 B - 3.0 - 5.0%	20,170,000	-	730,000	19,440,000	760,000
2007 - 4.0 - 5.0%	75,000,000	-	-	75,000,000	-
2008 - 4.0 - 6.0%	41,800,000	-	3,300,000	38,500,000	3,400,000
2010 - 6.3 - 6.5%	30,000,000	-	-	30,000,000	-
2010B - 2.0 - 3.0%	3,435,000	-	1,700,000	1,735,000	1,735,000
2010C - 1.18 - 6.1%	70,000,000	-	1,000,000	69,000,000	1,075,000
2012A - 2.0 - 4.0%	-	17,070,000	-	17,070,000	70,000
Total debt	$ 398,405,000	$ 17,070,000	$ 24,730,000	$ 390,745,000	$ 7,040,000
Consolidated					
Total Bonds	742,690,000	113,855,000	114,335,000	742,210,000	21,635,000
Total debt	$ 742,690,000	$ 113,855,000	$ 114,335,000	$ 742,210,000	$ 21,635,000

Other liabilities consist of the following:

	Balance June 30, 2011	Increase	Decrease	Balance June 30, 2012	Amounts Due Within One Year
TVA conservation program	$ 8,199,059	$ 3,282,245	$ (2,145,895)	$ 9,335,409	$ 1,500,000
Accrued compensated absences	8,219,683	11,060,994	(11,043,020)	8,237,657	2,600,000
Customer advances for construction	1,451,870	502,381	(670,624)	1,283,627	160,000
Supplemental environmental project	150,000	-	(150,000)	-	-
Other	1,864,017	6,676,954	(2,690,252)	5,850,719	301,000
	$ 19,884,629	$ 21,522,574	$ (16,699,791)	$ 24,707,412	$ 4,561,000

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

Fiscal Year	Principal	Interest	Total
2013	$ 21,635,000	$ 32,998,427	$ 54,633,427
2014	21,840,000	32,882,341	54,722,341
2015	22,675,000	32,094,566	54,769,566
2016	23,635,000	31,196,675	54,831,675
2017	24,110,000	30,259,277	54,369,277
2018-2022	136,665,000	135,095,868	271,760,868
2023-2027	151,850,000	102,986,664	254,836,664
2028-2032	128,425,000	70,287,201	198,712,201
2033-2037	89,450,000	44,351,114	133,801,114
2038-2042	91,925,000	21,902,577	113,827,577
2043-2045	30,000,000	3,800,000	33,800,000
Total	$ 742,210,000	$ 537,854,710	$ 1,280,064,710

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, 2012 these requirements had been satisfied.

During fiscal year 2004, KUB's Electric Division issued Series V 2004 bonds in part to retire certain existing debt and to fund electric system capital improvements. Concurrent with issuance of these bonds, KUB transferred funds to an irrevocable trust to pay a portion of the Series S 1998 revenue bonds as such amounts mature. 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. During fiscal year 2012, KUB's Electric Division issued Series AA 2012 bonds to retire a portion of outstanding Series V 2004 bonds. The outstanding principal balances on defeased bond issues were $106.2 million at June 30, 2012.

During fiscal year 2004, KUB's Gas Division issued Series K 2004 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 H 1998 bonds as such amounts mature. During fiscal year 2006, KUB's Gas Division issued Series L 2005 bonds in part to retire certain existing debt. Concurrent with the issuance of these bonds, KUB transferred funds to an irrevocable trust to pay a portion of the Series J 2001 bonds, as such amounts mature. KUB's Gas Division also issued Series M 2006 bonds in part to retire certain existing debt and to fund gas system capital improvements. Concurrent with the issuance of these bonds, KUB transferred funds to an irrevocable trust to pay the remaining maturities of principal and interest on the Series H 1998 bonds. During fiscal year 2008, KUB's Gas Division issued Series N 2007 to fund gas system capital improvements. During fiscal year 2010, KUB's Gas Division issued Series O 2010 bonds to retire Series I 2001 bonds. During fiscal year 2011, KUB's Gas Division issued Series P 2010 bonds to fund gas system capital improvements. The bonds were issued as federally taxable Build America Bonds with a 35 percent interest payment rebate to be received from the United States Government for each interest payment. During fiscal year 2012, KUB's Gas Division issued Series Q 2012 bonds to retire Series K 2004 bonds. The outstanding principal balances on defeased bond issues were $76.1 million at June 30, 2012.

During fiscal year 2004, KUB's Water Division issued Series Q 2004 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 the remaining maturities of principal and interest on the Series N 1998 bonds, as such amounts mature. During fiscal year 2006, KUB's Water Division issued Series R 2005 bonds for the purpose of funding water system capital improvements. KUB's Water Division also issued Series S 2005 bonds to retire certain existing debt and fund water system capital improvements. Concurrent with the issuance of these bonds, KUB transferred funds to an irrevocable trust to pay a portion of the Series P 2001 bonds, as such amounts mature. During fiscal year 2008, KUB's Water Division issued Series T 2007 bonds to fund water system capital improvements. During fiscal year 2010, KUB's Water Division issued Series U 2009 bonds to fund water system capital improvements. KUB's Water Division also issued Series V 2010 bonds to retire Series O 2001 bonds. During fiscal year 2012, KUB's Water Division issued Series W 2011 bonds to fund water system capital improvements. KUB's Water Division also issued Series X 2012 bonds to retire Series Q 2004 bonds. The outstanding principal balances on defeased bond issues were $23 million at June 30, 2012.

During fiscal year 2004, KUB's Wastewater Division issued Series 2004A bonds to fund wastewater system capital improvements. During fiscal year 2006, KUB's Wastewater Division issued Series 2005A bonds for the purpose of funding wastewater system capital improvements and to pay off a previously issued $30 million revenue anticipation note (line of credit), which was used to fund capital improvements to the wastewater system. KUB's Wastewater Division also issued Series 2005B bonds in part to retire certain existing debt and fund wastewater system capital improvements. Concurrent with the issuance of these bonds, KUB transferred funds to an irrevocable trust to pay a portion of the Series 1998 bonds and Series 2001A bonds, as such amounts mature. During fiscal year 2008, KUB's Wastewater Division issued Series 2007 bonds in part to pay off the outstanding balance on a previously issued revenue anticipation note (line of credit), and to fund wastewater system capital improvements. During fiscal year 2009, KUB's Wastewater Division issued Series 2008 bonds to fund wastewater system capital improvements. During fiscal year 2010, KUB's Wastewater Division issued Series 2010 bonds to fund capital improvements. These bonds were issued as federally taxable Build America Bonds with a 35 percent interest payment rebate to be received from the United States Government for each interest payment. 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. During fiscal year 2012, KUB's Wastewater Division issued Series 2012A bonds to retire Series 2004A bonds. The outstanding principal balances on defeased bond issues were $40.9 million at June 30, 2012.

7. Lease Commitments

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

2013	$	23,524
2014		20,899
2015		26,648
2016		6,917
Total operating minimum lease payments	$	77,988

8. Capital Assets

Capital asset activity for the year ended June 30, 2012, was as follows:

	Beginning 6/30/2011	Increase	Decrease	Ending 6/30/2012
Production Plant (Intakes)	$ 742,503	$ -	$ -	$ 742,503
Pumping and Treatment Plant	209,723,590	17,603,960	(222,765)	227,104,785
Distribution and Collection Plant*				
Mains and metering	684,458,952	25,675,472	(628,660)	709,505,764
Services and meters	136,714,164	3,925,546	(282,679)	140,357,031
Electric station equipment	104,661,003	847,216	(378,197)	105,130,022
Poles, towers and fixtures	103,012,592	7,983,054	(2,859,970)	108,135,676
Overhead conductors	106,129,118	3,066,631	(127,751)	109,067,998
Line transformers	81,312,040	3,291,076	(1,474,718)	83,128,398
Other accounts	223,850,015	29,911,009	(673,134)	253,087,890
Total Distribution & Collection Plant	$ 1,440,137,884	$ 74,700,004	$ (6,425,109)	$ 1,508,412,779
General Plant	122,147,343	12,591,181	(4,061,497)	130,677,027
Total Plant Assets	$ 1,772,751,320	$ 104,895,145	$ (10,709,371)	$ 1,866,937,094
Less Accumulated Depreciation	(610,679,323)	(46,758,259)	9,931,650	(647,505,932)
Net Plant Assets	$ 1,162,071,997	$ 58,136,886	$ (777,721)	$ 1,219,431,162
Work In Progress	107,852,362	141,164,809	(100,969,355)	148,047,816
Total Net Plant	$ 1,269,924,359	$ 199,301,695	$ (101,747,076)	$ 1,367,478,978

*Beginning balances of distribution and collection plant have been re-categorized in order to be consistent with the fiscal year 2012 presentation.

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 Assets. The liability is KUB's best estimate based on available information. At June 30, 2012, the amount of these liabilities was $1,827,919 resulting from the following changes:

	2012	2011
Balance, beginning of year	$ 2,175,294	$ 2,185,831
Current year claims and changes in estimates	14,130,565	22,721,716
Claims payments	(14,477,939)	(22,732,253)
Balance, end of year	$ 1,827,920	$ 2,175,294

10. Pension Plan

Description of Plan

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

At December 31, 2011, the Plan had approximately 652 retirees and beneficiaries currently receiving benefits and 56 terminated employees entitled to benefits but not yet receiving them. Of the approximately 873 current employees in the Plan, 730 were fully vested at December 31, 2011. 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 has frozen the Plan such that persons employed or re-employed by KUB on or after January 1, 2011, shall not be eligible to participate, but that eligible employees hired prior to January 1, 2011, who have not separated from service, shall continue as Participants and accrue benefits under the Plan.

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

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

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

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

All employees participating in the City System Plan A as of June 30, 1999 were eligible to participate in KUB's Plan A or the CEP program. Participants of Plan A are covered by Social Security. Plan A is a closed plan and is not available to KUB employees hired after July 1, 1999. Participation in Plan A requires employee contributions of 3 percent of the first $4,800 of annual earnings and 5 percent of annual earnings in excess of $4,800. Plan A provides for early retirement benefits with 25 years of service and normal retirement benefits at age 62 or older.

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

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

Funding Policy

For the Plan year ended December 31, 2011, a contribution of $3,593,282 is required to be made in the Plan sponsor's fiscal year ending June 30, 2013. The annual required contribution was determined as part of the January 1, 2011 valuation using the Individual Entry Age Normal funding method. The objective under this method is to fund each participant's benefits under the Plan as payments which are level as a percentage of salary, starting on the original participation date (employment date) and continuing until the assumed retirement, termination, disability or death. For the Plan year ended December 31, 2011, the Plan's actuarial funded ratio was 104.5 percent.

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

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

As of the actuarial report for the Plan year ended December 31, 2011, contributions of $3,593,282 and $3,244,057 for 2011 and 2010, respectively, are required to be made during the Plan sponsor's fiscal years ending June 30, 2013 and 2012, respectively.

Subsequent to June 30, 2012, the actuarial report for the Plan year ending December 31, 2012 was completed.

For the Plan year ending December 31, 2012, a contribution of $5,502,677 is required to be made in the Plan sponsor's fiscal year ending June 30, 2014. For the Plan year ending December 31, 2012, the Plan's actuarial funded ratio was 94.1 percent.

11. Defined Contribution Plan

KUB has a defined contribution 401(k) employee retirement savings plan covering eligible KUB employees. Employees hired prior to January 1, 2011 may participate and receive a matching contribution of 50 percent of their own contribution up to a maximum match of 3 percent. Employees hired on or after January 1, 2011 have an enhanced 401(k) Plan due to the closure of the Defined Benefit Pension Plan. They may participate and receive a matching contribution of 50 percent of their own contribution up to a maximum match of 3 percent. They also receive a nonelective KUB contribution of from 3 percent to 6 percent, depending on years of service, whether they contribute or not.

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

12. Other Post-Employment Benefits (OPEB)

The Governmental Accounting Standards Board (GASB) established new standards for the measurement, recognition, and reporting of other post-employment benefits (OPEB). OPEB includes post-employment benefits other than pension, which, for KUB, is presently limited to post-employment health care. GASB 45 requires the recognition of the accrued OPEB liability for the respective year, plus the disclosure of the total unfunded liability. GASB 45 was effective for KUB for the fiscal year beginning July 1, 2007.

KUB currently provides post-employment health care benefits to 633 former employees and 647 covered dependents. The cost of coverage is shared with retirees and beneficiaries. KUB recognizes its share of the cost of post-employment health care benefits as an expense as claims are paid.

In anticipation of GASB 45, KUB amended its Group Health Plan in 1999, eliminating post-employment health care benefits for all employees hired on or after July 1, 1999. As of June 30, 2012, 450 active employees were eligible for individual and dependent coverage at separation if the employee meets the Rule of 80 (age plus years of service) with a minimum of 20 years of service.

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 GASB 45 does not require pre-funding of the liability, KUB has determined that it is in the long-term economic interest of KUB and its ratepayers to establish a Trust to pre-fund KUB's OPEB liability.

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

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

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

Total contributions to the OPEB Trust for the fiscal year ended June 30, 2012 were $8.1 million. The contribution to the Trust exceeded the annual required contribution (ARC), as determined by the Postretirement Benefit Plan's actuarial valuation for the year ended December 31, 2010, which was $4.6 million. As of June 30, 2012, the employer's net OPEB obligation was $1.7 million.

The ARC for the fiscal year ending June 30, 2013, as determined by the Plan's actuarial valuation for the year ended December 31, 2011 is $3.3 million.

The actuarial valuation for the Plan for the year ending December 31, 2012 has been completed. The valuation determined that the Plan's actuarial accrued liability was $61.6 million. The actuarial value of the Plan's assets was $37.9 million. As a result, the Plan's unfunded actuarial accrued liability was $23.7 million. The Plan's actuarial funded ratio was 62 percent. The valuation also determined that the employer's ARC is $3.3 million for the fiscal year ending June 30, 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, 2012 and 2011 are summarized as follows:

		2012		2011
City of Knoxville				
Amounts billed by KUB for utilities and related services	$	11,457,145	$	11,678,173
Payments by KUB in lieu of property tax		13,453,228		12,899,181
Payments by KUB for services provided		1,118,297		1,217,819

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

		2012		2011
Accounts receivable	$	726,455	$	831,191

14. Natural Gas Supply Contract Commitments

For fiscal year 2012 the Gas Division hedged 67 percent of its total gas purchases via gas supply contracts. As of June 30, 2012, the Gas Division had hedged the price on approximately 10 percent of its anticipated gas purchases for fiscal year 2013.

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

		2013		2014		2015		2016		2017
Transportation										
Tennessee Gas Pipeline	$	7,325,892	$	9,211,524	$	9,211,524	$	3,070,508	$	-
East Tennessee Natural Gas		10,066,388		10,066,388		10,066,388		3,355,463		-
Storage										
Tennessee Gas Pipeline		2,076,288		2,076,288		2,076,288		692,096		-
East Tennessee Natural Gas		757,460		757,460		757,460		252,487		-
Saltville Natural Gas		1,545,960		981,900		981,900		981,900		981,900
Demand Total	$	21,771,988	$	23,093,560	$	23,093,560	$	8,352,454	$	981,900

Firm obligations related to purchased gas – commodity

	2013	2014	2015	2016	2017
Baseload					
Conoco	$ 1,251,400	$ -	$ -	$ -	$ -
Equitable	-	-	-	-	-
Shell Energy	2,423,970				
CNX	2,286,518	2,286,518	-	-	-
Commodity Total	$ 5,961,888	$ 2,286,518	$ -	$ -	$ -

The total commodity values presented here are based upon firm supply obligations with each individual natural gas supplier. The firm obligations value for Conoco, and Shell Energy are based upon firm supply obligations at locked prices with those suppliers. The firm obligations value for the CNX contract is based upon firm supply obligations and the applicable four month NYMEX strip prices on July 31, 2012.

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 December 31, 2016. KUB anticipates the Division will spend approximately $530 million in capital investments in order to comply with the terms of the Consent Decree related to the collection system. The Consent Decree also required KUB to perform an evaluation of the wet-weather performance and capacity of its wastewater treatment plants.

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

KUB anticipates it will invest a total of $650 million in capital improvements to meet the requirements of the Consent Decree.

During fiscal year 2006, KUB launched the Private Lateral Program (PLP), as required by the Consent Decree, under which KUB tests private collection system laterals on its wastewater system over a ten-year period. Defective laterals and improper connections can introduce rainwater overloading the wastewater system and add pollution to area waterways. If a private lateral fails the respective inspection test, then the customer is required to have the lateral repaired/replaced within a specified time period. The $2 million SEP provides funding for lateral repairs/replacements for eligible low-income customers. A $1.7 million liability was accrued in May 2006 for the SEP. During the current and previous fiscal years, KUB funded $1.5 million, thereby reducing the liability to $0.2 million. In fiscal year 2012, KUB completed funding of the SEP.

KUB's funding plan for the Consent Decree through 2016 includes approximately $680 million in bond issues through 2021 plus a series of rate increases phased in over the term of the order. As of June 30, 2012, the Wastewater Division had issued $360 million in bonds to fund system capital improvements since the inception of the Consent Decree. The KUB Board of Commissioners approved two 50 percent rate increases, which went into effect in April 2005 and January 2007, respectively. The Board also approved an 8 percent rate increase, which was effective in September 2008, and a 12 percent rate increase, which was effective in April 2011. The Board also adopted a 12 percent rate increase to be effective October 2012. KUB anticipates additional bond issues and rate increases over the next decade to help fund wastewater capital projects.

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 Assets

	2012			
	Electric	**Gas**	**Water**	**Wastewater**
Assets				
Current assets	$ 114,299,185	$ 37,206,451	$ 28,096,958	$ 45,109,244
Restricted assets	9,888,399	2,553,160	16,255,225	6,485,347
Net capital assets	376,337,837	208,788,070	207,968,631	574,384,440
Other assets	43,254,862	11,017,247	7,764,451	16,700,100
Total assets	$ 543,780,283	$ 259,564,928	$ 260,085,265	$ 642,679,131
Liabilities				
Current liabilities	$ 84,587,322	$ 15,096,022	$ 8,282,748	$ 17,554,728
Other liabilities	17,452,655	3,303,068	2,087,115	1,864,574
Long-term debt	151,950,000	82,845,000	102,075,000	383,705,000
Total liabilities	$ 253,989,977	$ 101,244,090	$ 112,444,863	$ 403,124,302
Net assets				
Invested in capital assets, net of related debt	$ 214,980,691	$ 120,403,561	$ 102,644,856	$ 183,963,788
Restricted	6,924,697	1,476,723	1,070,263	1,756,045
Unrestricted	67,884,918	36,440,554	43,925,283	53,834,996
Total net assets	$ 289,790,306	$ 158,320,838	$ 147,640,402	$ 239,554,829

Condensed Statement of Revenues, Expenses and Changes in Net Assets

	2012			
	Electric	Gas	Water	Wastewater
Operating revenues	$ 506,053,787	$ 86,760,687	$ 37,475,750	$ 70,502,494
Operating expenses	469,828,063	74,137,204	24,072,128	28,544,871
Provision for depreciation & amortization	20,655,981	8,277,943	5,768,349	12,911,050
Total operating expenses	490,484,044	82,415,147	29,840,477	41,455,921
Operating income	15,569,743	4,345,540	7,635,273	29,046,573
Non-operating expense	(6,738,141)	(3,794,060)	(3,854,058)	(18,954,728)
Change in net assets before capital contributions	8,831,602	551,480	3,781,215	10,091,845
Capital contributions	301,720	-	913,066	1,866,665
Change in net assets	9,133,322	551,480	4,694,281	11,958,510
Net assets				
Beginning of year	280,656,984	157,769,358	142,946,121	227,596,319
End of year	$ 289,790,306	$ 158,320,838	$ 147,640,402	$ 239,554,829

Condensed Statement of Cash Flows

	2012			
	Electric	Gas	Water	Wastewater
Net cash provided by operating activities	$ 38,986,071	$ 5,863,748	$ 13,911,736	$ 43,553,074
Net cash used in capital and related financing activities	(52,878,291)	(25,621,229)	(10,520,596)	(51,014,963)
Net cash provided by investing activities	(9,496,358)	(765,475)	(1,310,486)	(5,396,388)
Net increase (decrease) in cash and cash equivalents	(23,388,578)	(20,522,956)	2,080,654	(12,858,277)
Cash and cash equivalents, beginning of year	50,644,214	30,244,231	15,803,356	27,855,468
Cash and cash equivalents, end of year	$ 27,255,636	$ 9,721,275	$ 17,884,010	$ 14,997,191

Knoxville Utilities Board
Required Supplementary Information - Schedule of Funding Progress
June 30, 2012
(Unaudited)

Pension Plan

Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (b)	Unfunded Actuarial Accrued Liability (UAAL) (b-a)	Funded Ratio (a)/(b)	Annual Covered Payroll (c)	UAAL as a Percentage of Covered Payroll [(b)-(a)]/(c)
January 1, 2009	$ 183,447,296	$ 194,366,597	$ 10,919,301	94.4%	$ 49,602,223	22.01%
January 1, 2010	203,704,898	190,679,453	(13,025,445)	106.8%	48,228,428	(27.01%)
January 1, 2011	195,692,781	187,257,434	(8,435,347)	104.5%	47,405,874	(17.79%)
January 1, 2012	183,980,665	195,536,152	11,555,487	94.1%	48,836,721	23.66%

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%

Knoxville Utilities Board
Supplemental Information –
Schedule of Expenditures of Federal Awards by Grant
June 30, 2012 Schedule 1

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

Program Name	Federal/State Agency	CFDA Number	Contract Number	Beginning Deferred	Cash Receipts	Expenditures	Adjustments	Ending Deferred
ARRA-Electricity Delivery and Energy Reliability, Research, Development and Analysis	Department of Energy	81.122	DE-OE0000405	$ -	$ 2,111,261	$ 2,111,261	$ -	$ -
		Total Program 81.122		$ -	$ 2,111,261	$ 2,111,261	$ -	$ -
U.S. Department of Homeland Security	Tennessee Emergency Management	97.036	34101-0000009205	$ 1,561,320	$ 1,233,221	$ 345,861	$ 132,811	$ 806,771
U.S. Department of Homeland Security	Tennessee Emergency Management	97.036	34101-0000009832	$ 1,267,500	$ 2,950,392	$ 2,666,357	$ -	$ 983,465
		Total Program 97.036		$ 2,828,820	$ 4,183,613	$ 3,012,218	$ 132,811	$ 1,790,236
		Total Federal Awards		$ 2,828,820	$ 6,294,874	$ 5,123,479	$ 132,811	$ 1,790,236

NOTE 1 - BASIS OF PRESENTATION

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

Summary of Audit Results

Financial Statements

Type of auditors report issued:	Unqualified	
Internal control over financial reporting:		
Material weakness(es) identified?	___Yes	✓___ No
Significant deficiencies identified that are not considered to be material weakness(es)?	___Yes	✓___ None reported
Noncompliance material to financial statements noted?	___Yes	✓___ No

Federal Awards

Internal control over major programs:		
Material weakness(es) identified?	___Yes	✓___ No
Significant deficiencies identified that are not considered to be material weakness(es)?	___Yes	✓___ None reported
Type of auditor's report issued on compliance for major programs:	Unqualified	
Any audit findings disclosed that are required to be reported in Accordance with Section 510(a) of Circular A-133?	___Yes	✓___ None reported

Major programs:

CFDA Number	Name of Federal Program
81.122	ARRA-Electricity Delivery and Energy Reliability, Research, Development and Analysis
97.036	U.S. Department of Homeland Security

Dollar threshold used to distinguish between type A And type B programs	$300,000	
Auditee qualified as low-risk auditee?	___Yes	✓___ No

Findings – Financial Statements Audit

None

Findings and Questioned Costs – Major Federal Award Programs Audit

None

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); $5,000,000 deductible per occurrence.

Travel Accident
Covers losses related to employees' business travel. Limits of coverage - $1,375,000 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.

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Report on Internal Control Over Financial Reporting and On Compliance And Other Matters Based On An Audit Of Financial Statements Performed In Accordance With *Government Auditing Standards*

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

We have audited the consolidated financial statements of the Knoxville Utilities Board, (an independent agency and reported as a component unit for financial purposes only by the City of Knoxville), as of and for the year ended June 30, 2012, which collectively comprise the Knoxville Utilities Board's basic financial statements and have issued our report thereon dated October 18, 2012. 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.

In accordance with *Government Auditing Standards*, the report dated October 18, 2012, has been reissued due to the omission of two federal program contracts on the schedule of expenditures of federal, state and other awards. Since program CFDA 97.036 was considered major, additional audit procedures were performed. The changes to the previously issued report dated October 18, 2012 encompasses the addition of program CFDA 97.036 contract number 34101-0000009205 and contract number 34101-0000009832 to the schedule of expenditures of federal, state and other awards and to the schedule of findings and questioned costs.

Internal Control Over Financial Reporting

Management of the Knoxville Utilities Board is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered Knoxville Utilities Board's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Knoxville Utilities Board's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Knoxville Utilities Board's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Knoxville Utilities Board's financial statements are free of 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*.

This report is intended solely for the information and use of the Knoxville Utilities Board's audit committee, board of commissioners, and others within the entity, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Rodefer Moss & Co, PLLC

Knoxville, Tennessee
October 18, 2012
(Except as noted in paragraph 2 above,
as to which the date is October 22, 2013)

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Independent Auditors' Report On Compliance With Requirements That Could Have A Direct And Material Effect On Each Major Program And On Internal Control Over Compliance In Accordance With OMB CIRCULAR A-133

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

Compliance

We have audited the Knoxville Utilities Board's, (an independent agency and reported as a component unit for financial purposes only by the City of Knoxville) compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the Knoxville Utilities Board's major federal programs for the year ended June 30, 2012. Knoxville Utilities Board's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the Knoxville Utilities Board's management. Our responsibility is to express an opinion on the Knoxville Utilities Board's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Knoxville Utilities Board's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Knoxville Utilities Board's compliance with those requirements.

In our opinion, the Knoxville Utilities Board, complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2012.

In accordance with *Government Auditing Standards*, the report dated October 18, 2012, has been reissued due to the omission of two federal program contracts on the schedule of expenditures of federal, state and other awards. Since program CFDA 97.036 was considered major, additional audit procedures were performed. The changes to the previously issued report dated October 18, 2012 encompasses the addition of program CFDA 97.036 contract number 34101-0000009205 and contract number 34101-0000009832 to the schedule of expenditures of federal, state and other awards and to the schedule of findings and questioned costs.

Internal Control over Compliance

Management of the Knoxville Utilities Board is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Knoxville Utilities Board's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Knoxville Utilities Board's internal control over compliance.

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

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

This report is intended solely for the information and use of the Knoxville Utilities Board's audit committee, board of commissioners, others within the entity, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Rodefer Moss & Co, PLLC

Knoxville, Tennessee
October 18, 2012
(Except as noted in paragraph 4 above,
as to which the date is October 22, 2013)

Knoxville Utilities Board
Electric Division

Financial Statements and Supplemental Information
June 30, 2012 and 2011

Knoxville Utilities Board Electric Division
Index
June 30, 2012 and 2011

Page(s)

Independent Auditors' Report 1-2

Management's Discussion and Analysis 3-19

Basic Financial Statements

Statements of Net Assets 20-21

Statements of Revenues, Expenses and Changes in Net Assets 22

Statements of Cash Flows 23

Notes to Financial Statements 24-37

Required Supplementary Information – Schedule of Funding Progress 38

Supplemental Information

Schedule 1 – Schedule of Expenditures of Federal Awards 39

Schedule 2 – Schedule of Findings and Questioned Costs 40

Schedule 3 – Schedule of Insurance in Force 41

Schedule 4 – Schedule of Debt Maturities by Fiscal Year 42

Schedule 5 – Schedule of Current Rates in Force 43-67

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* 68-69

Report of Independent Auditors Report on Compliance with Requirements that could have a Direct Material Effect on each Major Program and on Internal Control over Compliance in Accordance with *OMB Circular A-133* 70-71

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Independent Auditors' Report

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

We have audited the accompanying consolidated financial statements of the Knoxville Utilities Board, Electric Division, an independent agency and reported as a component unit for financial reporting purposes only by the City of Knoxville, Tennessee, as of and for the years ended June 30, 2012 and 2011. These financial statements are the responsibility of Knoxville Utilities Board's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Knoxville Utilities Board, Electric Division, as of June 30, 2012 and 2011, and the respective changes in financial position, and cash flows, for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 18, 2012, on our consideration of the Knoxville Utilities Board'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* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 19 and Schedule of Funding Progress on page 38 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Knoxville Utilities Board's financial statements as a whole. The supplemental schedules on pages 41 through 67 are presented for the purpose of additional analysis and are not a required part of the financial statements. The accompanying schedule of expenditures of federal awards on page 39 is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local*

Governments, and Non-Profit Organizations, and is also not a required part of the financial statements. The schedule of expenditures of federal awards is the responsibility of management and was derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole. The supplemental schedules have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on them.

In accordance with *Government Auditing Standards*, the report on our consideration of the Board's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters dated October 18, 2012, has been reissued due to the omission of two federal program contracts on the schedule of expenditures of federal, state and other awards. Since program CFDA 97.036 was considered major, additional audit procedures were performed. The changes to the previously issued report dated October 18, 2012 encompasses the addition of program CFDA 97.036 contract number 34101-0000009205 and contract number 34101-0000009832 to the schedule of expenditures of federal, state and other awards and to the schedule of findings and questioned costs.

Rodefer Moss & Co, PLLC

Knoxville, Tennessee
October 18, 2012
(Except as noted in the last paragraph above,
as to which the date is October 22, 2013)

Knoxville Utilities Board (KUB), comprised of the Electric Division, Water Division, Gas Division, and Wastewater Division (Divisions), is reported as a component unit enterprise fund in the financial statements of the City of Knoxville. KUB's responsibility is to oversee the purchase, production, distribution, and processing of electricity, water, natural gas, and wastewater services. A seven-member Board of Commissioners governs KUB. The Board has all powers to construct, acquire, expand, or operate the Divisions. It has full control and complete jurisdiction over the management and operation of the Divisions. The Electric Division (Division) provides services to certain customers in Knox County and in seven surrounding counties in East Tennessee. The Division's accounts are maintained in conformity with the Uniform System of Accounts of the Federal Energy Regulatory Commission and the Governmental Accounting Standards Board, as applicable. The financial statements present only the Electric Division and do not purport to, and do not, present fairly the consolidated financial position of Knoxville Utilities Board at June 30, 2012 and 2011, 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, 2012 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 197,700 customers over a 688 square mile service area. KUB maintains 5,280 miles of service lines and 64 electric substations to provide 5.6 million mega watt-hours to its customers annually. Electric distribution system capacity is 2.6 million kVA. KUB met its peak single day capacity of 1,246,398 kW in January 2009.

Financial Highlights

The Division's net assets increased $9.1 million or 3.25 percent, compared to a $12.2 million increase last fiscal year.

Operating revenue decreased $15.5 million or 3 percent as purchased power expense declined $14.6 million compared with the prior year. The drop in operating revenue was primarily due to lower sales volumes, the result of the mildest winter in KUB's service territory in the last 25 years. The impact of lower sales was partially offset by additional revenue from a one percent KUB rate increase and the flow through of TVA rate adjustments. KUB flows changes to wholesale power rates directly through to its retail electric rates via its Purchased Power Adjustment. Margin on electric sales (operating revenue less purchased power expense) decreased $0.9 million or 1 percent, the combined result of a 4.6 percent decline in billed sales and a one percent rate increase effective October 2011.

Operating expenses (excluding purchased power expense) increased $1.6 million or 2 percent. Operating and maintenance ("O&M") expenditures increased $1.3 million or 2.7 percent. Depreciation expense decreased $0.1 million or 0.4 percent. Taxes and tax equivalents were $0.4 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 $0.2 million or 3.1 percent, reflecting a full year of interest expense on revenue bonds sold in December 2010. Those items contributed to a net decrease in other income of $0.3 million compared to the prior year.

Capital contributions fell $0.3 million, the result of street lighting assets provided to KUB in the prior fiscal year.

Total plant assets (net) increased $27.1 million or 7.7 percent over the end of the last fiscal year due to the net addition of $26.2 million for distribution system improvements and the installation of electric system facilities to provide for new electric services.

Long-term debt represented 35.4 percent of the Division's capital structure as of June 30, 2012, compared to 37.5 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 assets.

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 3.43. Maximum debt service coverage was 3.49.

Division Highlights

KUB added 1,200 customers to its electric system in fiscal year 2012. Last fiscal year KUB experienced a net reduction of 800 electric system customers.

The Board of Commissioners adopted a one percent rate increase, effective on October 2011 customer bills, to help fund the Century II electric program. The Division generated $4.8 million of additional margin during the fiscal year as a result of the rate increase.

The Division refunded $39.8 million in outstanding electric system revenue bonds at lower interest rates in April 2012. This refunding will provide debt service savings of $6.8 million over the life of the bonds.

In October 2011, TVA increased wholesale base power rates by 3 percent. KUB passed this rate increase along to its electric customers through the Purchased Power Adjustment.

The typical residential customer's monthly electric bill was $97.04 of June 30, 2012, representing a increase of $0.67 or 0.7 percent compared to June 30, 2011. The increase in the monthly bill was the combined result of KUB's 1 percent rate increase and the flow-through of TVA wholesale rate adjustments.

81 percent of electric system sales revenue was paid to TVA for wholesale power purchases for the fiscal year ended June 30, 2012.

Two historic storm events, with a combined cost of $8.4 million, impacted the electric system during fiscal year 2011. KUB received $4.2 million in reimbursements from the Federal Emergency Management Agency (FEMA) during fiscal year 2012. KUB anticipates an additional $2.1 million in reimbursements from FEMA in fiscal year 2013.

KUB was awarded a grant from the Department of Energy in October 2009 under DOE's Smart Grid Investment Grant Program. The grant, which totals $3.58 million, will be used to help fund a smart grid pilot project in the University of Tennessee and surrounding areas. The pilot project includes the installation of over 6,000 digital electronic smart meters and an advanced metering infrastructure (AMI) communications backbone, which will provide coverage for KUB's entire service territory. The communications infrastructure will enable KUB to remotely read the meters, and also provide remote service connection/disconnection capabilities. The term of the pilot is approximately three years. During fiscal year 2012, KUB installed the advanced metering infrastructure (AMI) communications backbone. The grant funded $2.1 million of the communications infrastructure installed this fiscal year.

Century II Infrastructure Program

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

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

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

In September 2011, the KUB Board adopted a resolution, which endorsed the Century II electric program and the associated ten-year funding plan. The resolution also adopted the initial three electric rate increases, the first of which was effective October 1, 2011. The remaining two will be effective October 1, 2012 and October 1, 2013, respectively. Each of the rate increases will generate an additional $5 million in annual electric sales revenue. For residential electric customers this will result in an increase of $1 in their monthly electric bill for each of the rate increases.

With Board approval, KUB immediately began implementing the accelerated pace of infrastructure replacement for the electric system. For the fiscal year ending June 30, 2012, KUB exceeded its target replacement goals for its key electric system assets, while staying within its total capital budget. 2,800 poles were replaced, exceeding the target level of 2,300, and 17.5 miles of underground electric cable were replaced, exceeding the target level of 12.5 miles.

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Division Cash Budget Appropriations

KUB's Board of Commissioners adopted an Electric Division budget of $579.2 million for fiscal year 2012, which included additional funding of $7.2 million for Century II capital projects. At year end, actual cash expenditures were $42.6 million or 7.4 percent below budget. Purchased power expense was $44.1 million below budget, reflecting lower than planned energy purchases as a result of warmer winter weather and lower than expected wholesale power rates. Capital expenditures were $1.2 million higher than expected, as KUB exceeded its planned replacement levels for its key electric asset programs. Operating receipts were $37.3 million less than expected, due to lower than expected customer demand and the flow-through of lower than expected wholesale power rates. Bond proceeds of $9.9 million were transferred to the Division's general fund to pay for capital during fiscal year 2012. The amount transferred was $4.2 million more than expected due to the timing of capital projects in fiscal year 2011. The Electric Division general fund year-end balance was $9.2 million higher than budgeted. The numbers below are presented on a cash basis.

Electric Division Cash Report
As of June 30, 2012

(in thousands of dollars)	FY 2012 Budget	FY 2012 Actual FYTD	Dollar Variance*	Percent Variance
Beginning Balance General Fund	$ 58,644	$ 58,644		
Operating Receipts	551,784	511,452	(40,332)	-7.3%
Disbursements				
Purchased Energy Expense	450,454	406,376	44,078	-9.8%
Operation & Maintenance Expense	48,299	48,047	252	-0.5%
Capital Expenditures	54,744	55,915	(1,171)	2.1%
Debt Service & Taxes	25,688	26,214	(526)	2.0%
Total Disbursements	579,185	536,552	42,633	-7.4%
Bond Proceeds	5,657	9,879	4,222	74.6%
Net Flow-throughs and Transfers	148	(167)	(315)	-
Ending General Fund Balance	$ 37,048	$ 43,256	$ 6,208	16.8%

**(-) indicates a decrease to cash*

KUB, Electric Division, Financial Statements

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

Statement of Net Assets

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

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

Invested in capital assets, net of related debt, 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 assets 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 assets are a residual classification; the amount remaining after reporting net assets as either invested in capital or restricted is reported there.

Statement of Revenues, Expenses and Changes in Net Assets

The Division reports its revenues and expenses (both operating and non-operating) on the Statement of Revenues, Expenses and Changes in Net Assets. 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 assets for the reporting period. Net assets at the beginning of the period are increased or decreased, as applicable, by the change in net assets for the reporting period.

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

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 Assets.

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Condensed Financial Statements

Statement of Net Assets

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

Statements of Net Assets
As of June 30

(in thousands of dollars)	2012	2011
Current and other assets	$ 167,442	$ 191,051
Capital assets, net	376,338	349,285
Total assets	543,780	540,336
Current and other liabilities	102,040	97,829
Long-term debt outstanding	151,950	161,850
Total liabilities	253,990	259,679
Net assets		
Invested in capital assets, net of related debt	214,981	181,333
Restricted	6,924	6,471
Unrestricted	67,885	92,853
Total net assets	$ 289,790	$ 280,657

Normal Impacts on Statement of Net Assets

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

- Change in net assets (from Statement of Revenues, Expenses and Changes in Net Assets): impacts (increase/decrease) current and other assets and/or capital assets and unrestricted net assets.
- Issuing debt for capital: increases current and other assets 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 assets and increases invested in capital assets, net of related debt.
- Principal payment on debt: (a) reduces current and other assets and reduces long-term debt and (b) reduces unrestricted net assets and increases invested in capital assets, net of related debt.
- Reduction of capital assets through depreciation: reduces capital assets and invested in capital assets, net of related debt.

Current Year Impacts and Analysis

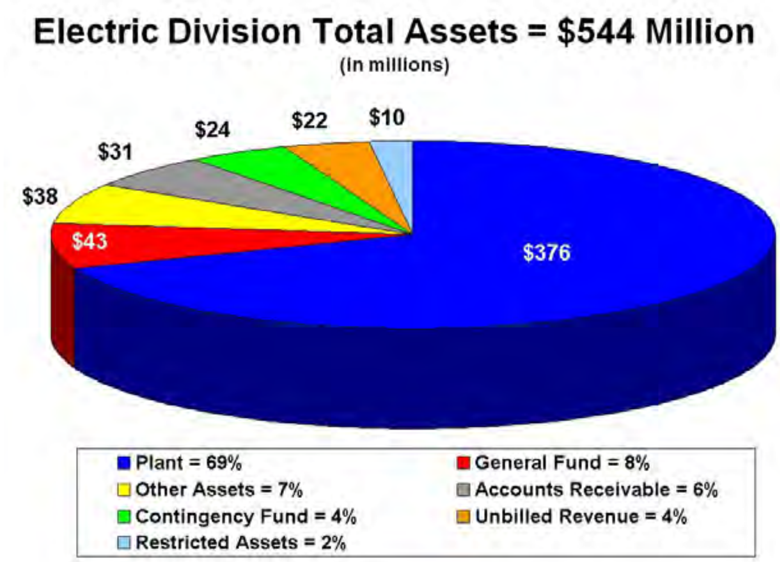
Current and Other Assets

Current and other assets decreased $23.6 million or 12.4 percent. A $15.4 million reduction in general fund cash due to the expending of cash for capital projects and a $5.9 million decrease in accounts receivable were primarily responsible for the overall decrease in assets. In the previous fiscal year, KUB incorporated a deferred accounting component to its Purchased Power Adjustment to ensure appropriate cost recovery over the long-term. As of June 30, 2012, KUB had under recovered $17.7 million in wholesale power costs, which represented a $1.7 million increase in net assets compared to the prior year. The $17.7 million will be recovered from KUB's electric customers through future adjustments to electric rates via the Purchased Power Adjustment.

The Division contributed $2 million to operating contingency reserves in order to maintain the required balance in the fund, which is 45 days of operating expenses.

Capital Assets

Capital assets, net of depreciation, increased $27.1 million or 7.7 percent. Major net plant additions included $22.7 million for distribution system improvements, $6.8 million for pole replacements, $3.5 million for system growth-related expenditures, and $2.8 million for smart grid infrastructure.

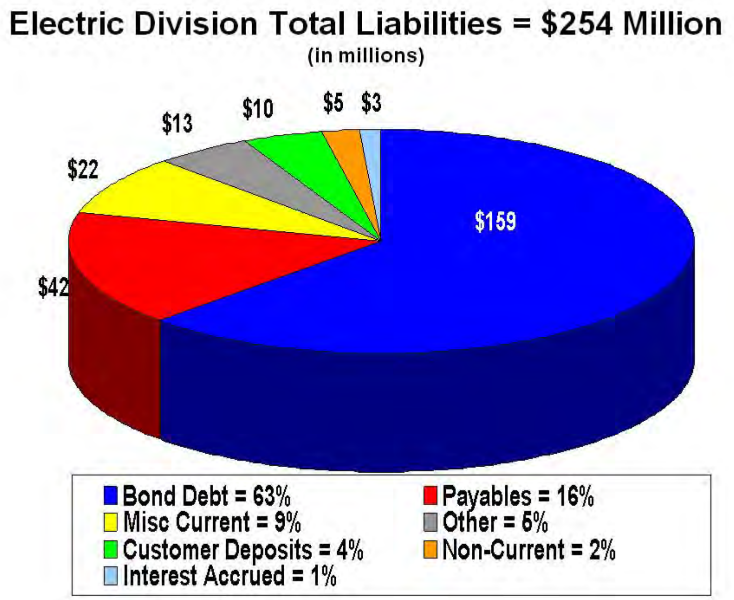


Current and Other Liabilities

Current and other liabilities increased $4.2 million or 4.3 percent, partially due to a $1.1 million rise in accounts payable. Wholesale energy costs for June 2012 were higher than the same month last year. The net unamortized cost of debt increased $2.6 million reflecting premiums received in the refunding of $39.8 million of long term debt in April 2012. The expense for electric power used but not billed to KUB customers as of June 30, 2012 was $16.9 million, which reflected an increase of $1 million compared to the prior year. This increase in liabilities was offset by the $1.7 million increase in the accrued asset for under recovered wholesale power costs. In addition, the Division's share of liability for post-employment medical benefits was $1.7 million lower than the prior year.

Long-Term Debt

Long-term debt decreased $9.9 million or 6.1 percent, the combined result of scheduled repayment of debt and a $3 million reduction in principal as a result of the April 2012 debt refunding.



Net Assets

Invested in capital assets, net of debt increased $33.6 million or 18.6 percent, primarily due to a $9.9 million decrease in long term debt, the expending of $9.9 million in remaining bond proceeds from a prior year debt issue, and a $9.1 million increase in net assets (as reported on the Statement of Revenue, Expenses and Changes in Net Assets). Unrestricted net assets decreased $25 million due to the $15.6 million decrease in current assets. Restricted net assets increased $0.5 million due to an increase in deposits for the repayment of debt.

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Statement of Revenues, Expenses and Changes in Net Assets

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

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

(in thousands of dollars)	2012	2011
Operating revenues	$ 506,054	$ 521,582
Less: Purchased power expense	409,443	424,041
Margin from sales	96,611	97,541
Operating expenses		
Distribution	29,123	27,129
Customer service	5,305	5,601
Administrative and general	13,954	14,386
Depreciation and amortization	20,656	20,732
Taxes and tax equivalents	12,003	11,631
Total operating expenses	81,041	79,479
Operating income	15,570	18,062
Interest income	502	623
Interest expense	(6,990)	(6,783)
Other income/(expense)	(251)	(307)
Change in net assets before capital contributions	8,831	11,595
Capital contributions	302	594
Change in net assets	$ 9,133	$ 12,189

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

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

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

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

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

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

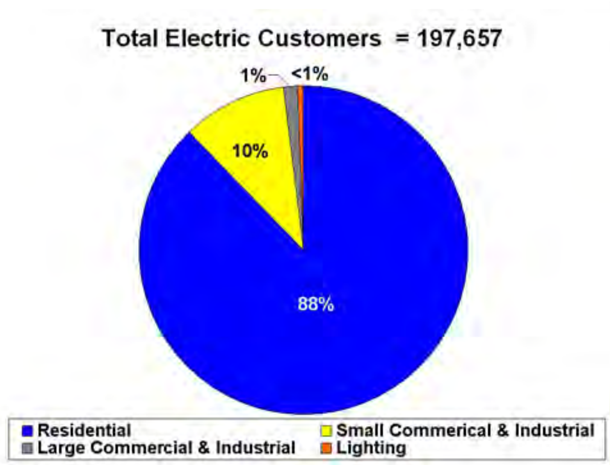
- Capital contributions are impacted by a donation of facilities/infrastructure to KUB by developers and governmental agencies. The contributions are recognized as revenue and recorded as plant in service based on the fair market value of the asset(s).

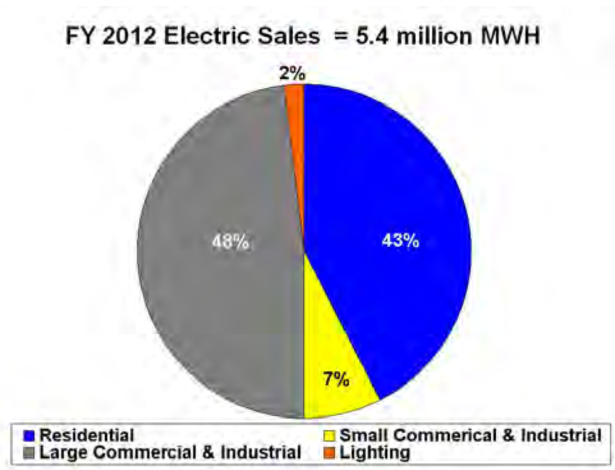
Current Year Impacts and Analysis

The Division's net assets increased $9.1 million, which was $3.1 million less than last year's $12.2 million increase. The lower earnings were due to the combined effect of a $0.9 million decrease in margin on sales, a $1.6 million rise in operating expenses, a $0.2 million increase in interest expense, and a $0.3 million decline in capital contributions.

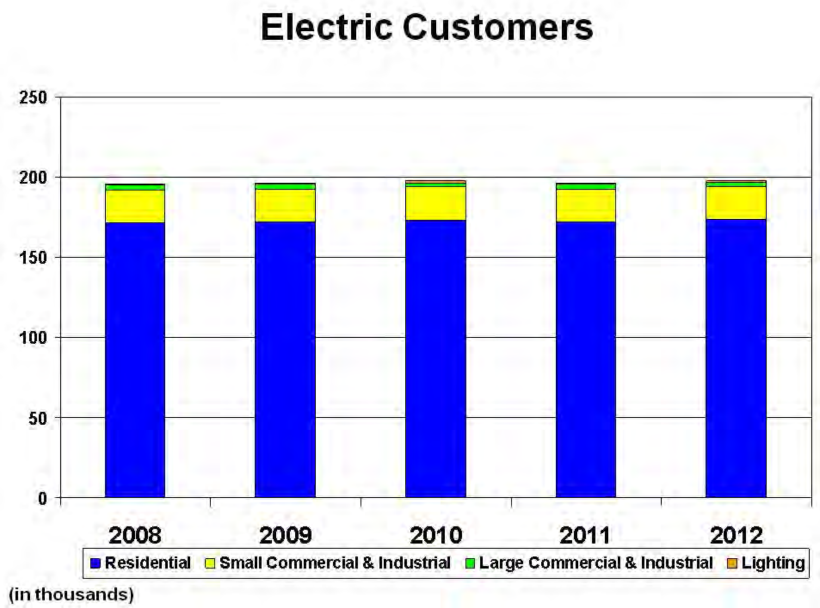
Margin on electric sales fell $0.9 million, which was the net result of a 4.6 percent decrease in sales volumes and additional revenue from the one percent October 2011 rate increase.

Operating revenue decreased $15.5 million or 3 percent. The 4.6 percent decrease in sales volumes was partially offset from the one percent electric rate increase and the flow through of a 3 percent wholesale TVA base rate increase. Purchased power expense decreased $14.6 million over last year, the net result of lower purchases and higher TVA wholesale power rates. Power sales of 5.4 million MWh were 4.6 percent lower than the prior year.

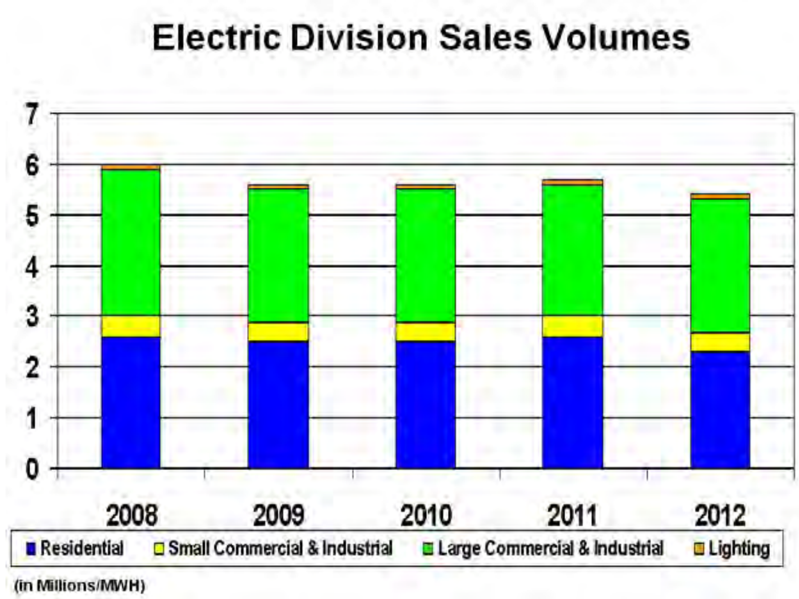




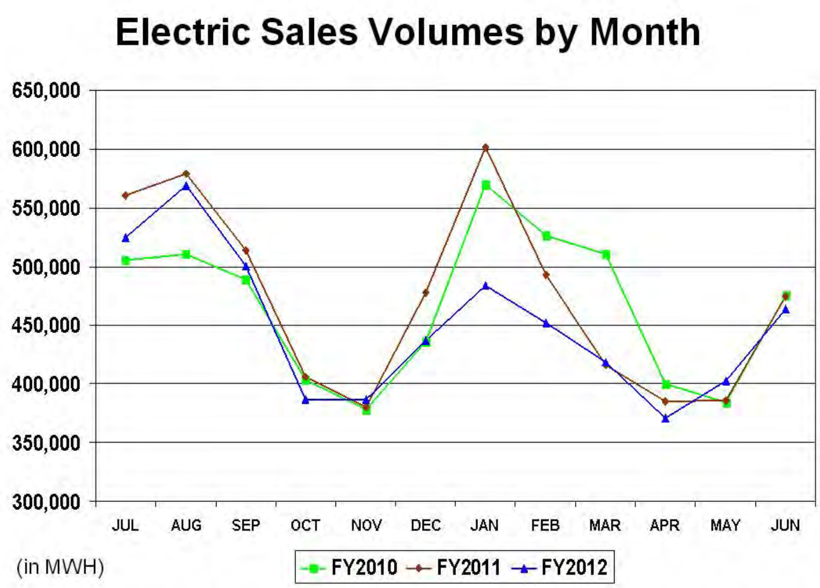
Residential customers represented 88 percent of total electric system customers and accounted for 43 percent of electric sales volumes for the year. Large commercial and industrial customers accounted for the largest portion of total sales volumes for the year. Sales to Gerdau Ameristeel, KUB's largest industrial customer, increased 34.8 MWH or 13.1 percent compared to the prior year.



KUB has added 1,900 electric system customers over the past five years, representing annual growth of 0.2 percent.



Electric sales volumes have declined 2.4 percent since fiscal year 2008 due to the effects of the economic recession. Large commercial and industrial sales have decreased 2.9 percent over the past five years.



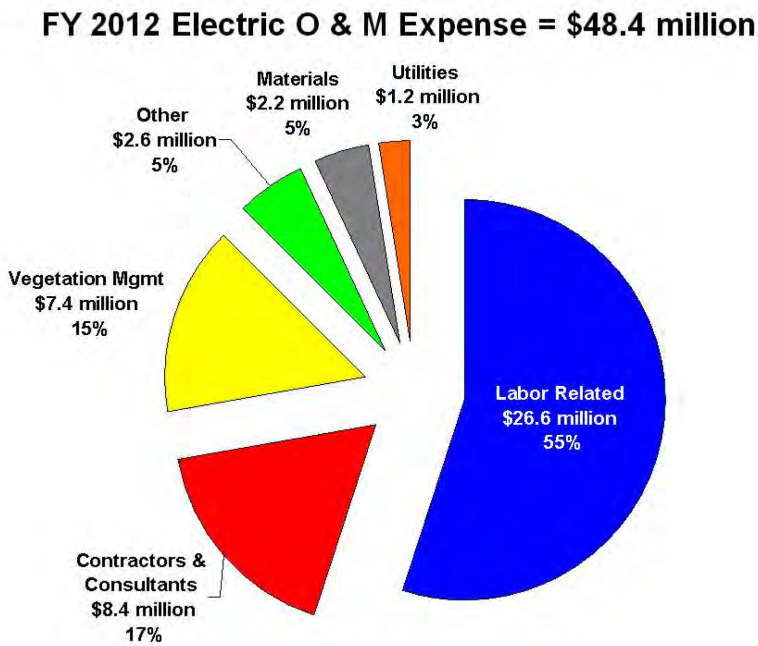
Electric sales were slightly lower during the first five months of fiscal year 2012 compared to the previous fiscal year. However, sales over the course of the winter heating season were significantly lower than the prior year, reflecting the extremely mild winter. Sales in the last quarter of the fiscal year were consistent with the previous year.

Sales for commercial and industrial customers were consistent with the prior year due to a steady customer base.

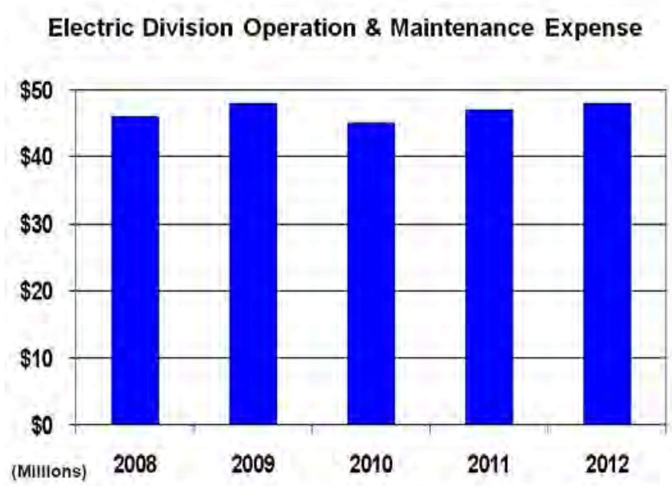
Operating Expenses

Operating expenses (excluding purchased power expense) increased $1.6 million or 2 percent compared to last fiscal year.

- Distribution expenses increased $2 million or 7.4 percent, due in part to an increase in vegetation management expenses.
- Customer service expenses were down $0.3 million compared with the prior year, primarily due to the Division's share of lower labor-related expenses.
- Administrative and general expenses decreased $0.4 million or 3 percent, due to a $0.7 million decrease in labor-related expenses, which includes the Division's share of an overall reduction in medical claims expenses.



Operation and Maintenance (O&M) expense has increased at a rate of 1.3 percent annually over the past five years. During this period, KUB management worked to identify cost saving measures and implemented staffing reductions through attrition in an effort to keep O&M expense relatively stable.



- Depreciation expense for fiscal year 2012 decreased $0.1 million or 0.4 percent, partially due to short-lived Supervisory Control And Data Acquisition (SCADA) assets that became fully depreciated during the year. Electric plant in service increased $36 million during the prior fiscal year. The Division recorded a full year of depreciation expense on these capital investments during fiscal year 2012. The Division also retired $7.1 million in assets over the course of the fiscal year.

- Taxes and tax equivalents were $0.4 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 as a result of capital asset and margin growth.

Other Income and Expense

Interest income decreased $0.1 million or 19.4 percent. This decrease was primarily due to lower long-term interest rates on operating contingency fund investments.

Interest expense increased $0.2 million or 3.1 percent, the net result of interest cost on $30 million of bonds issued during the prior fiscal year and savings on the refunding of $39.8 million of outstanding debt in April 2012.

Other income (net) increased $0.1 million.

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

Capital Assets and Debt Administration

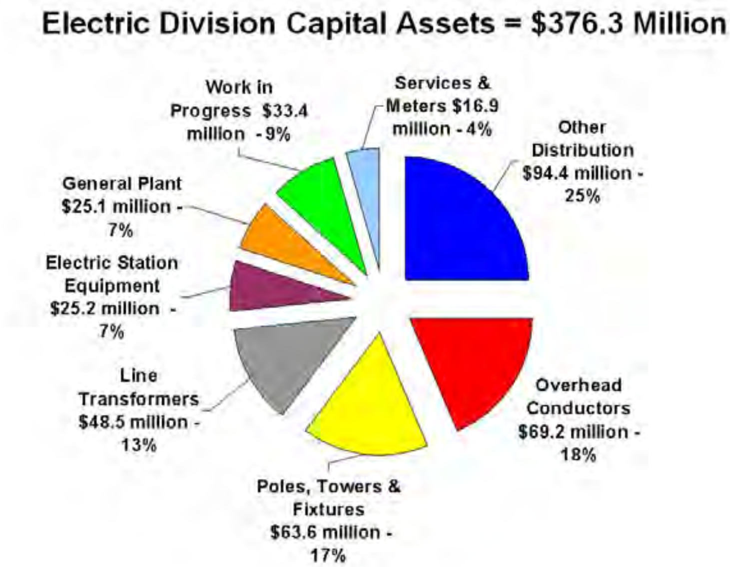
Capital Assets

As of June 30, 2012, the Division had $376.3 million invested in a variety of capital assets, as reflected in the schedule below, which represents a net increase (including additions, retirements, and depreciation) of $27.1 million or 7.7 percent over the end of the last fiscal year.

Capital Assets
As of June 30
(Net of Depreciation)

(in thousands of dollars)	**2012**	**2011**
Distribution plant:		
Services and meters	$ 16,949	$ 17,000
Electric station equipment	25,181	28,492
Poles, towers and fixtures	63,621	58,819
Overhead conductors	69,161	66,520
Line transformers	48,486	48,245
Others	94,414	94,440
Total distribution plant	317,812	313,516
General plant	25,131	22,156
Total plant	342,943	335,672
Work in progress	33,395	13,613
Total net plant	$ 376,338	$ 349,285

(Graph on following page)



Major capital asset additions during the year were as follows:

- $22.7 million for various electric distribution system improvements.
- $6.8 million for pole replacements.
- $3.5 million for installation of new electric services and the upgrade or replacement of existing services.
- $2.8 million for smart grid infrastructure.

Debt Outstanding

As of June 30, 2012, the Division had $158.9 million in debt outstanding (including the current portion of revenue bonds), compared to $168.3 million last year, a decrease of $9.4 million or 5.6 percent. The Division's weighted average cost of debt at June 30, 2012 was 4.16 percent (the effective weighted average cost of debt is 3.86 percent, which reflects the Build America Bond rebate for a portion of the outstanding debt).

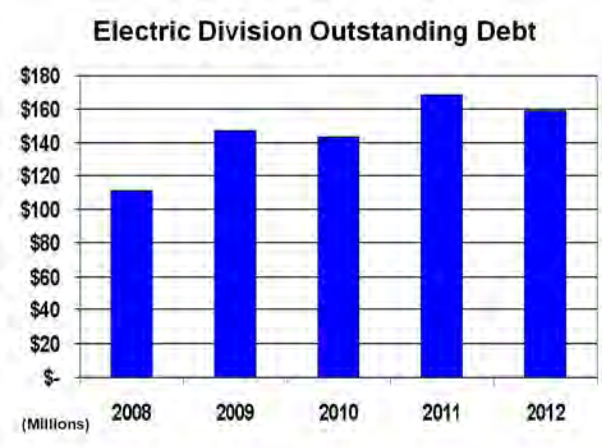
In April 2012, KUB sold $36.8 million in revenue refunding bonds for the purpose of refunding electric bonds issued in 2004 at lower interest rates. The $36.8 million in bond proceeds, which combined with a $3.8 million premium paid by the underwriter and a $0.5 million contribution by KUB, refunded $39.8 million in outstanding bonds, and paid the underwriter's discount, issuance cost, and any accrued interest on the refunded bonds. The Division will realize a total debt service savings of $6.8 million ($5.4 million on a net present value basis).

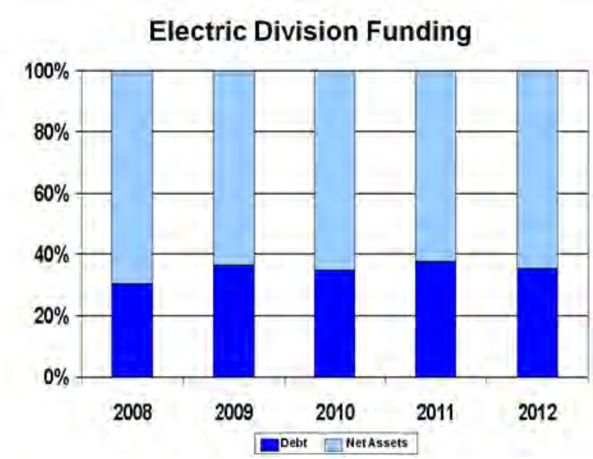
The Division's outstanding debt is rated by Standard & Poor's and Moody's Investors Service. As of June 30, 2012, the Division's revenue bonds were rated AA+ by Standard & Poor's and Aa2 by Moody's Investors Service.

The schedule of the Division's outstanding debt as of June 30, 2012 is reflected at the top of the following page.

Outstanding Debt
As of June 30

(in thousands of dollars)	**2012**	**2011**
Revenue bonds	$ 158,870	$ 168,265
Total outstanding debt	$ 158,870	$ 168,265





The Division's outstanding debt has increased over the past five years to its current level of $158.9 million. During that same time period, debt as a percentage of total capitalization has grown from 30.3 percent to 35.4 percent.

Impacts on Future Financial Position

KUB does not anticipate any net increase in electric system customers in fiscal year 2013.

In fiscal year 2013, KUB will enter into the third year of a three-year smart grid pilot project funded under the Department of Energy Smart Grid Investment Grant Program. Looking forward to the final year of the project in fiscal year 2013, KUB will deploy conservation voltage reduction on select circuits in and around the core project area. The core project area spans the University of Tennessee and Fort Sanders area. Also, KUB will deploy smart metering technology on its largest commercial and industrial customers.

A previously adopted one percent rate increase will be effective October 1, 2012.

The Division anticipates the issuance of up to $45 million in electric system revenue bonds in fiscal year 2013, for the purpose of funding electric system capital investment.

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 2013.

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, 2012 and 2011. 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 Assets
June 30, 2012 and 2011

	2012	2011
Assets		
Current assets:		
Cash and cash equivalents	$ 27,255,636	$ 50,644,214
Short-term investments	16,000,000	8,000,000
Short-term contingency fund investments	11,583,104	9,447,279
Other current assets	123,399	123,328
Accrued interest receivable	63,882	37,164
Accounts receivable, less allowance of uncollectible accounts of $706,300 in 2012 and $823,398 in 2011	52,375,520	57,146,794
Inventories	6,282,591	3,652,205
Prepaid expenses	615,053	601,860
Total current assets	114,299,185	129,652,844
Restricted assets:		
Electric bond fund	9,883,801	10,193,192
Other funds	4,598	55,971
Unused bond proceeds	-	9,874,717
Total restricted assets	9,888,399	20,123,880
Electric plant in service	672,256,230	652,403,498
Less accumulated depreciation	(329,313,025)	(316,731,807)
	342,943,205	335,671,691
Retirement in progress	575,826	232,750
Construction in progress	32,818,806	13,380,150
Net plant in service	376,337,837	349,284,591
Other assets:		
Long-term contingency fund investments	12,644,008	12,861,135
TVA conservation program receivable	9,552,209	8,549,048
Unrecovered purchased power cost	17,654,719	15,926,383
Deferred loss on refunding bonds	1,851,645	2,377,213
Other	1,552,281	1,560,638
Total other assets	43,254,862	41,274,417
Total assets	$ 543,780,283	$ 540,335,732

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

Knoxville Utilities Board Electric Division
Statements of Net Assets
June 30, 2012 and 2011

	2012	2011
Capitalization and Liabilities		
Current liabilities:		
Current portion of revenue bonds and revenue notes	$ 6,920,000	$ 6,415,000
Sales tax collections payable	849,237	820,110
Accounts payable	41,783,516	40,690,565
Accrued expenses	22,028,051	22,869,868
Customer deposits plus accrued interest	10,042,817	9,262,193
Accrued interest on revenue bonds	2,963,701	3,778,067
Total current liabilities	84,587,322	83,835,803
Other liabilities:		
TVA conservation program	9,335,409	8,199,059
Accrued compensated absences	3,766,444	3,708,615
Customer advances for construction	572,870	871,583
Other	3,777,932	1,213,688
Total other liabilities	17,452,655	13,992,945
Long-term debt:		
Electric revenue bonds	151,950,000	161,850,000
Total long-term debt	151,950,000	161,850,000
Total liabilities	253,989,977	259,678,748
Net assets		
Invested in capital assets, net of related debt	214,980,691	181,333,200
Restricted for:		
Debt service	6,920,100	6,415,125
Other	4,597	55,971
Unrestricted	67,884,918	92,852,688
Total net assets	289,790,306	280,656,984
Total liabilities and net assets	$ 543,780,283	$ 540,335,732

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

Knoxville Utilities Board Electric Division
Statements of Revenues, Expenses and Changes in Net Assets
Years Ended June 30, 2012 and 2011

	2012	2011
Operating revenues	$ 506,053,787	$ 521,581,959
Operating expenses		
Purchased power	409,442,667	424,040,924
Distribution	29,123,344	27,128,609
Customer service	5,305,047	5,600,961
Administrative and general	13,954,120	14,385,903
Provision for depreciation and amortization	20,655,981	20,731,788
Taxes and tax equivalents	12,002,885	11,631,272
Total operating expenses	490,484,044	503,519,457
Operating income	15,569,743	18,062,502
Non-operating revenues (expenses)		
Contributions in aid of construction	4,121,515	2,755,218
Interest and dividend income	501,903	622,710
Interest expense	(6,990,310)	(6,783,042)
Write-down of plant for costs recovered through contributions	(4,121,515)	(2,755,218)
Other	(249,734)	(306,642)
Total non-operating revenues (expenses)	(6,738,141)	(6,466,974)
Change in net assets before capital contributions	8,831,602	11,595,528
Capital contributions	301,720	593,769
Change in net assets	9,133,322	12,189,297
Net assets, beginning of year	280,656,984	268,467,687
Net assets, end of year	$ 289,790,306	$ 280,656,984

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

Knoxville Utilities Board Electric Division
Statements of Cash Flows
June 30, 2012 and 2011

	2012	2011
Cash flows from operating activities:		
Cash receipts from customers	$ 500,580,961	$ 517,353,292
Cash receipts from (payments to) other operations	11,622,384	(5,705,693)
Cash payments to suppliers of goods or services	(441,113,876)	(451,930,224)
Cash payments to employees for services	(21,788,995)	(7,483,861)
Payment in lieu of taxes	(10,506,823)	(10,122,071)
Cash receipts from collections of TVA conservation loan program participants	2,286,470	2,067,095
Cash payments for TVA conservation loan program	(2,094,050)	(2,206,781)
Net cash provided by operating activities	38,986,071	41,971,757
Cash flows from capital and related financing activities:		
Net proceeds from bond issuance	-	29,783,080
Principal paid on revenue bonds and notes payable	(6,415,000)	(4,355,000)
Decrease (increase) in unused bond proceeds	9,872,075	(9,872,075)
Interest paid on revenue bonds and notes payable	(7,804,677)	(6,103,263)
Acquisition and construction of electric plant	(52,689,771)	(35,506,066)
Changes in electric bond fund, restricted	309,391	(2,739,804)
Customer advances for construction	(298,713)	176,400
Proceeds received on disposal of plant	26,889	48,870
Cash received from developers and individuals for capital purposes	4,121,515	2,755,218
Net cash used in capital and related financing activities	(52,878,291)	(25,812,640)
Cash flows from investing activities:		
Changes in deposit and investment accounts:		
Purchase of investment securities	(10,152,809)	(5,628,606)
Maturities of investment securities	234,112	380,880
Interest received	501,903	622,710
Other property and investments	(79,564)	(357,605)
Net cash used in investing activities	(9,496,358)	(4,982,621)
Net (increase) decrease in cash and cash equivalents	(23,388,578)	11,176,496
Cash and cash equivalents, beginning of year	50,644,214	39,467,718
Cash and cash equivalents, end of year	27,255,636	$ 50,644,214
Reconciliation of operating income to net cash provided by operating activities		
Operating income	$ 15,569,743	$ 18,062,502
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization expenses	21,741,781	21,944,090
Changes in operating assets and liabilities:		
Accounts receivable	4,754,583	(3,491,660)
Inventories	(2,630,387)	995,649
Prepaid expenses	(13,193)	(51,617)
TVA conservation program receivable	(1,003,161)	(1,975,025)
Other assets	49,633	1,096,272
Sales tax collections payable	29,127	35,238
Accounts payable and accrued expenses	308,963	18,573,632
Unrecovered purchased power cost	(1,728,336)	(15,926,383)
TVA conservation program payable	1,136,351	1,767,193
Customer deposits plus accrued interest	780,624	920,199
Other liabilities	(9,657)	21,667
Net cash provided by operating activities	$ 38,986,071	$ 41,971,757
Noncash capital activities:		
Acquisition of plant assets through developer contributions	$ 301,720	$ 593,769

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

1. Description of Business

Knoxville Utilities Board (KUB), comprised of the Electric Division, Water Division, Gas Division, and Wastewater Division (Divisions), is reported as a component unit enterprise fund in the financial statements of the City of Knoxville. KUB's responsibility is to oversee the purchase, production, distribution, and processing of electricity, water, gas, and wastewater services. A seven-member Board of Commissioners governs KUB. The Board has all powers to construct, acquire, expand, or operate the Divisions. It has full control and complete jurisdiction over the management and operation of the Divisions. The Electric Division (Division) provides services to certain customers in Knox County and in seven surrounding counties in East Tennessee. The Division's accounts are maintained in conformity with the Uniform System of Accounts of the Federal Energy Regulatory Commission (FERC) and the Governmental Accounting Standards Board (GASB), as applicable. The financial statements present only the Electric Division and do not purport to, and do not, present fairly the consolidated financial position of Knoxville Utilities Board at June 30, 2012 and 2011, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

2. Summary of Significant Accounting Policies

Basis of Accounting

KUB follows the provisions of Statement No. 34 (Statement 34) of the Governmental Accounting Standards Board *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*. Statement 34 established standards for external financial reporting for all state and local governmental entities, which includes a statement of net assets; a statement of revenues, expenses and changes in net assets; and a statement of cash flows. It requires the classification of net assets into three components – invested in capital assets, net of related debt; restricted; and unrestricted. These classifications are defined as follows:

- Invested in capital assets, net of related debt – This component of net assets 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. If there are significant unspent related debt proceeds at year end, the portion of the debt attributable to the unspent proceeds is not included in the calculation of invested in capital assets, net of related debt. Rather, that portion of the debt is included in the same net assets component as the unspent proceeds.

- Restricted – This component of net assets consists of restrictions placed on net asset use through external constraints imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or restrictions imposed by law through constitutional provisions or enabling legislation.

- Unrestricted net assets – This component of net assets consist of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt."

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 assets. Net assets (i.e., total assets net of total liabilities) are segregated into invested in capital assets, net of related debt; restricted for capital activity and debt service; and unrestricted components.

As allowed by the Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, KUB's policy is to apply only those Financial Accounting Standards Board statements, related interpretations, Accounting Principles Board opinions and accounting research bulletins issued on or prior to November 30, 1989 that do not conflict with Governmental Accounting Standards.

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 assets does not include depreciation for transportation equipment of $1,085,800 in 2012 and $1,212,302 in 2011. Interest costs are expensed as incurred.

Operating Revenue

Operating revenue consists primarily of charges for services provided by the principal operations of the KUB Electric Division. Operating revenue is recorded when the service is rendered, on a cycle basis, and includes an estimate of unbilled revenue. Revenues are reported net of bad debt expense of $1,274,458 in 2012 and $2,365,451 in 2011.

Non-operating Revenue

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

Expense

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

Contributions in Aid of Construction and Capital Contributions

Contributions in aid of construction are cash collections from customers or others for a particular purpose, generally the construction of new facilities to serve new customers in excess of the investment KUB is willing to make for a particular incremental revenue source. KUB reduces the plant account balances to which contributions relate by the actual amount of the contribution and recognizes the contributions as non operating revenue in accordance with FAS 71, *"Accounting for the Effects of Certain Types of Regulation"*.

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 33, *"Accounting and Financial Reporting for Nonexchange Transactions"*, such contributions are recognized as revenues and capital assets upon receipt.

Inventories

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

Pension Plan

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

Investments

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

Self-Insurance

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

Estimates

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

Restricted and Designated Assets

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

Cash Equivalents

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

Environmental Cleanup Matters

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

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 18, 2012, the date these financial statements were issued, for items that should potentially be recognized or disclosed.

Reclassifications

Certain reclassifications have been made to the 2011 balances to conform to the 2012 presentation.

Purchased Power Adjustment

In October 2002, the Board adopted a Purchased Power Adjustment (PPA) to address changes in wholesale power costs. The PPA was established in response to an amendment to KUB's power supply contract under which, among other things, TVA relinquished its regulatory authority over KUB retail electric rates. The PPA allows KUB to promptly adjust retail electric rates in response to wholesale rate changes or adjustments, thus ensuring that KUB will recover the costs incurred for purchased power. These changes in electric costs are reflected as adjustments to the base electric rates established by KUB's Board of Commissioners. The rate-setting authority vested in the KUB Board by the City Charter meets the "self-regulated" provisions of SFAS No. 71, *"Accounting for the Effects of Certain Types of Regulation,"* and KUB meets the remaining criteria of SFAS No. 71.

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 & 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.

3. Deposits and Investments

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

Information related to the carrying value and bank balances of deposits, and the carrying value and fair value of investments, at June 30, 2012 is as follows:

	Carrying Value	Bank Balance
Deposits		
Deposits in financial institutions	$ 27,260,234	$ 36,612,653
Investments		
Certificates of deposits	36,592,794	36,592,794
State Treasurer's Investment Pool	-	-
Agency Bonds	13,445,530	13,445,530
	$ 77,298,558	$ 86,650,977

Classification of deposits and investments:

Depository Account	**Bank Balance**
Insured	$ 140,582
Collateralized:	
Collateral held by pledging bank's trust department in KUB's name	13,445,530
Collateral held by pledging bank's trust department not in KUB's name*	73,064,865
Total deposits and investments	$ 86,650,977

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

Classification of deposits and investment of net assets:

		2012
Current assets		
Cash and cash equivalents	$	27,255,636
Short-term investments		16,000,000
Short-term contingency fund investments		11,583,104
Other assets		
Long-term contingency fund investments		12,571,419
Restricted assets		
Electric bond fund		9,883,801
Other funds		4,598
	$	77,298,558

The above amounts do not include accrued interest of $72,589.

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

	Deposit and Investment Maturities (in Years)					
		Fair Value		Less Than 1		1-5
Supersweep NOW and Other Deposits	$	36,612,653	$	36,612,653	$	-
State Treasurer's Investment Pool		-		-		-
Agency Bonds		13,445,530		3,527,200		9,918,330
Certificates of deposits		36,592,794		33,939,705		2,653,089
	$	86,650,977	$	74,079,558	$	12,571,419

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

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

4. Accounts Receivable

Accounts receivable consists of the following:

	2012	2011
Wholesale and retail customers		
Billed services	$ 28,946,942	$ 31,333,723
Unbilled services	21,563,662	20,376,429
Other	2,571,216	6,260,040
Allowance for uncollectible accounts	(706,300)	(823,398)
	$ 52,375,520	$ 57,146,794

5. Accounts Payable and Accruals

Accounts payable and accruals were composed of the following:

	2012	2011
Trade accounts	$ 41,783,516	$ 40,690,565
Salaries and wages	458,932	368,512
Advances on pole rental	1,119,017	1,047,294
Self-insurance liabilities	880,493	1,065,904
Other current liabilities	19,569,609	20,388,158
	$ 63,811,567	$ 63,560,433

6. Long-Term Obligations

Long-term debt consists of the following:

	Balance June 30, 2011	Additions	Payments	Balance June 30, 2012	Amounts Due Within One Year
V-2004 - 2.0 - 4.75%	$ 41,800,000	$ -	$ 40,785,000	$ 1,015,000	$ 1,015,000
W-2005 - 3.0 - 4.5%	38,115,000	-	1,595,000	36,520,000	1,660,000
X-2006 - 4.0 - 5.0%	18,350,000	-	1,500,000	16,850,000	1,550,000
Y-2009 - 2.5 - 5.0%	40,000,000	-	1,300,000	38,700,000	1,350,000
Z-2010 - 1.45 - 6.35%	30,000,000	-	1,030,000	28,970,000	1,245,000
AA-2012 - 3.0 - 5.0%	-	36,815,000	-	36,815,000	100,000
Total debt	$ 168,265,000	$ 36,815,000	$ 46,210,000	$ 158,870,000	$ 6,920,000

Other liabilities consist of the following:

	Balance June 30, 2011	Increase	Decrease	Balance June 30, 2012	Amounts Due Within One Year
TVA conservation program	$ 8,199,059	$ 3,282,245	$ (2,145,895)	$ 9,335,409	$ 1,500,000
Accrued compensated absences	3,708,615	6,394,582	$ (6,336,753)	3,766,444	1,000,000
Customer advances for construction	871,583	271,292	(570,005)	572,870	100,000
Other	1,213,688	3,744,458	(1,180,214)	3,777,932	150,000
	$ 13,992,945	$ 13,692,577	$ (10,232,867)	$ 17,452,655	$ 2,750,000

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

Fiscal Year	Total Principal	Interest	Grand Total
2013	**$** 6,920,000	**$** 6,267,487	**$** 13,187,487
2014	6,995,000	6,481,935	13,476,935
2015	7,260,000	6,214,412	13,474,412
2016	7,570,000	5,921,818	13,491,818
2017	7,910,000	5,613,144	13,523,144
2018-2022	44,960,000	22,578,442	67,538,442
2023-2027	49,990,000	11,809,859	61,799,859
2028-2032	27,265,000	2,330,939	29,595,939
Total	$ 158,870,000	$ 67,218,036	$ 226,088,036

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, 2012, these requirements had been satisfied.

During fiscal year 2004, KUB's Electric Division issued Series V 2004 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 S 1998 bonds, as such amounts mature. During fiscal year 2012, Series V 2004 was defeased with the issuance of Series AA 2012.

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.

During fiscal year 2012, KUB's Electric Division issued Series AA 2012 bonds to retire a portion of outstanding Series V 2004 bonds.

The outstanding principal balances on defeased bond issues were $106.2 million at June 30, 2012.

7. Lease Commitments

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

2013	$	11,056
2014		9,822
2015		12,525
2016		3,251
Total operating minimum lease payments	$	36,654

8. Capital Assets

Capital asset activity for the year ended June 30, 2012 was as follows:

		Beginning 6/30/2011		Increase		Decrease		Ending 6/30/2012
Distribution Plant								
Services and Meters	$	38,644,866	$	954,358	$	(66,492)	$	39,532,732
Electric Station Equipment		104,661,003		847,216		(378,197)		105,130,022
Poles, Towers and Fixtures		103,012,592		7,983,054		(2,859,970)		108,135,676
Overhead Conductors		106,129,118		3,066,631		(127,751)		109,067,998
Line Transformers		81,312,040		3,291,076		(1,474,718)		83,128,398
Other Accounts		155,546,599		4,517,376		(660,791)		159,403,184
Total Distribution Plant	$	589,306,218	$	20,659,711	$	(5,567,919)	$	604,398,010
General Plant		63,097,281		6,350,581		(1,589,642)		67,858,220
Total Plant Assets	$	652,403,499	$	27,010,292	$	(7,157,561)	$	672,256,230
Less Accumulated Depreciation		(316,731,807)		(19,302,210)		6,720,992		(329,313,025)
Net Plant Assets	$	335,671,692	$	7,708,082	$	(436,569)	$	342,943,205
Work In Progress		13,612,900		45,726,624		(25,944,892)		33,394,632
Total Net Plant	$	349,284,592	$	53,434,706	$	(26,381,461)	$	376,337,837

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 Assets. The liability is KUB's best estimate based on available information. At June 30, 2012, the amount of these liabilities was $880,493 resulting from the following changes:

	2012	2011
Balance, beginning of year	$ 1,065,904	$ 1,057,202
Current year claims and changes in estimates	6,248,439	7,060,793
Claims payments	(6,433,850)	(7,052,091)
Balance, end of year	$ 880,493	$ 1,065,904

10. Pension Plan

Description of Plan

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

At December 31, 2011, the Plan had approximately 652 retirees and beneficiaries currently receiving benefits and 56 terminated employees entitled to benefits but not yet receiving them. Of the approximately 873 current employees in the Plan, 730 were fully vested at December 31, 2011. 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 has frozen the Plan such that persons employed or re-employed by KUB on or after January 1, 2011, shall not be eligible to participate, but that eligible employees hired prior to January 1, 2011, who have not separated from service, shall continue as Participants and accrue benefits under the Plan.

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

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

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

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

All employees participating in the City Division Plan A as of June 30, 1999 were eligible to participate in KUB's Plan A or the CEP program. Participants of Plan A are covered by Social Security. Plan A is a closed plan and is not available to KUB employees hired after July 1, 1999. Participation in Plan A requires employee contributions of 3 percent of the first $4,800 of annual earnings and 5 percent of annual earnings in excess of $4,800. Plan A provides for early retirement benefits with 25 years of service and normal retirement benefits at age 62 or older.

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

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

Funding Policy
For the Plan year ended December 31, 2011, a contribution of $3,593,282 is required to be made in the Plan sponsor's fiscal year ending June 30, 2013. The Electric Division's portion of this contribution is $1,688,843. The annual required contribution was determined as part of the January 1, 2011 valuation using the Individual Entry Age Normal funding method. The objective under this method is to fund each participant's benefits under the Plan as payments which are level as a percentage of salary, starting on the original participation date (employment date) and continuing until the assumed retirement, termination, disability or death. For the Plan year ended December 31, 2011, the Plan's actuarial funded ratio was 104.5 percent.

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

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

As of the actuarial report for the Plan year ended December 31, 2011, contributions of $3,593,282 and $3,244,057 for 2011 and 2010, respectively, are required to be made during the Plan sponsor's fiscal years ending June 30, 2013 and 2012, respectively. Of these amounts, $1,688,843 and $1,589,588 are attributable to the Electric Division.

Subsequent to June 30, 2012, the actuarial report for the Plan year ending December 31, 2012 was completed.

For the Plan year ending December 31, 2012, a contribution of $5,502,677 is required to be made in the Plan sponsor's fiscal year ending June 30, 2014. The Electric Division's portion of this contribution is $2,586,258. For the Plan year ending December 31, 2012, the Plan's actuarial funded ratio was 94.1 percent.

11. Defined Contribution Plan

KUB has a defined contribution 401(k) employee retirement savings plan covering eligible KUB employees. Employees hired prior to January 1, 2011 may participate and receive a matching contribution of 50 percent of their own contribution up to a maximum match of 3 percent. Employees hired on or after January 1, 2011 have an enhanced 401(k) Plan due to the closure of the Defined Benefit Pension Plan. They may participate and receive a matching contribution of 50 percent of their own contribution up to a maximum match of 3 percent. They also receive a nonelective KUB contribution of from 3 percent to 6 percent, depending on years of service, whether they contribute or not.

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

12. Other Post-Employment Benefits (OPEB)

The Governmental Accounting Standards Board (GASB) established new standards for the measurement, recognition, and reporting of other post-employment benefits (OPEB). OPEB includes post-employment benefits other than pension, which, for KUB, is presently limited to post-employment health care. GASB 45 requires the recognition of the accrued OPEB liability for the respective year, plus the disclosure of the total unfunded liability. GASB 45 was effective for KUB for the fiscal year beginning July 1, 2007.

KUB currently provides post-employment health care benefits to 633 former employees and 647 covered dependents. The cost of coverage is shared with retirees and beneficiaries. KUB recognizes its share of the cost of post-employment health care benefits as an expense as claims are paid.

In anticipation of GASB 45, KUB amended its Group Health Plan in 1999, eliminating post-employment health care benefits for all employees hired on or after July 1, 1999. As of June 30, 2012, 450 active employees were eligible for individual and dependent coverage at separation if the employee meets the Rule of 80 (age plus years of service) with a minimum of 20 years of service.

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 GASB 45 does not require pre-funding of the liability, KUB has determined that it is in the long-term economic interest of KUB and its ratepayers to establish a Trust to pre-fund KUB's OPEB liability.

In October 2007, the KUB Board authorized the establishment of an OPEB Trust. The applicable documentation was submitted to the State Funding Board and, in December 2007, the State

Funding Board approved the Trust. The Trust was also approved by the Internal Revenue Service in June 2008.

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

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

Total contributions to the OPEB Trust for the fiscal year ended June 30, 2012 were $8.1 million (Division's share $4 million). The contribution to the Trust exceeded the annual required contribution (ARC), as determined by the Postretirement Benefit Plan's actuarial valuation for the year ended December 31, 2010, which was $4.6 million (Division's share $2.2 million). As of June 30, 2012, the employer's net OPEB obligation was $1.7 million (Division's share $0.8 million).

The ARC for the fiscal year ending June 30, 2013, as determined by the Plan's actuarial valuation for the year ended December 31, 2011 is $3.3 million (Division's share $1.6 million).

The actuarial valuation for the Plan for the year ending December 31, 2012 has been completed. The valuation determined that the Plan's actuarial accrued liability was $61.6 million (Division's share $28.9 million). The actuarial value of the Plan's assets was $37.9 million (Division's share $17.8 million). As a result, the Plan's unfunded actuarial accrued liability was $23.7 million (Division's share $11.1 million). The Plan's actuarial funded ratio was 62 percent. The valuation also determined that the employer's ARC is $3.3 million for the fiscal year ending June 30, 2014 (Division's share $1.6 million).

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, 2012 and 2011 are summarized as follows:

	2012	2011
City of Knoxville		
Amounts billed by the Division for utilities and related services	$ 6,950,602	$ 7,128,919
Payments by the Division in lieu of property tax	5,250,083	5,070,589
Payments by the Division for services provided	81,734	63,811
Other divisions of KUB		
Amounts billed to other divisions for utilities and related services provided	4,450,495	5,266,915
Interdivisional rental expense	-	-
Interdivisional rental income	790,402	893,863
Amounts billed to the Division by other divisions for utilities services provided	176,456	209,309

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

	2012	2011
Accounts receivable	$ 424,732	$ 510,449

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, 2012
(Unaudited)

Pension Plan

Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (b)	Unfunded Actuarial Accrued Liability (UAAL) (b-a)	Funded Ratio (a)/(b)	Annual Covered Payroll (c)	UAAL as a Percentage of Covered Payroll [(b)-(a)]/(c)
January 1, 2009	$ 183,447,296	$ 194,366,597	$ 10,919,301	94.4%	$ 49,602,223	22.01%
January 1, 2010	203,704,898	190,679,453	(13,025,445)	106.8%	48,228,428	(27.01%)
January 1, 2011	195,692,781	187,257,434	(8,435,347)	104.5%	47,405,874	(17.79%)
January 1, 2012	183,980,665	195,536,152	11,555,487	94.1%	48,836,721	23.66%

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%

Knoxville Utilities Board Electric Division
Supplemental Information –
Schedule of Expenditures of Federal Awards by Grant
June 30, 2012 — Schedule 1

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

Program Name	Federal/State Agency	CFDA Number	Contract Number	Beginning Deferred	Cash Receipts	Expenditures	Adjustments	Ending Deferred
ARRA-Electricity Delivery and Energy Reliability, Research, Development and Analysis	Department of Energy	81.122	DE-OE0000405	$ -	$ 2,111,261	$ 2,111,261	$ -	$ -
		Total Program 81.122		$ -	$ 2,111,261	$ 2,111,261	$ -	$ -
U.S. Department of Homeland Security	Tennessee Emergency Management	97.036	34101-0000009205	$ 1,561,320	$ 1,233,221	$ 28,049	$ 132,811	$ 488,959
U.S. Department of Homeland Security	Tennessee Emergency Management	97.036	34101-0000009832	$ 1,267,500	$ 2,941,393	$ 2,654,358	$ -	$ 980,465
		Total Program 97.036		$ 2,828,820	$ 4,174,614	$ 2,682,407	$ 132,811	$ 1,469,424
		Total Federal Awards		$ 2,828,820	$ 6,285,875	$ 4,793,668	$ 132,811	$ 1,469,424

NOTE 1 - BASIS OF PRESENTATION

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

Summary of Audit Results

Financial Statements

Type of auditors report issued:	Unqualified	
Internal control over financial reporting:		
Material weakness(es) identified?	___Yes	✓ No
Significant deficiencies identified that are not considered to be material weakness(es)?	___Yes	✓ None reported
Noncompliance material to financial statements noted?	___Yes	✓ No

Federal Awards

Internal control over major programs:		
Material weakness(es) identified?	___Yes	✓ No
Significant deficiencies identified that are not considered to be material weakness(es)?	___Yes	✓ None reported
Type of auditor's report issued on compliance for major programs:	Unqualified	
Any audit findings disclosed that are required to be reported in Accordance with Section 510(a) of Circular A-133?	___Yes	✓ None reported

Major programs:

CFDA Number	Name of Federal Program
81.122	ARRA-Electricity Delivery and Energy Reliability, Research, Development and Analysis
97.036	U.S. Department of Homeland Security

Dollar threshold used to distinguish between type A And type B programs	$300,000	
Auditee qualified as low-risk auditee?	___Yes	✓ No

Findings – Financial Statements Audit

None

Findings and Questioned Costs – Major Federal Award Programs Audit

None

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); $5,000,000 deductible per occurrence.

Travel Accident
Covers losses related to employees' business travel. Limits of coverage - $1,375,000 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, 2012 — Schedule 4

	V-2004		W-2005		X-2006		Y-2009		Z-2010			AA-2012		Total		Grand Total (P + I)	Grand Total (Less Rebate)
FY	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Rebate*	Principal	Interest	Principal	Interest		
12-13	1,015,000	16,496	1,660,000	1,536,856	1,550,000	718,375	1,350,000	1,555,250	1,245,000	1,351,361	472,976	100,000	1,089,150	6,920,000	6,267,487	13,187,487	12,714,511
13-14			1,720,000	1,460,806	1,650,000	652,438	1,450,000	1,503,375	1,255,000	1,327,604	464,661	920,000	1,537,713	6,995,000	6,481,935	13,476,935	13,012,274
14-15			1,790,000	1,381,831	1,725,000	576,313	1,525,000	1,466,187	1,265,000	1,299,244	454,735	955,000	1,490,838	7,260,000	6,214,412	13,474,412	13,019,677
15-16			1,870,000	1,299,481	1,825,000	487,563	1,600,000	1,427,125	1,285,000	1,265,436	442,903	990,000	1,442,213	7,570,000	5,921,818	13,491,818	13,048,915
16-17			1,940,000	1,218,606	450,000	432,657	1,675,000	1,382,000	1,305,000	1,225,919	429,072	2,540,000	1,353,963	7,910,000	5,613,144	13,523,144	13,094,073
17-18			2,015,000	1,139,506	475,000	413,579	1,750,000	1,330,625	1,330,000	1,180,440	413,154	2,670,000	1,223,713	8,240,000	5,287,863	13,527,863	13,114,709
18-19			2,095,000	1,057,306	475,000	393,688	1,850,000	1,267,375	1,355,000	1,128,729	395,055	2,805,000	1,086,838	8,580,000	4,933,935	13,513,935	13,118,880
19-20			2,185,000	970,341	500,000	372,969	1,950,000	1,191,375	1,390,000	1,070,710	374,749	2,955,000	942,838	8,980,000	4,548,233	13,528,233	13,153,484
20-21			2,275,000	878,354	525,000	351,188	2,025,000	1,101,750	1,425,000	1,007,355	352,574	3,100,000	791,463	9,350,000	4,130,110	13,480,110	13,127,535
21-22			2,370,000	781,069	550,000	328,344	2,150,000	997,375	1,470,000	939,300	328,755	3,270,000	632,213	9,810,000	3,678,301	13,488,301	13,159,546
22-23			2,470,000	678,219	575,000	304,078	2,250,000	887,375	1,515,000	866,145	303,151	3,415,000	482,163	10,225,000	3,217,980	13,442,980	13,139,829
23-24			2,580,000	569,294	600,000	278,375	2,350,000	784,125	1,560,000	787,710	275,699	3,540,000	360,763	10,630,000	2,780,267	13,410,267	13,134,568
24-25			2,695,000	453,903	625,000	251,578	2,475,000	687,625	1,615,000	703,545	246,241	3,640,000	253,063	11,050,000	2,349,714	13,399,714	13,153,473
25-26			2,820,000	333,263	675,000	223,141	2,600,000	582,875	1,670,000	613,180	214,613	1,105,000	180,506	8,870,000	1,932,965	10,802,965	10,588,352
26-27			2,950,000	205,201	700,000	193,063	2,700,000	470,250	1,725,000	516,395	180,738	1,140,000	144,025	9,215,000	1,528,934	10,743,934	10,563,196
27-28			3,085,000	69,413	725,000	161,438	2,850,000	348,750	1,785,000	413,266	144,643	1,180,000	106,325	9,625,000	1,099,192	10,724,192	10,579,549
28-29			-	-	750,000	128,251	3,000,000	217,125	1,850,000	303,738	106,308	1,225,000	65,713	6,825,000	714,826	7,539,826	7,433,518
29-30			-	-	800,000	93,376	3,150,000	74,813	1,925,000	187,156	65,505	1,265,000	22,138	7,140,000	377,482	7,517,482	7,451,978
30-31			-	-	825,000	56,813			2,000,000	63,500	22,225			2,825,000	120,313	2,945,313	2,923,088
31-32			-	-	850,000	19,125								850,000	19,125	869,125	869,125
Total	$ 1,015,000	$ 16,496	$ 36,520,000	$ 14,033,449	$ 16,850,000	$ 6,436,352	$ 38,700,000	$ 17,275,375	$ 28,970,000	$ 16,250,733	$ 5,687,757	$ 36,815,000	$ 13,205,638	$ 158,870,000	$ 67,218,036	$ 226,088,036	$ 220,400,280

*Series Z-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.
The rebate payments will total $6,197,955 over the life of the bonds. The net cost of issuing the bonds is $11,510,487.

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Electric Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2012
(Unaudited)

Schedule 5

Rate Class		Base Charge			Number of Customers
Residential		Customer Charge:	$12.60 per month, less Hydro Allocation Credit: $1.60 per month.		173,362
		Energy Charge:	Summer Period	8.741 cents per kWh per month.	
			Winter Period	8.700 cents per kWh per month.	
			Transition Period	8.700 cents per kWh per month.	
Commercial/ Industrial	**A. 1.**	If (a) the higher of (i) the customer's currently effective contract demand, if any, or (ii) its highest billing demand during the latest 12-month period is not more than 50 kWh, and (b) customer's monthly energy takings for any month during such period do not exceed 15,000 kWh:			20,458
		Customer Charge:	$16.00 per delivery point per month.		
		Energy Charge:	Summer Period	10.005 cents per kWh.	
			Winter Period	9.964 cents per kWh.	
			Transition Period	9.964 cents per kWh.	
	2.	If (a) the higher of (i) the customer's currently effective contract demand or (ii) its highest billing demand during the latest 12-month period is greater than 50 kW but not more than 1,000 kW, or (b) if the customer's billing demand is less than 50 kW and its energy takings for any month during such period exceed 15,000 kWh:			2,840
		Customer Charge:	$50.00 per delivery point per month.		
		Demand Charge:	First 50 kW of billing demand per month, no demand charge.		
			Excess over 50 kW of billing demand per month, at		
			Summer Period	$12.19 per kW.	
			Winter Period	$11.40 per kW.	
			Transition Period	$11.40 per kW.	
		Energy Charge:	Summer Period	First 15,000 kWh per month at 10.404 cents per kWh Additional kWh per month at 6.084 cents per kWh.	
			Winter Period	First 15,000 kWh per month at 10.363 cents per kWh Additional kWh per month at 6.084 cents per kWh.	
			Transition Period	First 15,000 kWh per month at 10.363 cents per kWh Additional kWh per month at 6.084 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, 2012
(Unaudited)

Schedule 5

Rate Class				Number of Customers
3.	If (a) the higher of the customer's currently effective contract demand or (b) its highest billing demand during the latest 12-month period is greater than 1,000 kW:			55
	Customer Charge:	$140.00 per delivery point per month.		
	Demand Charge:	Summer Period	First 1,000 kW of billing demand per month, at $11.81 per kW. Excess over 1,000 kW of billing demand per month, at $13.70 per kW, plus an additional $13.70 per kW per month for each kW, if any, of the amount by which the customer's billing demand exceeds the higher of 2,500 kW or its contract demand.	
		Winter Period	First 1,000 kW of billing demand per month, at $11.05 per kW. Excess over 1,000 kW of billing demand per month, at $12.94 per kW, plus an additional $12.94 per kW per month for each kW, if any, of the amount by which the customer's billing demand exceeds the higher of 2,500 kW or its contract demand.	
		Transition Period	First 1,000 kW of billing demand per month, at $11.05 per kW. Excess over 1,000 kW of billing demand per month, at $12.94 per kW, plus an additional $12.94 per kW per month for each kW, if any, of the amount by which the customer's billing demand exceeds the higher of 2,500 kW or its contract demand.	
	Energy Charge:	Summer Period	6.250 cents per kWh.	
		Winter Period	6.250 cents per kWh.	
		Transition Period	6.250 cents per kWh.	

See accompanying Report of Independent Auditors on Supplemental Information.

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	$17.03 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 $17.03 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	$9.90 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 $9.90 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 $9.90 per kW per month for each kW of the amount, if any, by which the customer's offpeak billing demand exceeds its offpeak contract demand.	

Energy Charge:	Summer Period	9.874 cents per kWh per month for all metered onpeak kWh, plus 6.390 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 4.514 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 2.922 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	6.793 cents per kWh per month for all metered onpeak kWh, plus 6.390 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 4.514 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 2.922 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	6.390 cents per kWh per month for the first 425 hours use of maximum metered demand, plus 4.514 cents per kWh per month for the next 195 hours use of maximum metered demand, plus 2.922 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours.

Rate Class		Base Charge			Number of Customers
Commercial/ Industrial	**C.**	This rate shall apply to the firm electric power requirements where a customer's currently effective contract demand is greater than 15,000 kW but not more than 25,000 kW:			-
		Customer Charge:	$1,500 per delivery point per month.		
		Administrative Charge:	$700 per delivery point per month.		
		Demand Charge:	Summer Period	$16.38 per kW per month of the customer's onpeak billing demand, plus $3.87 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus $16.38 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	$9.25 per kW per month of the customer's onpeak billing demand, plus $3.87 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus $9.25 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.	
			Transition Period	$3.87 per kW per month of the customer's offpeak billing demand, plus $9.25 per kW per month for each kW of the amount, if any, by which the customer's offpeak billing demand exceeds its offpeak contract demand.	

Energy Charge:	Summer Period	9.512 cents per kWh per month for all metered onpeak kWh, plus 6.126 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 4.249 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 2.657 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	6.507 cents per kWh per month for all metered onpeak kWh, plus 6.126 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 4.249 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 2.657 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	6.126 cents per kWh per month for the first 425 hours use of maximum metered demand, plus 4.249 cents per kWh per month for the next 195 hours use of maximum metered demand, plus 2.657 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours.

Rate Class		Base Charge			Number of Customers
Commercial/ Industrial	**D.**	This rate shall apply to the firm electric power requirements where a customer's currently effective contract demand is greater than 25,000 kW:			1
		Customer Charge:	$1,500 per delivery point per month.		
		Administrative Charge:	$700 per delivery point per month.		
		Demand Charge:	Summer Period	$16.81 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 $16.81 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	$9.68 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 $9.68 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.	
			Transition Period	$4.30 per kW per month of the customer's offpeak billing demand, plus $9.68 per kW per month for each kW of the amount, if any, by which the customer's offpeak billing demand exceeds its offpeak contract demand.	

Energy Charge:	Summer Period	9.400 cents per kWh per month for all metered onpeak kWh, plus 5.908 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 4.033 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 2.440 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	6.307 cents per kWh per month for all metered onpeak kWh, plus 5.908 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 4.033 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 2.440 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	5.908 cents per kWh per month for the first 425 hours use of maximum metered demand, plus 4.033 cents per kWh per month for the next 195 hours use of maximum metered demand, plus 2.440 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours.

Rate Class		Base Charge			Number of Customers
Seasonal Time of Use	**A.**	This rate shall apply to the firm electric power requirements where a customer's currently effective contract demand is greater than 1,000 kW but not more than 5,000 kW:			3
		Customer Charge:	$1,500 per delivery point per month.		
		Administrative Charge:	$700 per delivery point per month.		
		Demand Charge:	Summer Period	$17.03 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 $17.03 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	$9.90 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 $9.90 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 $9.90 per kW per month for each kW of the amount, if any, by which the customer's offpeak billing demand exceeds its offpeak contract demand.	

Energy Charge:	Summer Period	9.874 cents per kWh per month for all metered onpeak kWh, plus 6.390 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 4.514 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 2.922 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	6.793 cents per kWh per month for all metered onpeak kWh, plus 6.390 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 4.514 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 2.922 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	6.390 cents per kWh per month for the first 425 hours use of maximum metered demand, plus 4.514 cents per kWh per month for the next 195 hours use of maximum metered demand, plus 2.922 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours.

Knoxville Utilities Board Electric Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2012
(Unaudited)

Schedule 5

Rate Class		Base Charge			Number of Customers
Seasonal	**B.**	This rate shall apply to the firm electric power requirements where a customer's currently effective contract demand is greater than 5,000 kW but not more than 15,000 kW:			3
		Customer Charge:	$1,500 per delivery point per month.		
		Administrative Charge:	$700 per delivery point per month.		
		Demand Charge:	Summer Period	$22.24 per kW per month of the customer's billing demand, plus $22.24 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.	
			Winter Period	$15.89 per kW per month of the customer's billing demand, plus $15.89 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	$11.10 per kW per month of the customer's billing demand, plus $11.10 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.	
		Energy Charge:	Summer Period	5.140 cents per kWh per month.	
			Winter Period	4.728 cents per kWh per month.	
			Transition Period	4.637 cents per kWh per month.	

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Knoxville Utilities Board Electric Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2012
(Unaudited)

Schedule 5

Rate Class		Base Charge			Number of Customers
Seasonal	**C.**	This rate shall apply to the firm electric power requirements where a customer's currently effective contract demand is greater than 15,000 kW but not more than 25,000 kW:			-
		Customer Charge:	$1,500 per delivery point per month.		
		Administrative Charge:	$700 per delivery point per month.		
		Demand Charge:	Summer Period	$21.59 per kW per month of the customer's billing demand, plus $21.59 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.	
			Winter Period	$15.24 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.	
			Transition Period	$10.45 per kW per month of the customer's billing demand, plus $10.45 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	5.152 cents per kWh per month.	
			Winter Period	4.731 cents per kWh per month.	
			Transition Period	4.644 cents per kWh per month.	

See accompanying Report of Independent Auditors on Supplemental Information.

Rate Class		Base Charge			Number of Customers
Seasonal	**D.**	This rate shall apply to the firm electric power requirements where a customer's currently effective contract demand is greater than 25,000 kW:			-
		Customer Charge:	$1,500 per delivery point per month.		
		Administrative Charge:	$700 per delivery point per month.		
		Demand Charge:	Summer Period	$25.61 per kW per month of the customer's billing demand, plus $25.61 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.	
			Winter Period	$19.24 per kW per month of the customer's billing demand, plus $19.24 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.	
			Transition Period	$14.47 per kW per month of the customer's billing demand, plus $14.47 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	4.483 cents per kWh per month.	
			Winter Period	4.116 cents per kWh per month.	
			Transition Period	4.036 cents per kWh per month.	

See accompanying Report of Independent Auditors on Supplemental Information.

Rate Class		Base Charge			Number of Customers
Manufacturing	**B.**	This rate shall apply to the firm electric power requirements where (a) a customer's currently effective contract demand is greater than 5,000 kW but not more than 15,000 kW and (b) the major use of electricity is for activities conducted at the delivery point serving that customer which are classified with a 2-digit Standard Industrial Classification Code between 20 and 39, inclusive.			-
		Customer Charge:	$1,500 per delivery point per month.		
		Administrative Charge:	$700 per delivery point per month.		
		Demand Charge:	Summer Period	$17.03 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 $17.03 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	$9.90 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 $9.90 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 $9.90 per kW per month for each kW of the amount, if any, by which the customer's offpeak billing demand exceeds its offpeak contract demand.	

Energy Charge:	Summer Period	8.349 cents per kWh per month for all metered onpeak kWh, plus 4.902 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 3.027 cents per kWh per month for the next 195 hours use of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 1.436 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours multiplied by the ratio of offpeak energy to total energy.
	Winter Period	5.331 cents per kWh per month for all metered onpeak kWh, plus 4.902 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 3.027 cents per kWh per month for the next 195 hours use of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 1.436 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours multiplied by the ratio of offpeak energy to total energy.
	Transition Period	4.902 cents per kWh per month for the first 425 hours use of maximum metered demand, plus 3.027 cents per kWh per month for the next 195 hours use of maximum metered demand, plus 1.436 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours.

Rate Class		Base Charge			Number of Customers
Manufacturing	**C.**	This rate shall apply to the firm electric power requirements where (a) a customer's currently effective contract demand is greater than 15,000 kW but not more than 25,000 kW and (b) the major use of electricity is for activities conducted at the delivery point serving that customer which are classified with a 2-digit Standard Industrial Classification Code between 20 and 39, inclusive.			-
		Customer Charge:	$1,500 per delivery point per month.		
		Administrative Charge:	$700 per delivery point per month.		
		Demand Charge:	Summer Period	$16.40 per kW per month of the customer's onpeak billing demand, plus $3.89 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus $16.40 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.	
			Winter Period	$9.27 per kW per month of the customer's onpeak billing demand, plus $3.89 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus $9.27 per kW per month for each kW of the amount, if any, by which (1) the customer's onpeak billing demand exceeds its onpeak contract demand or (2) the customer's offpeak billing demand exceeds its offpeak contract demand, whichever is higher.	
			Transition Period	$3.89 per kW per month of the customer's offpeak billing demand, plus $9.27 per kW per month for each kW of the amount, if any, by which the customer's offpeak billing demand exceeds its offpeak contract demand.	

Energy Charge:	Summer Period	8.431 cents per kWh per month for all metered onpeak kWh, plus 4.889 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 3.013 cents per kWh per month for the next 195 hours use of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 1.422 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours multiplied by the ratio of offpeak energy to total energy.
	Winter Period	5.345 cents per kWh per month for all metered onpeak kWh, plus 4.889 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 3.013 cents per kWh per month for the next 195 hours use of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 1.422 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours multiplied by the ratio of offpeak energy to total energy.
	Transition Period	4.889 cents per kWh per month for the first 425 hours use of maximum metered demand, plus 3.013 cents per kWh per month for the next 195 hours use of maximum metered demand, plus 1.422 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours.

Rate Class		Base Charge			Number of Customers
Manufacturing	**D.**	This rate shall apply to the firm electric power requirements where (a) a customer's currently effective contract demand is greater than 25,000 kW and (b) the major use of electricity is for activities conducted at the delivery point serving that customer which are classified with a 2-digit Standard Industrial Classification Code between 20 and 39, inclusive.			-
		Customer Charge:	$1,500 per delivery point per month.		
		Administrative Charge:	$700 per delivery point per month.		
		Demand Charge:	Summer Period	$16.79 per kW per month of the customer's onpeak billing demand, plus $4.28 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus $16.79 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	$9.66 per kW per month of the customer's onpeak billing demand, plus $4.28 per kW per month of the amount, if any, by which the customer's offpeak billing demand exceeds its onpeak billing demand, plus $9.66 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	$4.28 per kW per month of the customer's offpeak billing demand, plus $9.66 per kW per month for each kW of the amount, if any, by which the customer's offpeak billing demand exceeds its offpeak contract demand.	

Energy Charge:	Summer Period	8.292 cents per kWh per month for all metered onpeak kWh, plus 4.754 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 2.878 cents per kWh per month for the next 195 hours use of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 1.286 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours multiplied by the ratio of offpeak energy to total energy.
	Winter Period	5.190 cents per kWh per month for all metered onpeak kWh, plus 4.754 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 2.878 cents per kWh per month for the next 195 hours use of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 1.286 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours multiplied by the ratio of offpeak energy to total energy.
	Transition Period	4.754 cents per kWh per month for the first 425 hours use of maximum metered demand, plus 2.878 cents per kWh per month for the next 195 hours use of maximum metered demand, plus 1.286 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours.

Rate Class		Base Charge			Number of Customers
Manufacturing Seasonal Time of Use	**A.**	This rate shall apply to the firm electric power requirements where (a) a customer's currently effective contract demand is greater than 1,000 kW but not more than 5,000 kW and (b) the major use of electricity is for activities conducted at the delivery point serving that customer which are classified with a 2-digit Standard Industrial Classification Code between 20 and 39, inclusive.			-
		Customer Charge:	$1,500 per delivery point per month.		
		Administrative Charge:	$700 per delivery point per month.		
		Demand Charge:	Summer Period	$17.03 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 $17.03 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	$9.90 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 $9.90 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 $9.90 per kW per month for each kW of the amount, if any, by which the customer's offpeak billing demand exceeds its offpeak contract demand.	

Energy Charge:	Summer Period	8.349 cents per kWh per month for all metered onpeak kWh, plus 4.902 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 3.027 cents per kWh per month for the next 195 hours use of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 1.436 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours multiplied by the ratio of offpeak energy to total energy.
	Winter Period	5.331 cents per kWh per month for all metered onpeak kWh, plus 4.902 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 3.027 cents per kWh per month for the next 195 hours use of maximum metered demand multiplied by the ratio of offpeak energy to total energy, plus 1.436 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours multiplied by the ratio of offpeak energy to total energy.
	Transition Period	4.902 cents per kWh per month for the first 425 hours use of maximum metered demand, plus 3.027 cents per kWh per month for the next 195 hours use of maximum metered demand, plus 1.436 cents per kWh per month for the hours use of maximum metered demand in excess of 620 hours.

Manufacturing					**Number of Customers**
Seasonal	**B.**	This rate shall apply to the firm electric power requirements where (a) a customer's currently effective contract demand is greater than 5,000 kW but not more than 15,000 kW and (b) the major use of electricity is for activities conducted at the delivery point serving that customer which are classified with a 2-digit Standard Industrial Classification Code between 20 and 39, inclusive.			1
		Customer Charge:	$1,500 per delivery point per month.		
		Administrative Charge:	$700 per delivery point per month.		
		Demand Charge:	Summer Period	$19.33 per kW per month of the customer's billing demand, plus $19.33 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.	
			Winter Period	$12.98 per kW per month of the customer's billing demand, plus $12.98 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	$8.19 per kW per month of the customer's billing demand, plus $8.19 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	4.370 cents per kWh per month.	
			Winter Period	3.903 cents per kWh per month.	
			Transition Period	3.794 cents per kWh per month.	

					Number of Customers
Seasonal	**C.**	This rate shall apply to the firm electric power requirements where (a) a customer's currently effective contract demand is greater than 15,000 kW but not more than 25,000 kW and (b) the major use of electricity is for activities conducted at the delivery point serving that customer which are classified with a 2-digit Standard Industrial Classification Code between 20 and 39, inclusive.			2
		Customer Charge:	$1,500 per delivery point per month.		
		Administrative Charge:	$700 per delivery point per month.		
		Demand Charge:	Summer Period	$18.70 per kW per month of the customer's billing demand, plus $18.70 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.	
			Winter Period	$12.35 per kW per month of the customer's billing demand, plus $12.35 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.	
			Transition Period	$7.56 per kW per month of the customer's billing demand, plus $7.56 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	4.340 cents per kWh per month.	
			Winter Period	3.902 cents per kWh per month.	
			Transition Period	3.796 cents per kWh per month.	

Manufacturing					Number of Customers
Seasonal	**D.**	This rate shall apply to the firm electric power requirements where (a) a customer's currently effective contract demand is greater than 25,000 kW; and (b) the major use of electricity is for activities conducted at the delivery point serving that customer which are classified with a 2-digit Standard Industrial Classification Code between 20 and 39, inclusive.			1
		Customer Charge:	$1,500 per delivery point per month.		
		Administrative Charge:	$700 per delivery point per month.		
		Demand Charge:	Summer Period	$22.00 per kW per month of the customer's billing demand, plus $22.00 per kW per month for each kW of the amount, if any, by which the customer's billing demand exceeds its contract demand.	
			Winter Period	$15.65 per kW per month of the customer's billing demand, plus $15.65 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	$10.86 per kW per month of the customer's billing demand, plus $10.86 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	3.652 cents per kWh per month.	
			Winter Period	3.302 cents per kWh per month.	
			Transition Period	3.219 cents per kWh per month.	

Knoxville Utilities Board Electric Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2012
(Unaudited)

Schedule 5

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 — Number of Customers: 85

Energy Charge:	Summer Period	6.889 cents per kWh per month.
	Winter Period	6.889 cents per kWh per month.
	Transition Period	6.889 cents per kWh per month.

Facility Charge: The annual investment charge shall be 13.92 percent of the installed cost to the Board'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 of 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 — Number of Customers: 845

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	$ 4.35	$ 9.17
	400	19,100	155	6.07	16.75
	1000**	47,500	378	9.72	35.76
High Pressure Sodium	100	8,550	42	4.35	7.24
	250	23,000	105	5.16	12.39
	400	45,000	165	6.07	17.44
	1000**	126,000	385	9.72	36.24
Decorative	100	8,550	42	4.96	7.85

* 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, 6.889 cents per rated kWh per month.
Additional pole charge: $3.00 per pole.

See accompanying Report of Independent Auditors on Supplemental Information.

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Report on Internal Control Over Financial Reporting and On Compliance And Other Matters Based On An Audit Of Financial Statements Performed In Accordance With *Government Auditing Standards*

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

We have audited the financial statements of the Knoxville Utilities Board, (an independent agency and reported as a component unit for financial purposes only by the City of Knoxville), Electric Division, as of and for the year ended June 30, 2012, which collectively comprise the Knoxville Utilities Board's basic financial statements and have issued our report thereon dated October 18, 2012. 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.

In accordance with *Government Auditing Standards*, the report dated October 18, 2012, has been reissued due to the omission of two federal program contracts on the schedule of expenditures of federal, state and other awards. Since program CFDA 97.036 was considered major, additional audit procedures were performed. The changes to the previously issued report dated October 18, 2012 encompasses the addition of program CFDA 97.036 contract number 34101-0000009205 and contract number 34101-0000009832 to the schedule of expenditures of federal, state and other awards and to the schedule of findings and questioned costs.

Internal Control Over Financial Reporting

Management of the Knoxville Utilities Board is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered Knoxville Utilities Board's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Knoxville Utilities Board's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Knoxville Utilities Board's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Knoxville Utilities Board's financial statements are free of 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*.

This report is intended solely for the information and use of the Knoxville Utilities Board's audit committee, board of commissioners, and others within the entity, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Rodefer Moss & Co, PLLC

Knoxville, Tennessee
October 18, 2012
(Except as noted in paragraph 2 above,
as to which the date is October 22, 2013)

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Independent Auditors' Report On Compliance With Requirements That Could Have A Direct And Material Effect On Each Major Program And On Internal Control Over Compliance In Accordance With OMB CIRCULAR A-133

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

Compliance

We have audited the Knoxville Utilities Board's, (an independent agency and reported as a component unit for financial purposes only by the City of Knoxville) compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the Knoxville Utilities Board's major federal programs for the year ended June 30, 2012. Knoxville Utilities Board's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the Knoxville Utilities Board's management. Our responsibility is to express an opinion on the Knoxville Utilities Board's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Knoxville Utilities Board's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Knoxville Utilities Board's compliance with those requirements.

In our opinion, the Knoxville Utilities Board, complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2012.

In accordance with *Government Auditing Standards*, the report dated October 18, 2012, has been reissued due to the omission of two federal program contracts on the schedule of expenditures of federal, state and other awards. Since program CFDA 97.036 was considered major, additional audit procedures were performed. The changes to the previously issued report dated October 18, 2012 encompasses the addition of program CFDA 97.036 contract number 34101-0000009205 and contract number 34101-0000009832 to the schedule of expenditures of federal, state and other awards and to the schedule of findings and questioned costs.

Internal Control over Compliance

Management of the Knoxville Utilities Board is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Knoxville Utilities Board's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Knoxville Utilities Board's internal control over compliance.

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

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

This report is intended solely for the information and use of the Knoxville Utilities Board's audit committee, board of commissioners, others within the entity, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Rodefer Moss & Co, PLLC

Knoxville, Tennessee
October 18, 2012
(Except as noted in paragraph 4 above,
as to which the date is October 22, 2013)

Knoxville Utilities Board
Gas Division
Financial Statements and Supplemental Information
June 30, 2012 and 2011

Knoxville Utilities Board Gas Division
Index
June 30, 2012 and 2011

Page(s)

Independent Auditors' Report..1-2

Management's Discussion and Analysis 3-17

Basic Financial Statements

Statements of Net Assets..18-19

Statements of Revenues, Expenses and Changes in Net Assets..20

Statements of Cash Flows 21

Notes to Financial Statements 22-35

Required Supplementary Information – Schedule of Funding Progress 36

Supplemental Information

Schedule 1 – Schedule of Insurance in Force 37

Schedule 2 – Schedule of Debt Maturities by Fiscal Year 38-39

Schedule 3 – Schedule of Current Rates in Force..40-44

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*..45

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INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying consolidated financial statements of the Knoxville Utilities Board, Gas Division, an independent agency and reported as a component unit for financial reporting purposes only by the City of Knoxville, Tennessee, as of and for the years ended June 30, 2012 and 2011. These financial statements are the responsibility of Knoxville Utilities Board's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Knoxville Utilities Board, Gas Division, as of June 30, 2012 and 2011, and the respective changes in financial position, and cash flows, for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 18, 2012, on our consideration of the Knoxville Utilities Board'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* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 17 and Schedule of Funding Progress on page 36 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Knoxville Utilities Board's financial statements as a whole. The supplemental schedules on pages 37 through 44 are presented for the purpose of additional analysis and are not a required part of the financial statements. The supplemental schedules have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on them.

Rodefer Moss & Co, PLLC

Knoxville, Tennessee
October 18, 2012

Knoxville Utilities Board (KUB), comprised of Electric Division, Water Division, Gas Division, and Wastewater Division (Divisions), is reported as a component unit enterprise fund in the financial statements of the City of Knoxville. KUB's responsibility is to oversee the purchase, production, distribution, and processing of electricity, water, natural gas, and wastewater services. A seven-member Board of Commissioners oversees KUB. The Board has all powers to construct, acquire, expand, or operate the Divisions. It has full control and complete jurisdiction over the management and operation of the Divisions. The Gas Division (Division) provides services to certain customers in Knox County. 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, 2012 and 2011, 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, 2012 activities, resulting changes and current known facts, and should be read in conjunction with the Division's financial statements.

Gas Division Highlights

System Highlights

KUB's gas system serves 97,650 customers, and its service territory covers 279 square miles. KUB maintains 2,330 miles of service mains to provide 10.4 million dekatherms of natural gas to its customers annually. Peak day capacity for the gas distribution system is 157,381 dekatherms. The actual peak day throughput for the gas system was 119,282 dekatherms in January 2010.

Financial Highlights

The Division's net assets increased $0.6 million or 0.3 percent, compared to a $2.4 million increase last fiscal year.

Operating revenue decreased $19.5 million or 18.4 percent, the combined result of the flow-through of lower wholesale gas costs via the Division's Purchased Gas Adjustment and a 13.3 percent decline in sales volumes. Purchased gas expense was $13 million or 20.3 percent lower due to the decline in sales volumes and lower wholesale gas prices. Margin on gas sales (operating revenue less purchased gas expense) decreased $6.5 million or 15.5 percent, the result of a 13.3 percent decline in sales volumes due to milder winter weather.

Operating expenses (excluding purchased gas expense) decreased $4.7 million or 12.9 percent. Operating and maintenance (O&M) expenditures decreased $5.1 million or 22.9 percent. Depreciation expense was $0.4 million higher than the prior year. Taxes and tax equivalents were $0.1 million higher than the prior year.

Lower interest rates on longer-term investments resulted in a $0.1 million decrease in interest income. Interest expense decreased $0.1 million. These items combined to hold other income flat when compared to the prior year.

Total plant assets (net) increased $12.8 million or 6.6 percent over the end of the last fiscal year primarily due to the replacement and construction of gas mains.

Long-term debt represented 35.6 percent of the Division's capital structure, compared to 37 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 assets.

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 2.22. Maximum debt service coverage was 2.30.

Division Highlights

The Division added approximately 730 customers during fiscal year 2012. Last fiscal year, the Division experienced a net loss of 300 customers. System growth over the last three years has been limited due to the economic recession.

Natural gas sales were 13.3 percent lower than last year primarily due to a 23.4 percent decrease in residential sales from milder than normal winter temperatures. The winter of fiscal year 2012 was the mildest winter experienced in the KUB service territory over the last twenty-five years.

The Division sold $24.9 million in revenue refunding bonds in April 2012, which when combined with a reoffering premium of $2 million, refunded $26.1 million in outstanding bonds, and paid the underwriter's discount and costs of issuance. This refunding will result in a savings of $4.6 million over the life of the bonds ($3.8 million in a net present value basis).

The typical residential gas customer's average monthly gas bill was $60.11 for the twelve months ending June 30, 2012, representing a decrease of $1.06 compared to last year based on the same volumes. The decrease was attributed to lower wholesale gas costs.

The Division expended approximately 59 percent of its sales revenues on wholesale gas purchases for the year.

Century II Infrastructure Program

In April 2011, management provided an updated assessment of the overall condition of each utility system's infrastructure to the KUB Board. The assessment concluded that the gas distribution system is relatively new and that current funding levels are sufficient to support the gas infrastructure replacement program. For the fiscal year ended June 30, 2012, KUB exceeded its target replacement levels as 9.75 miles of cast iron/ductile iron main were replaced, exceeding the target of 8 miles.

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Division Cash Budget Appropriations

KUB's Board of Commissioners adopted a Gas Division budget of $124.2 million for fiscal year 2012. At year end, the Division was $7.7 million under budget due in large part to a $9.1 million decrease in purchased gas costs. Lower than anticipated purchased gas costs were the result of the mild winter and lower wholesale gas costs. Capital expenditures were over budget by $2.1 million primarily due to the acceleration of a gas main extension project designed to meet increased service needs of the University of Tennessee. $3.7 million in bond proceeds from bonds sold in fiscal year 2011 were transferred into the general fund based on capital expenditures in fiscal year 2012. The numbers below are presented on a cash basis.

Gas Division Cash Report
As of June 30, 2012

(in thousands of dollars)	**FY 2012 Budget**	**FY 2012 Actual FYTD**	**Dollar Variance***	**Percent Variance**
Beginning Balance General Fund	$ 32,244	$ 32,244		
Operating Receipts	113,879	92,630	(21,249)	-18.7%
Disbursements				
Purchased Energy Expense	71,354	62,220	9,134	-12.8%
Operation & Maintenance Expense	18,472	17,933	539	-2.9%
Capital Expenditures	20,050	22,172	(2,122)	10.6%
Debt Service & Taxes	14,331	14,195	136	-0.9%
Total Disbursements	124,207	116,520	7,687	-6.2%
Bond Proceeds	-	3,701	3,701	100.0%
Net Flow-throughs and Transfers	48	666	618	100.0%
Ending General Fund Balance	$ 21,964	$ 12,721	$ (9,243)	-44.1%

*(-) indicates a decrease to cash

KUB, Gas Division, Financial Statements

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

Statement of Net Assets

The Division reports its assets, liabilities, and net assets (previously reported as accumulated earnings) in the Statement of Net Assets. Assets are classified as current, restricted, gas plant in service, or other assets.

Liabilities are classified as current, other, or long-term debt. Net assets are classified as invested in capital assets, net of related debt; restricted; or unrestricted. Net assets represent what was previously reported as accumulated or retained earnings. Net assets tell the user what the Division has done with its accumulated earnings not just the balance.

Invested in capital assets, net of related debt, 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 assets 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 assets are a residual classification; the amount remaining after reporting net assets as either invested in capital or restricted is reported there.

Statement of Revenues, Expenses and Changes in Net Assets

The Division reports its revenues and expenses (both operating and non-operating) on the Statement of Revenues, Expenses and Changes in Net Assets. 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 assets for the reporting. Net assets at the beginning of the period are increased or decreased, as applicable, by the change in net assets for the reporting period.

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

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 Assets.

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Condensed Financial Statements

Statement of Net Assets

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

Statements of Net Assets
As of June 30

(in thousands of dollars)	**2012**	**2011**
Current and other assets	$ 50,777	$ 72,322
Capital assets, net	208,788	195,944
Total assets	259,565	268,266
Current and other liabilities	18,399	21,937
Long-term debt outstanding	82,845	88,560
Total liabilities	101,244	110,497
Net assets		
Invested in capital assets, net of related debt	120,404	103,652
Restricted	1,476	1,411
Unrestricted	36,441	52,706
Total net assets	$ 158,321	$ 157,769

Normal Impacts on Statement of Net Assets

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

- Change in net assets (from Statement of Revenues, Expenses and Changes in Net Assets): impacts (increase/decrease) current and other assets and/or capital assets and unrestricted net assets.
- Issuing debt for capital: increases current and other assets 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 assets and increases invested in capital assets, net of related debt.
- Principal payment on debt: (a) reduces current and other assets and reduces long-term debt and (b) reduces unrestricted net assets and increases invested in capital assets, net of related debt.
- Reduction of capital assets through depreciation: reduces capital assets and invested in capital assets, net of related debt.

Current Year Impacts and Analysis

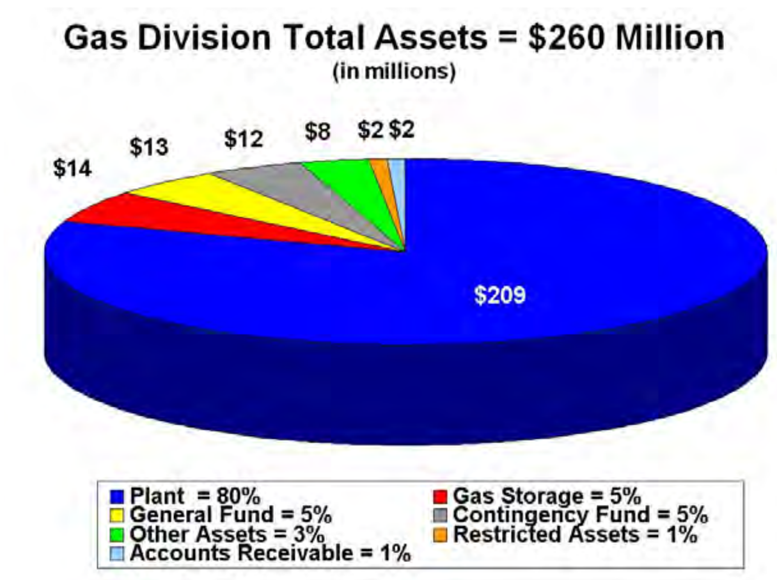
Current and Other Assets

Current and other assets decreased $21.5 million or 29.8 percent. General fund cash and investments decreased $19.5 million, due in part to the use of general fund cash to fund capital expenditures. Additionally, $3.7 million of the remaining proceeds from the December 2010 bond issue was expended on capital assets. Gas in storage increased $3 million due to a 35.5 percent increase in storage volumes compared to last June.

The Division under recovered $2.8 million in wholesale gas costs from its customers through its Purchased Gas Adjustment mechanism in fiscal year 2012, as compared to a $1.1 million over recovery in fiscal year 2011. This under recovery of costs will be collected from customers next fiscal year through adjustments to rates via the Purchased Gas Adjustment. The net effect was a $2.8 million addition in assets.

Capital Assets

Capital assets increased $12.8 million or 6.6 percent. Major plant additions during the year included $10.3 million for the construction of mains and service extensions and $7 million for gas main replacement.



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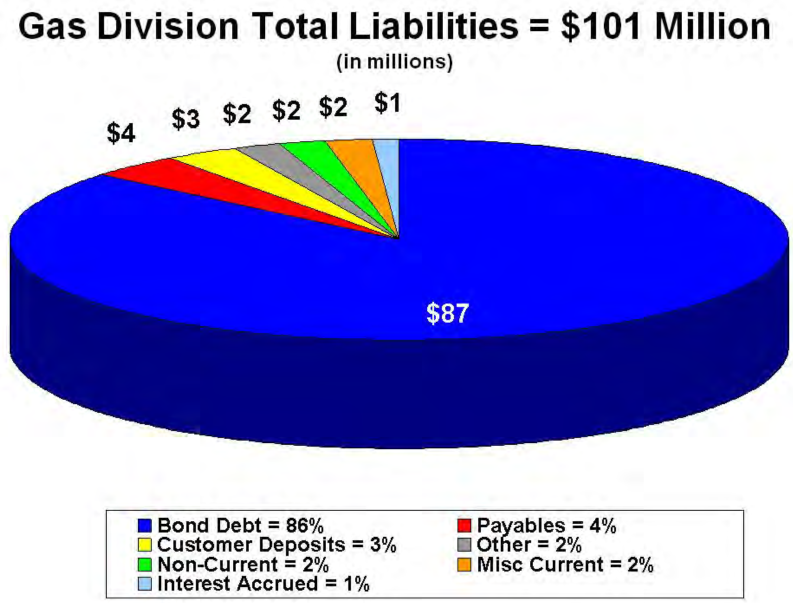
Current and Other Liabilities
Current and other liabilities decreased $3.5 million or 16.1 percent. The Division under recovered $2.8 million in wholesale gas costs from its customers in fiscal year 2012, as compared to a $1.1 million over recovery in fiscal year 2011. The net effect was a $1.1 million reduction in liabilities. Accounts payable declined $2.9 million, due to lower purchased gas expenses, the result of fewer volumes purchased for injection into storage in June 2012 compared with last fiscal year. In addition, the Division's share of KUB's liability for other post-employment medical benefits was $0.7 million lower than the prior year. The net unamortized cost of debt increased $1 million reflecting the $2 million reoffering premium received from the underwriter in the refunding of outstanding gas system bonds.



Long-Term Debt
Long-term debt fell $5.7 million or 6.5 percent, the result of the scheduled repayment of bond debt during the fiscal year and a $1.2 million reduction in principal as a result of the April 2012 debt refunding.

Net Assets
Invested in capital assets, net of debt increased $16.8 million or 16.2 percent, primarily attributed to a $5.7 million decrease in long term debt, the expending of $3.7 million in remaining bond proceeds on capital infrastructure, and a $0.6 million increase in net assets (as reported on the Statement of Revenue, Expenses and Changes in Net Assets). Restricted net assets were up $0.1 million. Unrestricted net assets decreased $16.3 million primarily due to a $19.5 million reduction in general fund cash compared to June of the prior year.

Statement of Revenues, Expenses and Changes in Net Assets

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

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

(in thousands of dollars)		**2012**		**2011**
Operating revenues	$	86,761	$	106,282
Less: Purchased gas expense		51,006		63,982
Margin from sales		35,755		42,300
Operating expenses				
Distribution		7,386		11,759
Customer service		2,448		2,569
Administrative and general		7,255		7,845
Depreciation and amortization		8,278		7,908
Taxes and tax equivalents		6,042		5,986
Total operating expenses		31,409		36,067
Operating income		4,346		6,233
Interest income		239		336
Interest expense		(3,826)		(3,927)
Other income/(expense)		(207)		(249)
Change in net assets	$	552	$	2,393

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

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

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

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

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

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

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

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

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

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

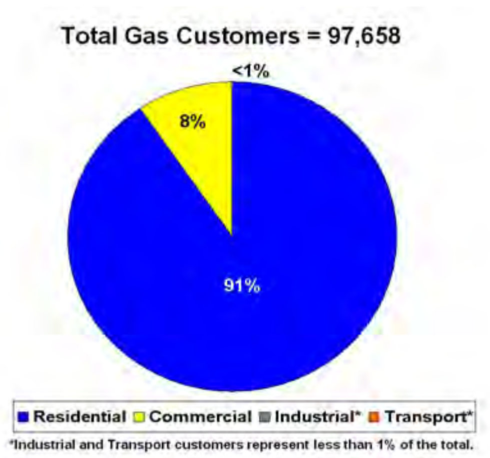
Current Year Impacts and Analysis

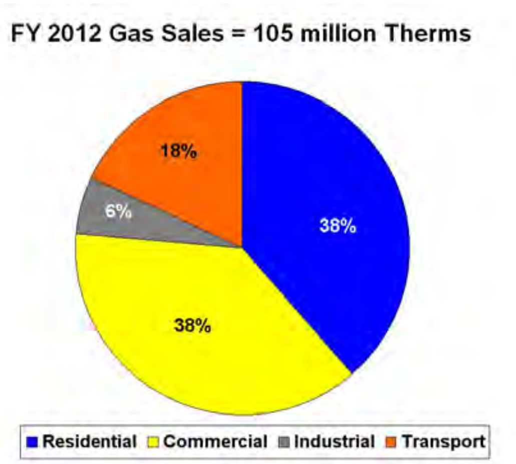
The Division’s net assets increased $0.6 million, representing a decrease of $1.8 million compared to last fiscal year’s $2.4 million increase in net assets. The decline in earnings was the net result of a decrease in margin on sales and lower operating expenses.

Margin on gas sales (operating revenue less purchased gas expense) decreased $6.5 million or 15.5 percent due to a 13.3 percent decline in sales volumes, the product of the mildest winter in KUB’s service territory over the last twenty-five years.

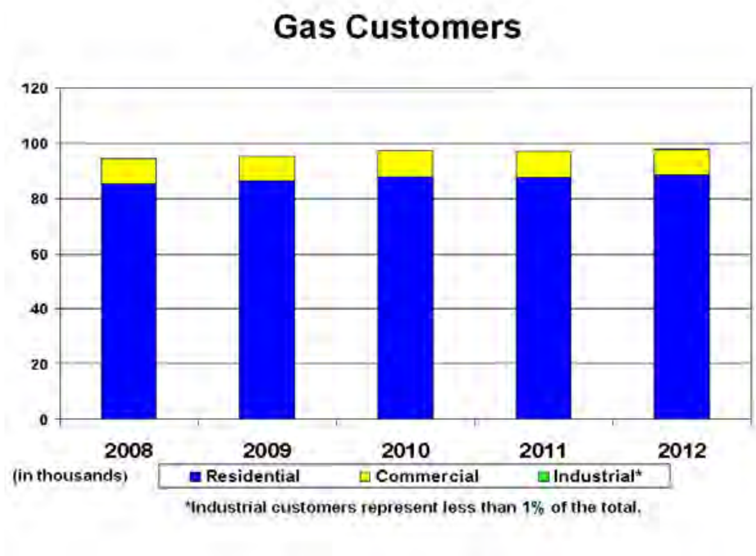
Operating revenue decreased $19.5 million or 18.4 percent for the fiscal year ending June 30, 2012, due to lower sales volumes and the flow-through of lower wholesale natural gas prices to customers through the Purchased Gas Adjustment.

Purchased gas expense decreased $13 million or 20.3 percent, due to lower wholesale gas costs combined with lower customer demand. KUB purchased 7.7 percent less gas from its suppliers during fiscal year 2012. The Division’s weighted average cost of gas purchased for fiscal year 2012 was $3.73 per dekatherm, as compared to $4.26 per dekatherm last year.

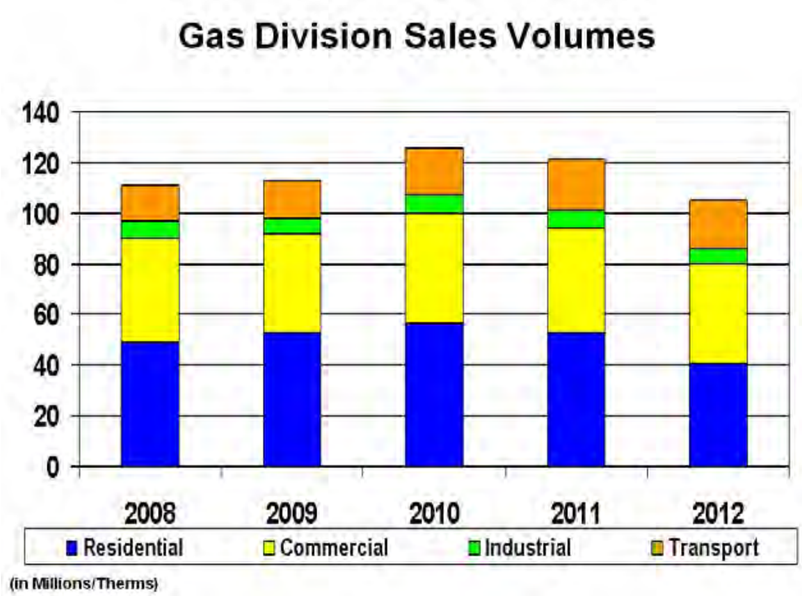




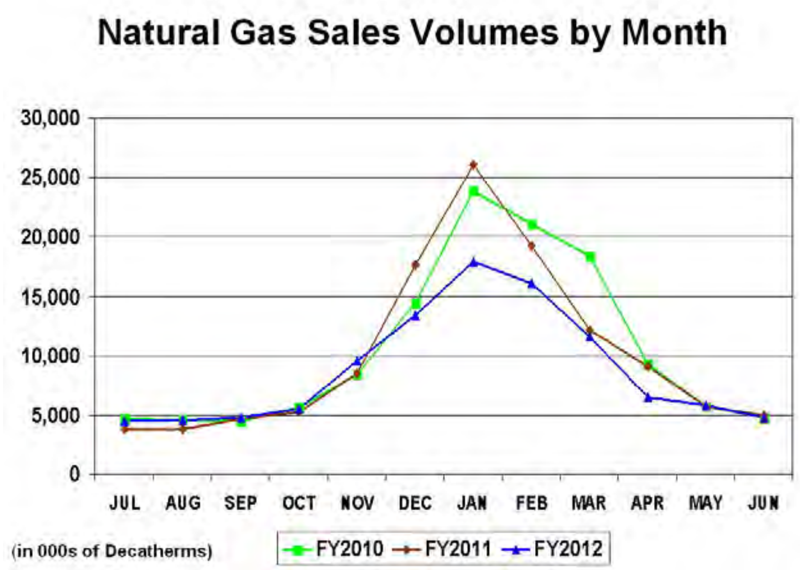
Residential customers, whose natural gas is primarily used as a heat source during winter months, accounted for 91 percent of customers billed and 38 percent of total volumes sold during the year.



The gas system has added approximately 3,100 customers over the past five years representing annual growth of 0.8 percent. System growth has been limited over the five year term due to the economic recession.



Gas sales volumes have declined at an annual rate of 8.5 percent over the past three years, due to milder winter weather. In fiscal year 2012, winter weather was 23 percent warmer than normal as compared to relatively normal winter weather last fiscal year. Sales volumes were lower for all rate classes as a result of the mild winter weather. KUB has 14 transport customers who purchase gas directly from a supplier other than KUB. KUB provides transportation service on its gas distribution system to these customers.



Residential sales volumes were lower than the prior year throughout the winter heating season of fiscal year 2012, resulting in an overall 23.4 percent decrease for the year.

Commercial and Industrial sales volumes (including transportation customers) were down 5.6 percent compared to the prior year, although the University of Tennessee increased its natural gas usage of by approximately 50 percent, as a less expensive alternative to coal.

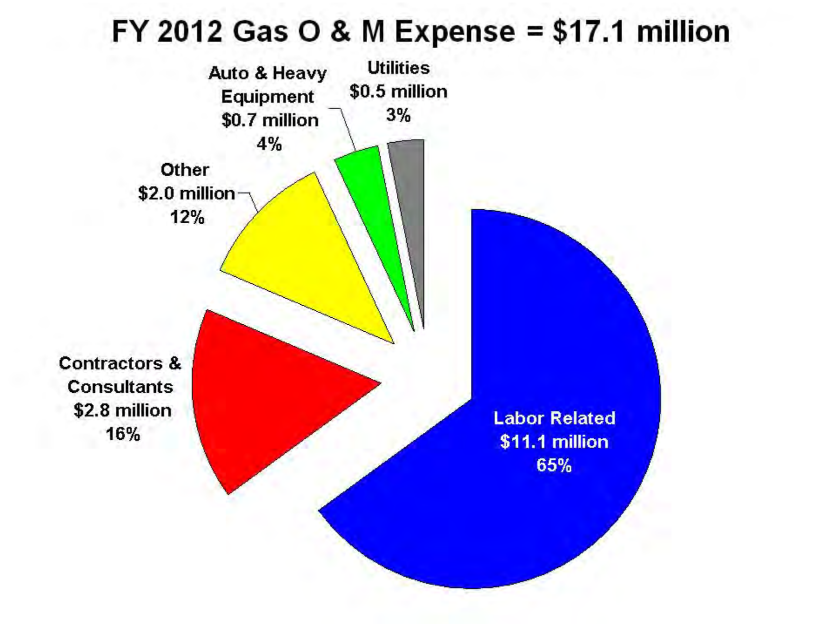
Operating Expenses

Operating expenses (excluding purchased gas expense) decreased $4.7 million or 12.9 percent over last fiscal year.

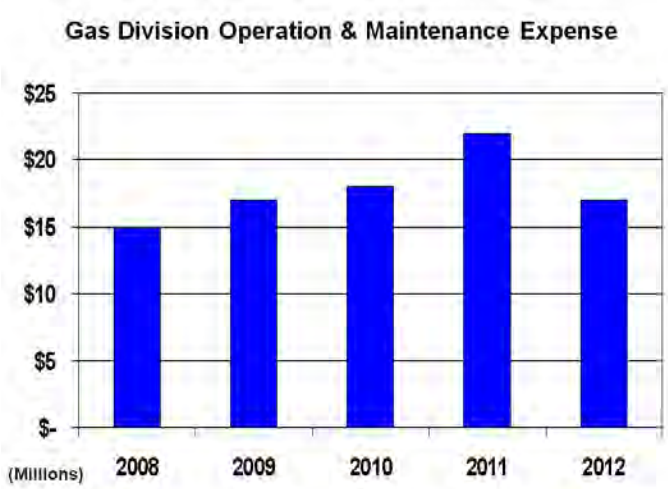
- Distribution system operating and maintenance expenses were $4.4 million lower than the last fiscal year. During fiscal year 2011, KUB initiated and completed a gas saddle tee replacement program, which resulted in approximately $4 million in incremental expenses last year.

- Customer service expenses decreased $0.1 million compared to the prior fiscal year, partially due to a decline in the Division's share of labor-related expenditures.

- Administrative and general expenses fell $0.6 million or 7.5 percent, reflecting a $0.5 million reduction in labor-related expenses.



Labor-related expenses accounted for 65 percent of fiscal year 2012 O&M expense. O&M expense decreased $5.1 million in fiscal year 2012, due to the initiation and completion of the gas saddle tee inspection and replacement program in the prior fiscal year and the Division's share of a reduction in pension and other post-employment benefits (OPEB) expenses.



- Depreciation expense was $0.4 million higher than the prior year, the result of a full year of depreciation for $13.2 million of assets added to plant in service the previous fiscal year.
- Taxes and tax equivalents were up $0.1 million compared with the prior fiscal year as result of higher tax equivalent payments to taxing jurisdictions due to increased net plant and margin levels.

Other Income and Expense

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

Interest expense was down $0.1 million or 2.6 percent, due to lower interest payments resulting from the April 2012 debt refunding.

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

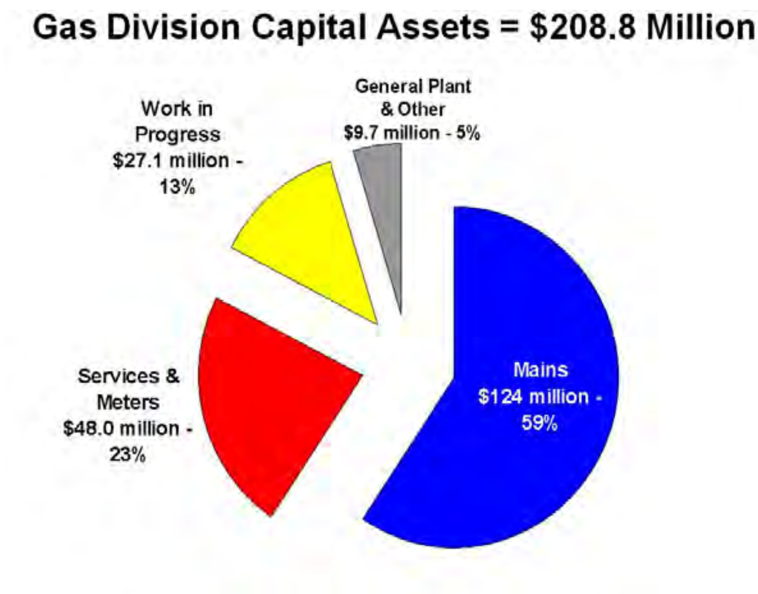
Capital Assets and Debt Administration

Capital Assets

As of June 30, 2012, the Division had $208.8 million invested in a variety of capital assets, as reflected in the schedule below, which represents a net increase (including additions, retirements, and depreciation) of $12.8 million or 6.6 percent over the end of the last fiscal year.

Capital Assets
As of June 30
(Net of Depreciation)

(in thousands of dollars)	**2012**	**2011**
Distribution plant:		
Mains	$ 124,045	$ 127,735
Services and meters	47,963	48,212
Others	851	843
Total distribution plant	172,859	176,790
General plant	8,822	7,390
Total plant	181,681	184,180
Work in progress	27,107	11,764
Total net plant	$ 208,788	$ 195,944



Major capital asset additions during the year were as follows:

- $10.3 million for installation of new main and service extensions
- $7.0 million for main replacement

Debt Outstanding

As of June 30, 2012, the Division had $87.4 million in debt outstanding (including current portions of revenue bonds), compared to $92.7 million last year, representing a decrease of $5.3 million or 5.8 percent. The Division's weighted average cost of debt as of June 30, 2012 was 4.01 percent (the effective weighted average cost of debt is 3.76 percent, which reflects the Build America Bond rebate for a portion of the outstanding debt).

In October 2011, the Gas Division issued a $20 million line of credit. The line of credit was issued in anticipation of funding purchased gas costs during the off-peak sales months. The Division did not draw down on the line of credit during the year, due to lower than anticipated gas purchases and wholesale natural gas prices.

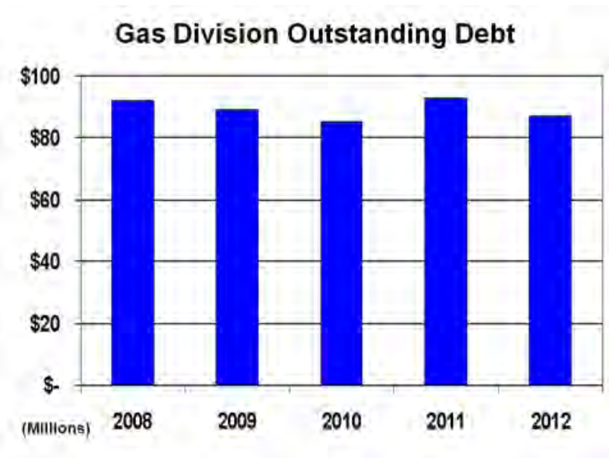
The Division sold $24.9 million in revenue refunding bonds in April 2012 for the purpose of refunding outstanding bonds at lower interest rates. The refunding will result in total debt service savings of $4.6 million over the life of the bonds (or $3.8 million on a net present value basis).

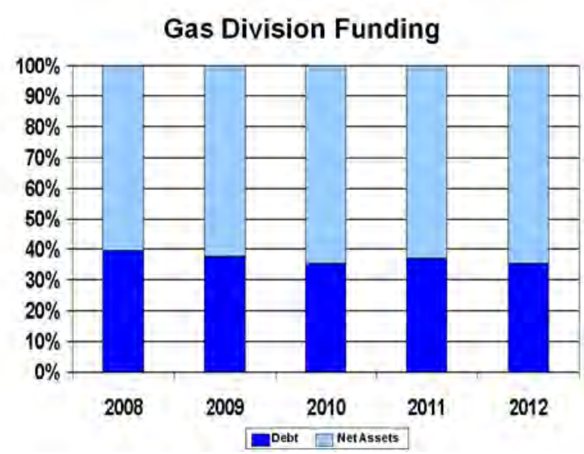
The Division's outstanding debt is rated by Standard & Poor's and Moody's Investors Service. As of June 30, 2012, the Division's revenue bonds were rated AA by Standard & Poor's and Aa2 by Moody's Investors Service.

The following is a schedule of the Division's outstanding debt as of June 30, 2012.

Outstanding Debt
As of June 30

(in thousands of dollars)	**2012**	**2011**
Revenue bonds	$ 87,360	$ 92,725
Total outstanding debt	$ 87,360	$ 92,725





Impacts on Future Financial Position

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

The Division does not anticipate a margin rate increase during fiscal year 2013.

In July 2012, the Division issued a short-term revenue anticipation note (line of credit) for $20 million for the purpose of managing seasonal cash flow during the winter heating season. The Division does anticipate a $10 million bond issue during fiscal year 2013 to help fund its Century II capital program.

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 2013.

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, 2012 and 2011. 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 Assets
June 30, 2012 and 2011

	2012	2011
Assets		
Current assets:		
Cash and cash equivalents	$ 9,721,275	$ 30,244,231
Short-term investments	3,000,000	2,000,000
Short-term contingency fund investments	5,112,602	4,650,992
Other current assets	2,146,735	2,441,215
Accrued interest receivable	12,974	8,096
Accounts receivable, less allowance of uncollectible accounts of $86,071 in 2012 and $79,107 in 2011	3,022,018	6,145,196
Inventories	347,735	382,575
Prepaid gas purchases (storage)	13,789,493	10,836,632
Prepaid expenses	53,619	60,959
Total current assets	37,206,451	56,769,896
Restricted assets:		
Gas bond fund	2,551,537	2,763,028
Other funds	1,623	23,641
Unused bond proceeds	-	3,700,165
Total restricted assets	2,553,160	6,486,834
Gas plant in service	271,310,274	266,163,277
Less accumulated depreciation	(89,629,690)	(81,983,447)
	181,680,584	184,179,830
Retirement in progress	340,492	22,831
Construction in progress	26,766,994	11,741,518
Net plant in service	208,788,070	195,944,179
Other assets:		
Long-term contingency fund investments	6,685,621	7,191,239
Deferred loss on refunding bonds	824,615	1,192,767
Under recovered purchased gas costs	2,825,163	-
Other	681,848	681,137
Total other assets	11,017,247	9,065,143
Total assets	$ 259,564,928	$ 268,266,052

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

Knoxville Utilities Board Gas Division
Statements of Net Assets
June 30, 2012 and 2011

	2012	2011
Capitalization and Liabilities		
Current liabilities:		
Current portion of revenue bonds	$ 4,515,000	$ 4,165,000
Sales tax collections payable	68,825	70,789
Accounts payable	4,198,375	7,124,630
Accrued expenses	1,995,744	2,875,953
Customer deposits plus accrued interest	3,241,641	3,051,459
Over recovered gas costs	-	1,067,074
Accrued interest on revenue bonds	1,076,437	1,374,595
Total current liabilities	15,096,022	19,729,500
Other liabilities:		
Accrued compensated absences	1,400,043	1,380,135
Customer advances for construction	368,757	230,397
Other	1,534,268	596,662
Total other liabilities	3,303,068	2,207,194
Long-term debt:		
Gas revenue bonds	82,845,000	88,560,000
Total long-term debt	82,845,000	88,560,000
Total liabilities	101,244,090	110,496,694
Net assets		
Invested in capital assets, net of related debt	120,403,561	103,651,532
Restricted for:		
Debt service	1,475,100	1,388,433
Other	1,623	23,641
Unrestricted	36,440,554	52,705,752
Total net assets	158,320,838	157,769,358
Total liabilities and net assets	$ 259,564,928	$ 268,266,052

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

Knoxville Utilities Board Gas Division
Statements of Revenues, Expenses and Changes in Net Assets
Years Ended June 30, 2012 and 2011

	2012	2011
Operating revenues	$ 86,760,687	$ 106,282,222
Operating expenses		
Purchased gas	51,006,266	63,982,133
Distribution	7,385,570	11,759,431
Customer service	2,447,805	2,568,779
Administrative and general	7,255,134	7,845,161
Provision for depreciation and amortization	8,277,943	7,907,736
Taxes and tax equivalents	6,042,429	5,986,189
Total operating expenses	82,415,147	100,049,429
Operating income	4,345,540	6,232,793
Non-operating revenues (expenses)		
Contributions in aid of construction	890,983	1,186,180
Interest and dividend income	239,596	336,259
Interest expense	(3,825,625)	(3,927,030)
Write-down of plant for costs recovered through contributions	(890,983)	(1,186,180)
Other	(208,031)	(249,128)
Total non-operating revenues (expenses)	(3,794,060)	(3,839,899)
Change in net assets	551,480	2,392,894
Net assets, beginning of year	157,769,358	155,376,464
Net assets, end of year	$ 158,320,838	$ 157,769,358

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

Knoxville Utilities Board Gas Division
Statements of Cash Flows
June 30, 2012 and 2011

	2012	2011
Cash flows from operating activities:		
Cash receipts from customers	$ 89,443,390	$ 108,595,045
Cash (receipts from) payments to other operations	1,270,540	(286,487)
Cash payments to suppliers of goods or services	(70,128,776)	(77,098,441)
Cash payments to employees for services	(9,198,452)	(11,123,786)
Payment in lieu of taxes	(5,522,954)	(5,385,367)
Net cash provided by operating activities	5,863,748	14,700,964
Cash flows from capital and related financing activities:		
Net proceeds from bond issuance	-	11,882,025
Principal paid on revenue bonds and notes payable	(4,165,000)	(4,035,000)
Decrease (increase) in unused bond proceeds	3,699,364	(3,699,364)
Interest paid on revenue bonds and notes payable	(4,123,782)	(3,642,239)
Acquisition and construction of gas plant	(22,283,643)	(11,573,265)
Changes in gas bond fund, restricted	211,490	(170,283)
Customer advances for construction	138,360	(163,225)
Proceeds received on disposal of plant	10,999	-
Cash received from developers and individuals for capital purposes	890,983	1,186,180
Net cash (used in) capital and related financing activities	(25,621,229)	(10,215,171)
Cash flows from investing activities:		
Changes in deposit and investment accounts:		
Purchase of investment securities	(1,097,464)	(3,030,222)
Maturities of investment securities	141,473	220,542
Interest received	239,596	336,259
Other property and investments	(49,080)	(310,913)
Net cash (used in) investing activities	(765,475)	(2,784,334)
Net increase (decrease) in cash and cash equivalents	(20,522,956)	1,701,459
Cash and cash equivalents, beginning of year	30,244,231	28,542,772
Cash and cash equivalents, end of year	$ 9,721,275	$ 30,244,231
Reconciliation of operating income to net cash provided by operating activities		
Operating income	$ 4,345,540	$ 6,232,793
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization expenses	8,498,122	8,145,142
Changes in operating assets and liabilities:		
Accounts receivable	3,123,181	2,420,396
Inventories	34,839	(26,811)
Prepaid expenses	(2,945,521)	619,550
Other assets	310,908	(1,226,902)
Sales tax collections payable	(1,964)	(3,131)
Accounts payable and accrued expenses	(3,786,557)	765,859
Underrecovered gas costs	(3,892,237)	(2,450,026)
Customer deposits plus accrued interest	190,181	233,477
Other liabilities	(12,744)	(9,383)
Net cash provided by operating activities	$ 5,863,748	$ 14,700,964
Noncash capital activities:		
Acquisition of plant assets through developer contributions	$ -	$ -

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

1. Description of Business

Knoxville Utilities Board (KUB), comprised of Electric Division, Water Division, Gas Division, and Wastewater Division (Divisions), is reported as a component unit enterprise fund in the financial statements of the City of Knoxville. KUB's responsibility is to oversee the purchase, production, distribution, and processing of electricity, water, gas, and wastewater services. A seven-member Board of Commissioners oversees KUB. The Board has all powers to construct, acquire, expand, or operate the Divisions. It has full control and complete jurisdiction over the management and operation of the Divisions. The Gas Division (Division) provides services to certain customers in Knox County. 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, 2012 and 2011, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

2. Significant Accounting Policies

Basis of Accounting

KUB follows the provisions of Statement No. 34 (Statement 34) of the Governmental Accounting Standards Board, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments.* Statement 34 established standards for external financial reporting for all state and local governmental entities, which includes a statement of net assets; a statement of revenues, expenses and changes in net assets; and a statement of cash flows. It requires the classification of net assets into three components – invested in capital assets, net of related debt; restricted; and unrestricted. These classifications are defined as follows:

- Invested in capital assets, net of related debt – This component of net assets 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. If there are significant unspent related debt proceeds at year end, the portion of the debt attributable to the unspent proceeds is not included in the calculation of invested in capital assets, net of related debt. Rather, that portion of the debt is included in the same net assets component as the unspent proceeds.

- Restricted – This component of net assets consists of restrictions placed on net asset use through external constraints imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or restrictions imposed by law through constitutional provisions or enabling legislation.

- Unrestricted net assets – This component of net assets consists of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt."

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 assets. Net assets (i.e., total assets net of total liabilities) are segregated into invested in capital assets, net of related debt; restricted for capital activity and debt service; and unrestricted components.

As allowed by the Governmental Accounting Standards Board (GASB) Statement No. 20*, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use* Proprietary *Fund Accounting,* KUB’s policy is to apply only those Financial Accounting Standards Board statements, related interpretations, Accounting Principles Board opinions and accounting research bulletins issued on or prior to November 30, 1989 that do not conflict with Governmental Accounting Standards.

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 assets does not include depreciation for transportation equipment of $220,179 in 2012 and $237,406 in 2011. Interest costs are expensed as incurred.

Operating Revenue

Operating revenue consists primarily of charges for services provided by the principal operations of the KUB Gas Division. Operating revenue is recorded when the service is rendered, on a cycle basis, and includes an estimate of unbilled revenue. Revenues are reported net of bad debt expense of $10,597 in 2012 and $138,442 in 2011.

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.

Purchased Gas Adjustment

In November 1990, the Division implemented a deferred Purchased Gas (Cost) Adjustment (PGA) mechanism, which allows the Division to flow changes in purchased gas costs through to its customers. These changes in gas costs are reflected as adjustments to the base gas rates established by KUB's Board of Commissioners. The rate-setting authority vested in the KUB Board by the City Charter meets the “self-regulated” provisions of SFAS No. 71, *“Accounting for the Effects of Certain Types of Regulation,”* and KUB meets the remaining criteria of SFAS No. 71.

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

Under the PGA mechanism, the Division tracks the actual over/under recovered amount in the Over/Under recovered Purchased Gas Costs accounts. These accounts are rolled into the PGA rate adjustment on June 30 of each year thereby assuring that any (under)/over recovered amounts are passed on to the Division's customers. The amount of (under)/over recovered cost was ($2,825,163) at June 30, 2012 and $1,067,074 at June 30, 2011.

Contributions in Aid of Construction

Contributions in aid of construction are cash collections from customers or others for a particular purpose, generally the construction of new facilities to serve new customers in excess of the investment KUB is willing to make for a particular incremental revenue source. KUB reduces the plant account balances to which contributions relate by the actual amount of the contribution and recognizes the contributions as non operating revenue in accordance with FAS 71, *"Accounting for the Effects of Certain Types of Regulation"*.

Estimates

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

Inventories

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

Pension Plan

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

Investments

Investments are carried at fair values 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-insured health plan administered by a third party.

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.

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.

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 18, 2012, the date these financial statements were issued, for items that should potentially be recognized or disclosed.

Reclassifications
Certain reclassifications have been made to the 2011 balances to conform to the 2012 presentation.

3. Deposits and Investments

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

Information related to the carrying value and bank balances of deposits (except as noted below) and the carrying value and fair value of investments at June 30, 2012, is as follows:

	Carrying Value	Bank Balance
Deposits		
Deposits in financial institutions	$ 9,722,897	$ 13,066,900
Investments		
Certificates of Deposits	9,807,828	9,807,828
State Treasurer's Investment Pool	-	-
Agency Bonds	7,499,532	7,499,532
	$ 27,030,257	$ 30,374,260

Classification of deposits and investments:

Depository Account		**Bank Balance**
Insured	$	60,250
Collateralized:		
Collateral held by pledging bank's trust department in KUB's name		7,499,532
Collateral held by pledging bank's trust department not in KUB's name*		22,814,478
Total deposits and investments	$	30,374,260

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

Classification of deposits and investments per statement of net assets:

		2012
Current assets		
Cash and cash equivalents	$	9,721,275
Short-term investments		3,000,000
Short-term contingency fund investments		5,112,602
Other assets		
Long-term contingency fund investments		6,643,220
Restricted assets		
Gas bond fund		2,551,537
Other funds		1,623
	$	27,030,257

The above amounts do not include accrued interest of $42,401

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

	Deposit and Investment Maturities (in Years)					
		Fair Value		**Less Than 1**		**1-5**
Supersweep NOW and Other Deposits	$	13,066,900	$	13,066,900	$	-
State Treasurer's Investment Pool		-		-		-
Agency Bonds		7,499,532		1,403,431		6,096,101
Certificates of deposits		9,807,828		9,260,708		547,120
	$	30,374,260	$	23,731,039	$	6,643,221

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

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

4. Accounts Receivable

Accounts receivable consists of the following:

	2012	2011
Wholesale and retail customers		
Billed services	$ 1,728,934	$ 4,478,594
Unbilled services	897,698	1,064,477
Other	481,457	681,232
Allowance for uncollectible accounts	(86,071)	(79,107)
	$ 3,022,018	$ 6,145,196

5. Accounts Payable and Accruals

Accounts payable and accruals were composed of the following:

	2012	2011
Trade accounts	$ 4,198,375	$ 7,124,630
Salaries and wages	90,806	31,642
Self-insurance liabilities	368,673	456,808
Other current liabilities	1,536,265	2,387,503
	$ 6,194,119	$ 10,000,583

6. Long-Term Obligations

Long-term debt consists of the following:

	Balance June 30, 2011	Additions	Payments	Balance June 30, 2012	Amounts Due Within One Year
K-2004 - 2.0 - 4.75%	$ 26,160,000	$ -	$ 26,160,000	$ -	$ -
L-2005 - 3.0 - 4.75%	13,245,000	-	600,000	12,645,000	620,000
M-2006 - 4.0 - 5.0%	19,025,000	-	3,400,000	15,625,000	3,550,000
N-2007 - 4.0 - 5.0%	12,000,000	-	-	12,000,000	-
O-2010 - 2.0 - 3.0%	10,295,000	-	125,000	10,170,000	120,000
P-2010 - 3.3 - 6.2%	12,000,000	-	-	12,000,000	-
Q-2012 - 2.0 - 4.0%	-	24,920,000	-	24,920,000	225,000
Total debt	$ 92,725,000	$ 24,920,000	$ 30,285,000	$ 87,360,000	$ 4,515,000

Other liabilities consist of the following:

	Balance June 30, 2011	Increase	Decrease	Balance June 30, 2012	Amounts Due Within One Year
Accrued compensated absences	$ 1,380,135	$ 2,437,372	$ (2,417,464)	$ 1,400,043	$ 350,000
Customer advances for construction	230,397	231,089	(92,729)	368,757	50,000
Other	596,662	1,696,485	(758,879)	1,534,268	100,000
	$ 2,207,194	$ 4,364,946	$ (3,269,072)	$ 3,303,068	$ 500,000

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

Fiscal Year	Total Principal	Total Interest	Grand Total
2013	$ 4,515,000	$ 3,461,257	$ 7,976,257
2014	4,535,000	3,368,030	7,903,030
2015	4,700,000	3,228,955	7,928,955
2016	4,870,000	3,116,667	7,986,667
2017	4,455,000	2,965,405	7,420,405
2018 - 2022	25,155,000	12,147,404	37,302,404
2023 - 2027	24,655,000	6,636,074	31,291,074
2028 - 2032	14,475,000	1,902,235	16,377,235
Total	$ 87,360,000	$ 36,826,027	$ 124,186,027

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, 2012, these bond covenant requirements had been satisfied.

During fiscal year 2004, KUB's Gas Division issued Series K 2004 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 H 1998 bonds, as such amounts mature. During fiscal year 2012, Series K 2004 was defeased with the issuance of Series Q 2012.

During fiscal year 2006, KUB's Gas Division issued Series L 2005 bonds to retire certain existing debt and fund gas system capital improvements. Concurrent with the issuance of these bonds, KUB transferred funds to an irrevocable trust to pay a portion of the Series J 2001 bonds, as such amounts mature. KUB's Gas Division also issued Series M 2006 bonds in part to retire certain existing debt and to fund gas system capital improvements. Concurrent with the issuance of these bonds, KUB transferred funds to an irrevocable trust to pay the remaining maturities of principal and interest on the Series H 1998 revenue bonds.

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

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

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

During fiscal year 2012, KUB's Gas Division issued Series Q 2012 bonds to retire Series K 2004 bonds.

The outstanding principal balances on defeased bond issues were $76.1 million at June 30, 2012.

7. Lease Commitments

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

2013	$	4,470
2014		3,971
2015		5,063
2016		1,314
Total operating minimum lease payments	$	14,818

8. Capital Assets

Capital assets activity for the year ended June 30, 2012, was as follows:

	Beginning 6/30/2011	Increase	Decrease	Ending 6/30/2012
Production Plant	$ 14,640	$ -	$ -	$ 14,640
Distribution Plant				
Mains	173,503,507	1,535,197	(13,030)	175,025,674
Services and Meters/Regulators	71,700,193	1,944,948	(33,928)	73,611,213
Other Accounts	1,331,179	30,146	(5,000)	1,356,325
Total Distribution Plant	$ 246,534,879	$ 3,510,291	$ (51,958)	$ 249,993,212
Total General Plant	19,613,758	2,531,136	(842,472)	21,302,422
Total Plant Assets	$ 266,163,277	$ 6,041,427	$ (894,430)	$ 271,310,274
Less Accumulated Depreciation	(81,983,447)	(8,465,421)	819,178	(89,629,690)
Net Plant Assets	$ 184,179,830	$ (2,423,994)	$ (75,252)	$ 181,680,584
Work In Progress	11,764,349	21,031,676	(5,688,539)	27,107,486
Total Net Plant	$ 195,944,179	$ 18,607,682	$ (5,763,791)	$ 208,788,070

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 Assets. The liability is KUB's best estimate based on available information. At June 30, 2012, the amount of these liabilities was $368,673 resulting from the following changes:

	2012	2011
Balance, beginning of year	$ 456,808	$ 455,245
Current year claims and changes in estimates	2,623,245	3,038,713
Claims payments	(2,711,380)	(3,037,150)
Balance, end of year	$ 368,673	$ 456,808

10. Pension Plan

Description of Plan

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

At December 31, 2011, the Plan had approximately 652 retirees and beneficiaries currently receiving benefits and 56 terminated employees entitled to benefits but not yet receiving them. Of the approximately 873 current employees in the Plan, 730 were fully vested at December 31, 2011. The Plan issues a financial report, which includes financial statements and required supplementary information. The report may be obtained by writing the Knoxville Utilities Board Pension Division, P.O. Box 59017, Knoxville, TN 37950-9017.

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

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

Career Equity Program (CEP)

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

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

Plan A

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

All employees participating in the City Division Plan A as of June 30, 1999, were eligible to participate in KUB's Plan A or the CEP program. Participants of Plan A are covered by Social Security. Plan A is a closed plan and is not available to KUB employees hired after July 1, 1999. Participation in Plan A requires employee contributions of 3 percent of the first $4,800 of annual earnings and 4 percent of annual earnings in excess of $4,800. Plan A provides for early retirement benefits with 25 years of service and normal retirement benefits at age 62 or older.

Plan B

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

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

Funding Policy

For the Plan year ended December 31, 2011, a contribution of $3,593,282 is required to be made in the Plan sponsor's fiscal year ending June 30, 2013. The Gas Division's portion of this contribution is $682,724. The annual required contribution was determined as part of the January 1, 2011 valuation using the Individual Entry Age Normal funding method. The objective under this method is to fund each participant's benefits under the Plan as payments which are level as a percentage of salary, starting on the original participation date (employment date) and continuing until the assumed retirement, termination, disability or death. For the Plan year ended December 31, 2011, the Plan's actuarial funded ratio was 104.5 percent.

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

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

As of the actuarial report for the Plan year ended December 31, 2011, contributions of $3,593,282 and $3,244,057 for 2011 and 2010, respectively, are required to be made during the Plan sponsor's fiscal years ending June 30, 2013 and 2012, respectively. Of these amounts, $682,724 and $682,252 are attributable to the Gas Division.

Subsequent to June 30, 2012, the actuarial report for the Plan year ending December 31, 2012 was completed.

For the Plan year ending December 31, 2012, a contribution of $5,502,677 is required to be made in the Plan sponsor's fiscal year ending June 30, 2014. The Gas Division's portion of this contribution is $1,045,509. For the Plan year ending December 31, 2012, the Plan's actuarial funded ratio was 94.1 percent.

11. Defined Contribution Plan

KUB has a defined contribution 401(k) employee retirement savings plan covering eligible KUB employees. Employees hired prior to January 1, 2011 may participate and receive a matching contribution of 50 percent of their own contribution up to a maximum match of 3 percent. Employees hired on or after January 1, 2011 have an enhanced 401(k) Plan due to the closure of the Defined Benefit Pension Plan. They may participate and receive a matching contribution of 50 percent of their own contribution up to a maximum match of 3 percent. They also receive a nonelective KUB contribution of from 3 percent to 6 percent, depending on years of service, whether they contribute or not.

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

12. Other Post-Employment Benefits (OPEB)

The Governmental Accounting Standards Board (GASB) established new standards for the measurement, recognition, and reporting of other post-employment benefits (OPEB). OPEB includes post-employment benefits other than pension, which, for KUB, is presently limited to post-employment health care. GASB 45 requires the recognition of the accrued OPEB liability for the respective year, plus the disclosure of the total unfunded liability. GASB 45 was effective for KUB for the fiscal year beginning July 1, 2007.

KUB currently provides post-employment health care benefits to 633 former employees and 647 covered dependents. The cost of coverage is shared with retirees and beneficiaries. KUB recognizes its share of the cost of post-employment health care benefits as an expense as claims are paid.

In anticipation of GASB 45, KUB amended its Group Health Plan in 1999, eliminating post-employment health care benefits for all employees hired on or after July 1, 1999. As of June 30, 2012, 450 active employees were eligible for individual and dependent coverage at separation if the employee meets the Rule of 80 (age plus years of service) with a minimum of 20 years of service.

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 GASB 45 does not require pre-funding of the liability, KUB has determined that it is in the long-term economic interest of KUB and its ratepayers to establish a Trust to pre-fund KUB's OPEB liability.

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

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

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

Total contributions to the OPEB Trust for the fiscal year ended June 30, 2012 were $8.1 million (Division's share $1.7 million). The contribution to the Trust exceeded the annual required contribution (ARC), as determined by the Postretirement Benefit Plan's actuarial valuation for the year ended December 31, 2010, which was $4.6 million (Division's share $1 million). As of June 30, 2012, the employer's net OPEB obligation was $1.7 million (Division's share $0.4 million).

The ARC for the fiscal year ending June 30, 2013, as determined by the Plan's actuarial valuation for the year ended December 31, 2011 is $3.3 million (Division's share $0.6 million).

The actuarial valuation for the Plan for the year ending December 31, 2012 has been completed. The valuation determined that the Plan's actuarial accrued liability was $61.6 million (Division's share $11.7 million). The actuarial value of the Plan's assets was $37.9 million (Division's share $7.2 million). As a result, the Plan's unfunded actuarial accrued liability was $23.7 million (Division's share $4.5 million). The Plan's actuarial funded ratio was 62 percent. The valuation also determined that the employer's ARC is $3.3 million for the fiscal year ending June 30, 2014 (Division's share $0.6 million).

13. Related Party Transactions

The Division, in the normal course of operations, is involved in transactions with the City of Knoxville and with other systems of KUB. Such transactions for the years ended June 30, 2012 and 2011 are summarized as follows:

	2012	2011
City of Knoxville		
Amounts billed by the Division for utilities and related services	$ 440,968	$ 596,295
Payments by the Division in lieu of property tax	2,980,679	2,866,580
Payments by the Division for services provided	139,257	124,021
Other divisions of KUB		
Amounts billed to other divisions for utilities and related services provided	1,234,140	661,188
Interdivisional rental expense	464,288	544,369
Amounts billed to the Division by other divisions for utilities services provided	272,278	266,898

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

	2012	2011
Accounts receivable	$ 9,969	$ 19,289

14. Natural Gas Supply Contract Commitments

For fiscal year 2012 the Gas Division hedged 67 percent of its total gas purchases via gas supply contracts. As of June 30, 2012, the Gas Division had hedged the price on approximately 10 percent of its anticipated gas purchases for fiscal year 2013.

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

	2013	2014	2015	2016	2017
Transportation					
Tennessee Gas Pipeline	$ 7,325,892	$ 9,211,524	$ 9,211,524	$ 3,070,508	$ -
East Tennessee Natural Gas	10,066,388	10,066,388	10,066,388	3,355,463	-
Storage					
Tennessee Gas Pipeline	2,076,288	2,076,288	2,076,288	692,096	-
East Tennessee Natural Gas	757,460	757,460	757,460	252,487	-
Saltville Natural Gas	1,545,960	981,900	981,900	981,900	981,900
Demand Total	$ 21,771,988	$ 23,093,560	$ 23,093,560	$ 8,352,454	$ 981,900

Firm obligations related to purchased gas - commodity

	2013	2014	2015	2016	2017
Baseload					
Conoco	$ 1,251,400	$ -	$ -	$ -	$ -
Equitable	-	-	-	-	-
Shell Energy	2,423,970				
CNX	2,286,518	2,286,518	-	-	-
Commodity Total	$ 5,961,888	$ 2,286,518	$ -	$ -	$ -

The total commodity values presented here are based upon firm supply obligations with each individual natural gas supplier. The firm obligations value for Conoco, and Shell Energy are based upon firm supply obligations at locked prices with those suppliers. The firm obligations value for the CNX contract is based upon firm supply obligations and the applicable four month NYMEX strip prices on July 31, 2012.

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 Supplementary Information – Schedule of Funding Progress
June 30, 2012

Pension Plan

Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (b)	Unfunded Actuarial Accrued Liability (UAAL) (b-a)	Funded Ratio (a)/(b)	Annual Covered Payroll (c)	UAAL as a Percentage of Covered Payroll [(b)-(a)]/(c)
January 1, 2009	$183,447,296	$ 194,366,597	$ 10,919,301	94.4%	$ 49,602,223	22.01%
January 1, 2010	203,704,898	190,679,453	(13,025,445)	106.8%	48,228,428	(27.01%)
January 1, 2011	195,692,781	187,257,434	(8,435,347)	104.5%	47,405,874	(17.79%)
January 1, 2012	183,980,665	195,536,152	11,555,487	94.1%	48,836,721	23.66%

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%

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); $5,000,000 deductible per occurrence.

Travel Accident
Covers losses related to employees' business travel. Limits of coverage - $1,375,000 aggregate.

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

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

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

Knoxville Utilities Board Gas Division
Supplemental Information - Schedule of Debt Maturities by Fiscal Year
June 30, 2012

Schedule 2

Continued on Next Page

	L-2005		M-2006		N-2007		O-2010		P-2010		
FY	**Principal**	**Interest**	**Principal**	**Interest**	**Principal**	**Interest**	**Principal**	**Interest**	**Principal**	**Interest**	**Rebate***
12-13	620,000	559,703	3,550,000	707,531		541,706	120,000	270,400		645,843	226,045
13-14	645,000	534,903		530,031		541,706	3,225,000	268,000		645,843	226,045
14-15	665,000	505,878		530,031		541,706	3,350,000	171,250		645,843	226,045
15-16	695,000	474,290		530,031		541,706	3,475,000	104,250		645,843	226,045
16-17	725,000	441,278	575,000	530,031	550,000	541,706			540,000	645,843	226,045
17-18	760,000	406,840	600,000	507,031	575,000	514,206			570,000	628,023	219,808
18-19	795,000	372,640	625,000	481,531	625,000	491,206			595,000	606,363	212,227
19-20	830,000	336,865	650,000	454,969	650,000	465,425			620,000	581,075	203,376
20-21	865,000	299,515	700,000	427,344	675,000	437,800			645,000	553,175	193,611
21-22	910,000	260,590	725,000	396,719	700,000	408,269			670,000	521,731	182,606
22-23	945,000	223,053	750,000	365,000	750,000	377,469			695,000	488,231	170,881
23-24	980,000	182,890	775,000	332,188	775,000	343,719			725,000	453,481	158,718
24-25	1,025,000	141,240	825,000	298,281	825,000	308,844			750,000	413,606	144,762
25-26	1,065,000	96,140	850,000	262,188	875,000	271,719			785,000	372,358	130,325
26-27	1,120,000	49,280	900,000	225,000	900,000	231,250			815,000	328,200	114,870
27-28			950,000	184,500	1,000,000	189,625			845,000	279,300	97,755
28-29			1,000,000	141,750	1,000,000	143,375			880,000	228,600	80,010
29-30			1,050,000	96,750	1,000,000	97,125			915,000	175,800	61,530
30-31			1,100,000	49,500	1,100,000	50,875			950,000	120,900	42,315
31-32									1,000,000	62,000	21,700
Total	$ 12,645,000	$ 4,885,105	$ 15,625,000	$ 7,050,406	$ 12,000,000	$ 7,039,437	$ 10,170,000	$ 813,900	$ 12,000,000	$ 9,042,058	$ 3,164,719

*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. The rebate payments will total $3,442,880 over the life of the bonds. The net cost of issuing the bonds is $6,393,919.

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, 2012

Schedule 2

Continued from Previous Page

	Q-2012		Totals		Grand Total	Grand Total
FY	Principal	Interest	Principal	Interest	(P + I)	(Less Rebate)
12-13	225,000	736,074	4,515,000	3,461,257	7,976,257	7,750,212
13-14	665,000	847,548	4,535,000	3,368,031	7,903,031	7,676,986
14-15	685,000	834,248	4,700,000	3,228,956	7,928,956	7,702,911
15-16	700,000	820,548	4,870,000	3,116,668	7,986,668	7,760,623
16-17	2,065,000	806,548	4,455,000	2,965,406	7,420,406	7,194,361
17-18	2,125,000	744,598	4,630,000	2,800,698	7,430,698	7,210,890
18-19	2,190,000	680,848	4,830,000	2,632,588	7,462,588	7,250,361
19-20	2,260,000	615,148	5,010,000	2,453,482	7,463,482	7,260,106
20-21	2,350,000	524,756	5,235,000	2,242,584	7,477,590	7,283,970
21-22	2,445,000	430,748	5,450,000	2,018,057	7,468,057	7,285,451
22-23	2,540,000	332,948	5,680,000	1,786,701	7,466,701	7,295,820
23-24	2,645,000	231,348	5,900,000	1,543,626	7,443,626	7,284,908
24-25	760,000	125,548	4,185,000	1,287,519	5,472,519	5,327,757
25-26	780,000	102,748	4,355,000	1,105,153	5,460,153	5,329,828
26-27	800,000	79,348	4,535,000	913,078	5,448,078	5,333,208
27-28	830,000	54,348	3,625,000	707,773	4,332,773	4,235,018
28-29	855,000	27,788	3,735,000	541,513	4,276,513	4,196,503
29-30			2,965,000	369,675	3,334,675	3,273,145
30-31			3,150,000	221,275	3,371,275	3,328,960
31-32			1,000,000	62,000	1,062,000	1,040,300
Total	$ 24,920,000	$ 7,995,140	$ 87,360,000	$ 36,826,040	$ 124,186,046	$ 121,021,318

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Gas Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2012
(Unaudited)

Schedule 3

Rate Class	Base Charge	Number of Customers
Residential (G-2)	For the regular monthly billing period for the months of November to April, inclusive: Customer charge per month $5.30 First 30 therms per month at 111.62 cents per therm Excess over 30 therms per month at 90.40 cents per therm For the regular monthly billing periods for the months of May to October, inclusive: First 50 therms per month 93.75 cents per therm Excess over 50 therms per month at 81.89 cents per therm	88,404
Commercial (G-4)	Available to any commercial or industrial customer: Customer charge per month $5.30 First 250 therms per month at 99.09 cents per therm Excess over 250 therms per month at 88.22 cents per therm	8,921
Commercial (G-6)	Available to any commercial or industrial customer incurring a demand of 27 therms or more during the current monthly billing period or during any of the eleven net preceding monthly billing periods. The net rate is the sum of the following demand and commodity charges: Customer charge: $105.00 per month Demand charge: $1.70 per therm of demand Commodity charge: First 30,000 therms per month at 62.47 cents per therm Excess over 30,000 therms per month at 53.94 cents per therm	300
Industrial (G-7)	Service under Rate Schedule G-7 shall be available to any customer who meets the following conditions: (a) Customer's annual Interruptible Gas use, on an actual or projected basis, shall not be less than 25,000 dekatherms; (b) Customer shall be permitted to purchase only one (1) dekatherm of Firm Gas under Rate Schedule G-7 for each two (2) dekatherms of Interruptible Gas which are purchased; (c) Customer must have standby equipment of sufficient capacity capable of providing the customer's normal gas service requirements for a period of five (5) working days without replenishment when Interruptible Gas is completely interrupted. Customer shall maintain such equipment ready for operation at any time and shall utilize a fuel other than gas furnished by KUB and shall be subject to periodic inspections by KUB to ensure compliance with this provision; and (d) KUB must determine that its existing distribution system facilities are adequate and available for the requested service.	19

See accompanying Report of Independent Auditors on Supplemental Information.

Rate Class	Base Charge		Number of Customers
	The net rate is the sum of the following demand and commodity charges:		
	Customer charge:	$180 per month	
	Demand charge:	$17.00 per month per dekatherm of demand	
	Commodity charge:	(a) Firm Gas - $5.394 per dekatherm	
		(b) Interruptible Gas - (i) First 3,000 dekatherms per month at $4.669 per dekatherm; excess of 3,000 to 20,000 dekatherms per month at $4.182 per dekatherm; plus excess over 20,000 to 50,000 dekatherms per month at $3.606 per dekatherm; excess over 50,000 dekatherms per month at $3.500 per dekatherm	
		(c) Supplemental Gas - The Commodity Charge for Supplemental Gas shall be the total of: (a) the cost per dekatherm to KUB for the applicable Day of acquiring Supplemental Gas on the open market, subject to the approval of the Customer to purchase Supplemental Gas at or above such price and (b) the costs incurred by KUB in transporting such Supplemental Gas via connecting pipelines to one or more of KUB's delivery points.	
	Transportation charge:	$1.599 per dekatherm for the first 3,000 dekatherms of gas Redelivered plus Unauthorized Gas; plus $1.112 per dekatherm for each dekatherm from 3,000 to and including 20,000 dekatherms of gas Redelivered plus Unauthorized Gas; plus $.536 per dekatherm for each dekatherm from 20,000 to and including 50,000 dekatherms of gas Redelivered plus Unauthorized Gas; plus $.430 per dekatherm for the excess over 50,000 dekatherms of gas Redelivered plus Unauthorized Gas.	
	Unauthorized Gas charge:	$15.00 per dekatherm of Unauthorized Gas as a penalty, plus the total of: (a) the cost per dekatherm of obtaining such gas on the open market as determined by the higher of (1) the applicable Gulf Coast Price Index for the applicable Day as published in *Gas Daily* or, if *Gas Daily* is no longer published, in a comparable reliable source for natural gas prices or (2) the applicable first of the month Gulf Coast Price Index as published in *Inside FERC*, or if *Inside FERC* is no longer published, in a comparable reliable source for natural gas prices and (b) the costs incurred by KUB in transporting such Unauthorized Gas via connecting pipelines to one or more of KUB's delivery points.	

See accompanying Report of Independent Auditors on Supplemental Information.

Rate Class	Base Charge	Number of Customers
G-11	Service under Rate Schedule G-11 shall be available to any customer who meets the following conditions:	10

(a) Customer's annual gas usage (excluding Firm Gas), on an actual or projected basis, shall not be less than 25,000 dekatherms;

(b) Customer shall be permitted to purchase only one (1) dekatherm of Firm Gas under Rate Schedule G-11 for each two (2) dekatherms of Transport Gas delivered by KUB to the Customer;

(c) Customer must have standby equipment of sufficient capacity capable of providing the customer's normal gas service requirements for a period of five (5) working days without replenishment when Transport Gas is completely interrupted. Customer shall maintain such equipment ready for operation at any time and shall utilize a fuel other than gas furnished by KUB and shall be subject to periodic inspections by KUB to ensure compliance with this provision;

(d) Customer's use under this rate shall not work a hardship on any other customers of KUB, nor adversely affect any other class of KUB's customers and further provided the Customer's use under this rate shall not adversely affect KUB's gas purchase plans and/or effective utilization of the daily demands under KUB's gas purchase contracts with its suppliers, as solely determined by KUB.

(e) KUB must determine that its existing distribution system facilities are adequate and available for the requested service; and

(f) Customer must execute a Transportation Service Agreement for interruptible transportation gas service.

The net rate is the sum of the following charges:

Customer charge:	$265.00
Demand charge:	$17.00 per dekatherm of demand
Firm Gas charge:	$5.394 per dekatherm
Transportation charge:	$1.599 per dekatherm for the first 3,000 dekatherms of non-Firm gas delivered to Customer; plus $1.112 per dekatherm for each dekatherm from 3,000 to and including 20,000 dekatherms of non-Firm gas delivered to Customer; plus $.536 per dekatherm for each dekatherm from 20,000 to and including 50,000 dekatherms of non-Firm gas delivered to Customer; plus $.430 per dekatherm for the excess over 50,000 dekatherms of non-Firm gas delivered to Customer.
Standby Gas charge:	The charge for Standby Gas shall be the total of: (a) the cost per dekatherm to KUB for the applicable Day of acquiring Standby Gas on the open market, subject to the approval of the Customer to purchase Standby Gas at or above such price and (b) the costs incurred by KUB in transporting such Standby Gas via connecting pipelines to one or more of KUB's delivery points.

Rate Class	Base Charge		Number of Customers
	Unauthorized Gas charge:	$15.00 per dekatherm of Unauthorized Gas as a penalty, plus the total of: (a) the cost per dekatherm of obtaining such gas on the open market as determined by the higher of (1) the applicable Gulf Coast Price Index for the applicable Day as published in *Gas Daily* or, if *Gas Daily* is no longer published, in a comparable reliable source for natural gas prices or (2) the applicable first of the month Gulf Coast Price Index as published in *Inside FERC* , or if *Inside FERC* is no longer published, in a comparable reliable source for natural gas prices and (b) the costs incurred by KUB in transporting such Unauthorized Gas via connecting pipelines to one or more of KUB's delivery points.	
	Other charges:	Imbalance Charges, and any pipeline scheduling, balancing, transportation, or other similar charges incurred by KUB in connection with the transportation of gas on behalf of the Customer, as applicable.	
G-12	Service under Rate Schedule G-12 shall be available to any customer when the following conditions are met:		4

(a) Customer's annual gas usage, on an actual or projected basis, shall not be less than 12,500 dekatherms;
(b) KUB must determine that its existing distribution system facilities are adequate and available for the requested service;
(c) Customer must execute a Transportation Service Agreement for firm transportation gas service; and
(d) Customer's use under this rate shall not work a hardship on any other customers of KUB, nor adversely affect any other class of KUB's customers and further provided the Customer's use under this rate shall not adversely affect KUB's gas purchase plans and/or effective utilization of the daily demands under KUB's gas purchase contracts with its suppliers, as solely determined by KUB.

The net rate is the sum of the following charges:

Customer charge:	$265.00
Demand charge:	$5.70 per dekatherm of demand
Transportation charge:	$1.808 per dekatherm for the first 3,000 dekatherms of gas delivered to Customer; plus $1.292 per dekatherm for each dekatherm from 3,000 to and including 10,000 dekatherms of gas delivered to Customer; plus $1.072 per dekatherm for each dekatherm from 10,000 to an including 20,000 dekatherms of gas delivered to Customer; plus $.717 per dekatherm for the excess over 20,000 dekatherms of gas delivered to Customer.

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

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Report on Internal Control Over Financial Reporting and On Compliance And Other Matters Based On An Audit Of Financial Statements Performed In Accordance With *Government Auditing Standards*

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

We have audited the financial statements of the Knoxville Utilities Board, (an independent agency and reported as a component unit for financial purposes only by the City of Knoxville), Gas Division, as of and for the year ended June 30, 2012, which collectively comprise the Knoxville Utilities Board's basic financial statements and have issued our report thereon dated October 18, 2012. 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.

Internal Control Over Financial Reporting

Management of the Knoxville Utilities Board is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered Knoxville Utilities Board's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Knoxville Utilities Board's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Knoxville Utilities Board's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Knoxville Utilities Board's financial statements are free of 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*.

This report is intended solely for the information and use of the Knoxville Utilities Board's audit committee, board of commissioners, and others within the entity, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Rodefer Moss & Co, PLLC

Knoxville, Tennessee
October 18, 2012

Knoxville Utilities Board
Water Division
Financial Statements and Supplemental Information
June 30, 2012 and 2011

Knoxville Utilities Board Water Division
Index
June 30, 2012 and 2011

Page(s)

Independent Auditors' Report 1-2

Management's Discussion and Analysis 3-18

Financial Statements

Statements of Net Assets 19-20

Statements of Revenues, Expenses and Changes in Net Assets 21

Statements of Cash Flows 22

Notes to Financial Statements 23-36

Required Supplementary Information – Schedule of Funding Progress 37

Supplemental Information

Schedule 1 – Schedule of Insurance in Force 38

Schedule 2 – Schedule of Debt Maturities by Fiscal Year 39-40

Schedule 3 – Schedule of Current Rates in Force 41-42

Schedule 4 – Schedule of Unaccounted for Water 43

Schedule 5 – Schedule of Expenditures of Federal Awards 44

Schedule 6 – Schedule of Findings and Questioned Costs 45

Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards* 46-47

Report of Independent Auditors Report on Compliance with Requirements that could have a Direct Material Effect on each Major Program and on Internal Control over Compliance in Accordance with *OMB Circular A-133* 48-49

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Independent Auditors' Report

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

We have audited the accompanying consolidated financial statements of the Knoxville Utilities Board, Water Division, an independent agency and reported as a component unit for financial reporting purposes only by the City of Knoxville, Tennessee, as of and for the years ended June 30, 2012 and 2011. These financial statements are the responsibility of Knoxville Utilities Board's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Knoxville Utilities Board, Water Division, as of June 30, 2012 and 2011, and the respective changes in financial position, and cash flows, for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 18, 2012, on our consideration of the Knoxville Utilities Board'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* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 18 and Schedule of Funding Progress on page 37 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Knoxville Utilities Board's financial statements as a whole. The supplemental schedules on pages 38 through 43 are presented for the purpose of additional analysis and are not a required part of the financial statements. The accompanying schedule of expenditures of federal awards on page 44 is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local*

Governments, and Non-Profit Organizations, and is also not a required part of the financial statements. The schedule of expenditures of federal awards is the responsibility of management and was derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole. The supplemental schedules have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on them.

In accordance with *Government Auditing Standards*, the report on our consideration of the Board's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters dated October 18, 2012, has been reissued due to the omission of two federal program contracts on the schedule of expenditures of federal, state and other awards. Since program CFDA 97.036 was considered major, additional audit procedures were performed. The changes to the previously issued report dated October 18, 2012 encompasses the addition of program CFDA 97.036 contract number 34101-0000009205 and contract number 34101-0000009832 to the schedule of expenditures of federal, state and other awards and to the schedule of findings and questioned costs.

Rodefer Moss & Co, PLLC

Knoxville, Tennessee
October 18, 2012
(Except as noted in the last paragraph above,
as to which the date is October 22, 2013)

Knoxville Utilities Board (KUB), comprised of the Electric Division, Water Division, Gas Division, and Wastewater Division (Divisions), is reported as a component unit enterprise fund in the financial statements of the City of Knoxville. KUB's responsibility is to oversee the purchase, production, distribution, and processing of electricity, water, natural gas, and wastewater services. A seven-member Board of Commissioners governs KUB. The Board has all powers to construct, acquire, expand, or operate the Divisions. It has full control and complete jurisdiction over the management and operation of the Divisions. The Water Division (Division) provides services to certain customers in Knox County and in two surrounding counties in East Tennessee. The Division's accounts are maintained in conformity with the Uniform System of Accounts of the National Association of Regulatory Utility Commissioners (NARUC) and the Governmental Accounting Standards Board (GASB), as applicable. The financial statements present only the Water Division and do not purport to, and do not, present fairly the consolidated financial position of Knoxville Utilities Board at June 30, 2012 and 2011, 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, 2012 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 78,000 water system customers over a 187 square mile service area. KUB maintains 1,325 miles of service mains, 30 storage facilities, 28 booster pump stations, and 1 treatment plant, which provided 12.2 billion gallons of water to KUB's water customers in fiscal year 2012. Peak day capacity is 61.2 MGD (millions of gallons per day). The average daily flow for fiscal year 2012 was 33.5 million gallons.

Financial Highlights

The Division's net assets increased $4.7 million or 3.3 percent, compared to a $3.7 million increase last fiscal year.

Operating revenue increased $1.1 million or 2.9 percent, the net result of a half year of revenue from a five percent rate increase, which was effective January 2012, and a 0.8 percent decrease in water sales volumes.

Operating expenses increased $0.3 million or 1 percent. Operating and maintenance expenses ("O&M") were consistent with the prior year. Depreciation expense increased $0.2 million or 4.1 percent. Taxes and tax equivalents were $0.1 million higher than the prior year.

Higher levels of investments, due to proceeds from a $25 million bond issue in December 2011, combined with lower interest rates, resulted in a modest decline in interest income. Interest expense increased $0.4 million, reflecting interest cost on the bonds issued in December 2011.

Capital contributions increased $0.6 million, the result of growth in contributed assets from developers due to new construction in the service area.

Total plant assets (net) increased $9.9 million or 5 percent over the end of the last fiscal year.

Long-term debt represented 41.6 percent of the Division's capital structure as of June 30, 2012, as compared to 36.8 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 assets.

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 2.56. Maximum debt service coverage was 2.13.

Division Highlights

KUB added approximately 400 customers to its water system during the fiscal year. System growth over the last three years has been limited in large part due to the economic recession.

The Board of Commissions adopted a five percent rate increase, effective on January 1, 2012 customer bills, to help fund the Century II water program. The Division generated $1 million of additional revenue during the fiscal year as a result of the rate increase.

In December 2011, the Division issued $25 million in water system revenue bonds to fund capital system improvements.

The Division refunded $10.7 million in outstanding water system revenue bonds at lower interest rates in April 2012. This refunding will provide debt service savings of $1.3 million over the life of the bonds.

The typical residential water customer's average monthly bill was $17.45 for the twelve months ending June 30, 2012.

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 0.5 percent over the past decade.

Lost and unaccounted for water represented 29.2 percent of total water treated and purchased by KUB for fiscal year 2012. The lost and unaccounted for calculation is reflected on Schedule 4 of Supplemental Information. For fiscal year 2011, the lost and unaccounted for ratio was 30.2 percent.

Century II Infrastructure Program

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

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

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

The comprehensive infrastructure assessment presented to the Board in April 2011 set forth a plan that would remove all galvanized water main from the water distribution system by 2020.

Ten years of Century II water funding will remove all remaining galvanized water main. It will also remove approximately 50 miles of cast iron pipe by the end of ten years. As a result, the water system loss ratio will experience a significant reduction from its current level of 30 percent. At the end of ten years, the water system will look dramatically different with approximately two-thirds of the system consisting of newer pipe.

In September 2011, the Board adopted a resolution which endorsed the Century II water program and the ten-year funding plan. The resolution also adopted the initial three water rate increases, the first of which was effective January 1, 2012. The remaining two will be effective January 1, 2013 and January 1, 2014, respectively. Each of the rate increases will generate an additional $1.7 million in annual water sales revenue. For residential water customers, this would result in an increase of $1 in their monthly water bill each year.

For Fiscal Year 2012, KUB exceeded its target replacement goals for both galvanized and cast iron main while remaining under the total water capital budget.

Division Cash Budget Appropriations

KUB's Board of Commissioners adopted a Water Division budget of $50.8 million for fiscal year 2012, which included additional appropriations of $3.3 million for Century II. At year end, the Division's actual cash expenditures were $4.6 million under budget. O&M expenditures were $1.1 million lower than expected, primarily due to lower labor related expenses. Capital expenditures were $3.6 million under budget, partially due to the timing of two main replacement and improvement projects. Operating receipts were $0.9 million lower than expected, primarily due to lower than expected capital project reimbursements. In total, $11.2 million in bond proceeds were transferred to the general fund for capital expenditures in fiscal year 2012. The amount transferred was $1.9 million greater than anticipated. As a result, the year end general fund balance was $4.6 million higher than expected. The numbers below are presented on a cash basis.

Water Division Cash Report
As of June 30, 2012

(in thousands of dollars)	**FY 2012 Budget**	**FY 2012 Actual FYTD**	**Dollar Variance***	**Percent Variance**
Beginning Balance General Fund	$ 16,803	$ 16,803		
Operating Receipts	38,216	38,407	191	0.5%
Disbursements				
Operation & Maintenance Expense	22,403	21,344	1,059	4.7%
Capital Expenditures	18,914	15,280	3,634	19.2%
Debt Service & Taxes	9,508	9,601	(93)	-1.0%
Total Disbursements	50,825	46,225	4,600	9.1%
Bond Proceeds	9,309	11,211	1,902	20.4%
Net Flow-Throughs and Transfers	111	(812)	(923)	-100.0%
Ending General Fund Balance	$ 13,614	$ 19,384	$ 5,770	42.4%

** (-) indicates a decrease to cash*

KUB, Water Division, Financial Statements

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

Statement of Net Assets

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

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

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

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

Statement of Revenues, Expenses, and Changes in Net Assets

The Division reports its revenues and expenses (both operating and non-operating) on the Statement of Revenues, Expenses, and Changes in Net Assets. 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 assets for the reporting period. Net assets at the beginning of the period are increased or decreased, as applicable, by the change in net assets for the reporting period.

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

Statement of Cash Flows

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

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

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

Condensed Financial Statements

Statement of Net Assets

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

Statements of Net Assets
As of June 30

(in thousands of dollars)	2012	2011
Current and other assets	$ 52,116	$ 34,887
Capital assets, net	207,969	198,073
Total assets	260,085	232,960
Current and other liabilities	10,370	9,159
Long-term debt outstanding	102,075	80,855
Total liabilities	112,445	90,014
Net assets		
Invested in capital assets, net of related debt	102,645	115,339
Restricted	1,070	844
Unrestricted	43,925	26,763
Total net assets	$ 147,640	$ 142,946

Normal Impacts on Statement of Net Assets

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

- Change in net assets (from Statement of Revenues, Expenses, and Change in Net Assets): impacts (increase/decrease) current and other assets and/or capital assets and unrestricted net assets.
- Issuing debt for capital: increases current and other assets 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 assets and increases invested in capital assets, net of related debt.
- Principal payment on debt: (a) reduces current and other assets and reduces long-term debt and (b) reduces unrestricted net assets and increases invested in capital assets, net of related debt.
- Reduction of capital assets through depreciation: reduces capital assets and invested in capital assets, net of related debt.

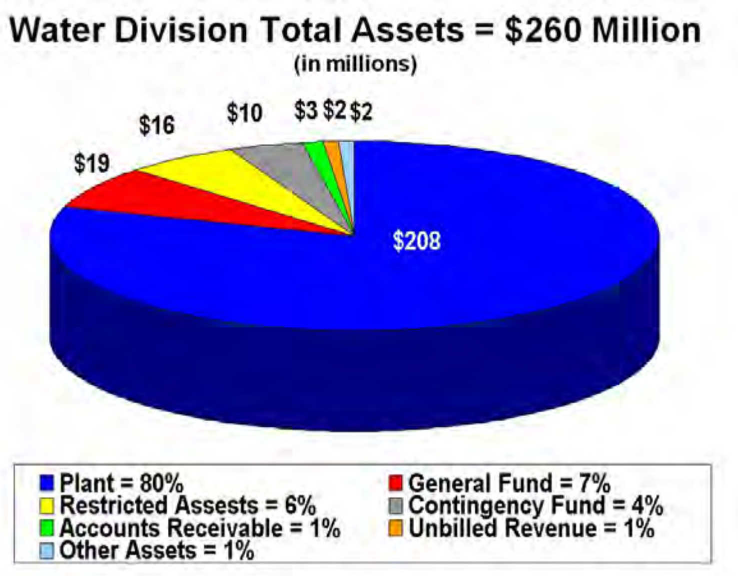
Current Year Impacts and Analysis

Current and Other Assets

Current and other assets increased $17.2 million. The Division's general fund cash (consisting of cash and cash equivalents, short-term investments, and long-term investments) increased $2.6 million compared to last year, largely due to the fact that a majority of capital expenditures were funded with $11.2 million in bond proceeds. Unused bond proceeds as of June 30, 2012 were $13.8 million, which contributed to the overall increase in assets. The Division contributed $1 million to operating contingency reserves in order to maintain the required balance in the fund, which is 45 days of operating expenses.

Capital Assets

Capital assets, net of depreciation, increased $9.9 million or 5 percent. Plant additions (including construction work in progress) during the year included $7 million for water main replacement, $4.5 million for plant and system improvements, and $0.7 million for the construction of services and main extensions. The Division also retired $0.9 million of assets during the fiscal year.



Current and Other Liabilities

Current and other liabilities increased $1.2 million. The current portion of outstanding debt rose $0.7 million, reflecting the $25 million in revenue bonds issued in 2011. The Division also incurred $0.8 million of unamortized premium expense as part of the refunding of $10.7 million in outstanding bonds, which is reflected as an increase in other liabilities compared to the prior year.

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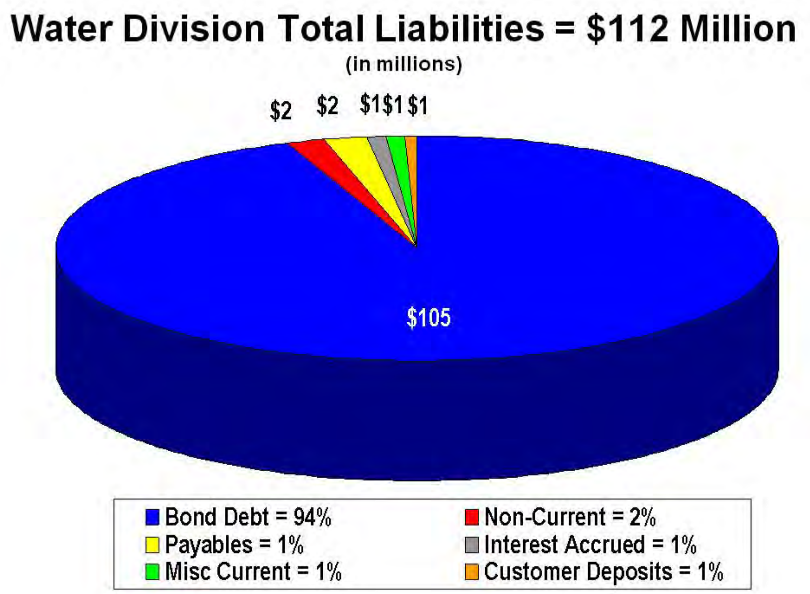
Long-Term Debt
Long-term debt increased $21.2 million or 26.2 percent, the net result of scheduled repayment of outstanding revenue bonds during the fiscal year, $25 million of debt issued in December 2011, and a $0.6 million debt reduction due to the April 2012 refunding.



Net Assets
Invested in capital assets, net of debt decreased $12.7 million or 11 percent. Restricted assets increased $0.2 million compared to the prior year. Unrestricted net assets increased $17.2 million. These changes were the net result of the $4.7 million increase in net assets (as reported on the Statement of Revenues, Expenses and Changes in Net Assets).

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Statement of Revenues, Expenses, and Changes in Net Assets

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

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

(in thousands of dollars)		**2012**		**2011**
Operating revenues	$	37,476	$	36,416
Operating expenses				
Treatment		3,440		3,706
Distribution		11,806		11,775
Customer service		1,402		1,494
Administrative and general		4,542		4,209
Depreciation and amortization		5,768		5,542
Taxes and tax equivalents		2,883		2,817
Total operating expenses		29,841		29,543
Operating income		7,635		6,873
Interest income		200		234
Interest expense		(3,948)		(3,563)
Other income/(expense)		(106)		(161)
Change in net assets before capital contributions		3,781		3,383
Capital Contributions		913		363
Change in net assets	$	4,694	$	3,746

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

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

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

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

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

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

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

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

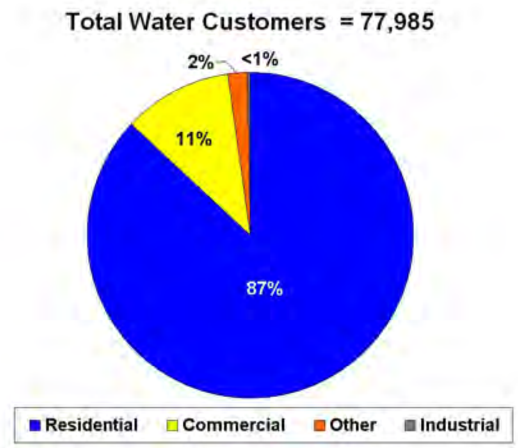
- Other income (net) is impacted by non-operating revenues, netted against miscellaneous operating expenses.

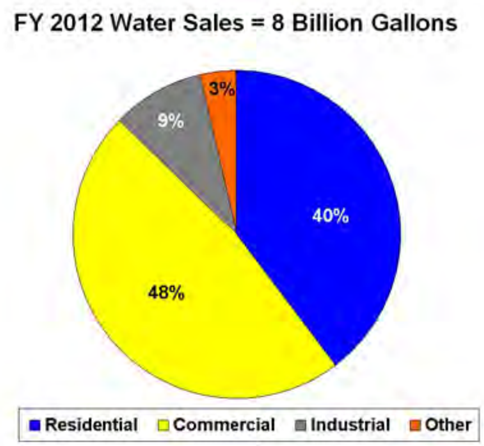
- Capital contributions are impacted by a donation of facilities/infrastructure to KUB by developers and governmental agencies. The contributions are recognized as revenue and recorded as plant in service based on the fair market value of the asset(s).

Current Year Impacts and Analysis

The Division's net assets increased $4.7 million, compared to a $3.7 million increase last fiscal year. The increase in earnings is due to a $1.1 million rise in operating revenue and a $0.6 million increase in capital contributions from developers, which was partially offset by a $0.3 million rise in operating expenses and a $0.4 increase in interest expense.

Operating revenue increased $1.1 million or 2.9 percent, the result of additional revenue from a five percent rate increase, which was effective on customers' bills in January 2012. The additional revenue from the rate increase was partially offset by a 1 percent reduction in water sales volumes compared to the prior year.





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

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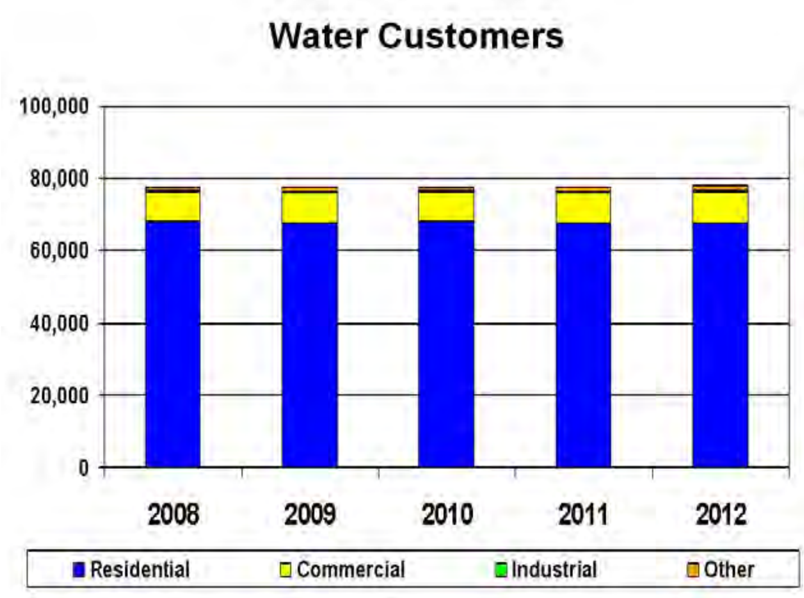
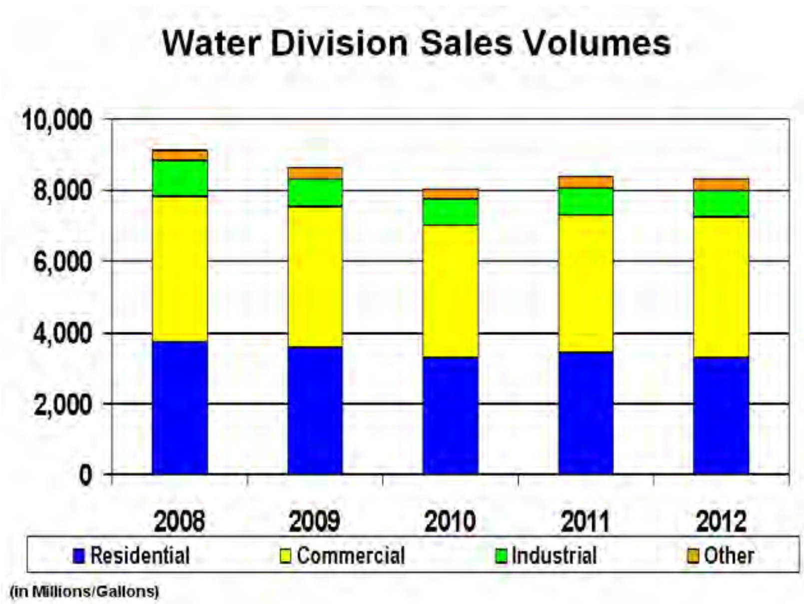
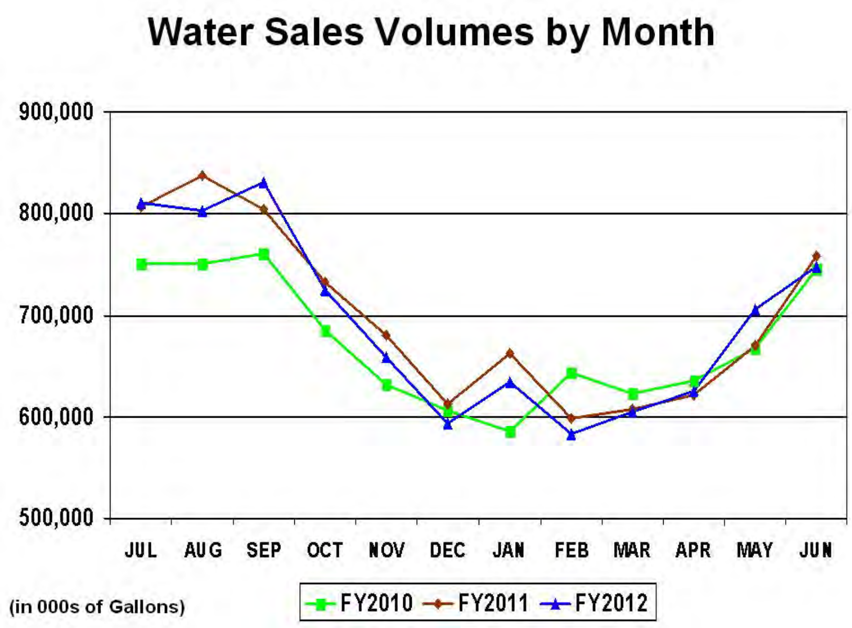


KUB has added 375 water customers over the past five years, representing annual growth of less than 1 percent. Water system growth has slowed in recent years, in large part due to the slowdown of new housing construction.



Fiscal year 2012 water sales volumes were slightly lower than the prior year, due to lower water sales for residential and industrial customers. Sales volumes have decreased at an annual rate of 1.5 percent since 2008, reflecting limited growth and lower average usage for all customer classes.



Residential sales volumes were 3.3 percent lower than the prior fiscal year. Residential sales were lower during the first six months of the fiscal year, but higher during the spring due to below normal precipitation levels.

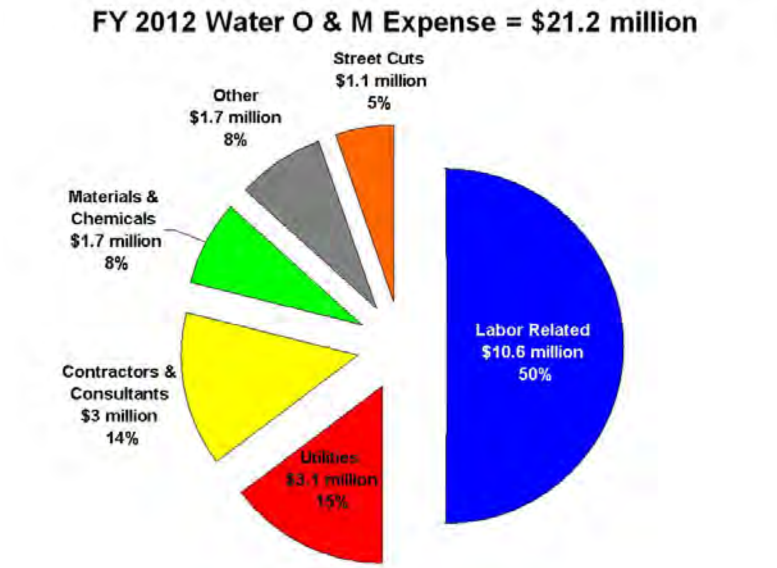
Commercial sales volumes increased 1.4 percent compared to the prior year. Industrial sales volumes decreased 2.5 percent compared to the prior year.

Operating Expenses

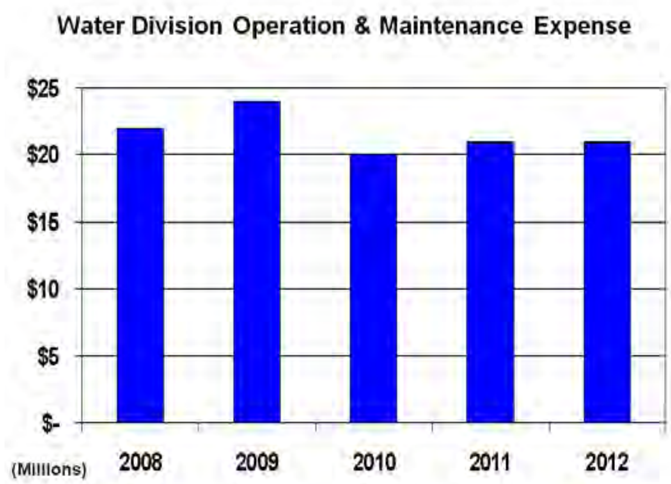
Operating expenses increased $0.3 million or 1 percent.

- Treatment expenses decreased $0.3 million or 7.2 percent, reflecting lower labor-related expenses.
- Distribution expenses were consistent with the prior fiscal year. Increased expenses associated with a water valve inspection program were offset by lower labor-related expenses.
- Customer service expenses decreased $0.1 million.
- Administrative and general expenses increased $0.3 million or 7.9 percent, partially due to a $0.2 million increase in damage claims resulting from a water main break in the downtown Knoxville area.

(Graph on following page)



- O&M expense for fiscal year 2012 was consistent with the prior year and below the level of O&M five years ago. The decline in fiscal year 2010 O&M reflected a lower shared cost allocation for the Water Division. Since 2010, O&M has grown at an annual rate of 2.76 percent, reflecting a modest increase in distribution system maintenance expenses.



- Depreciation expense was up $0.2 million reflecting a full year of depreciation on $13.3 million of water system assets added the previous fiscal year.

- Taxes and tax equivalents were up $0.1 million or 2.3 percent. Tax equivalent payments rose $0.1 million as a result of higher net plant values.

Other Income and Expense

Interest income was consistent with the prior year. An overall higher investment balance, the net result of the $25 million bond issue, was offset by lower longer-term interest rates.

Interest expense increased $0.4 million, reflecting interest expense on $25 million in long-term bonds sold during the fiscal year.

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

Capital contributions (KUB records the fair market value of assets contributed to the water system by developers) were $0.6 million higher than fiscal year 2011.

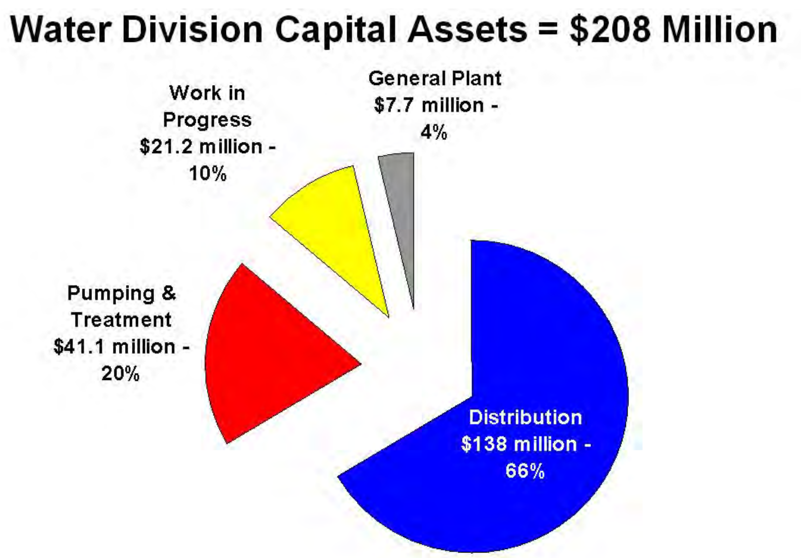
Capital Assets and Debt Administration

Capital Assets

As of June 30, 2012, the Division had $208 million invested in a variety of capital assets, as reflected in the schedule below, which represented a net increase (including additions, retirements, and depreciation) of $9.9 million or 5 percent over the end of the last fiscal year.

Capital Assets
As of June 30
(Net of Depreciation)

(in thousands of dollars)	2012	2011
Production plant	$ 103	$ 117
Pumping & treatment plant	41,028	39,128
Distribution plant:		
Distribution Mains	92,994	91,331
Transmission Mains	17,942	18,326
Services and meters	16,563	16,438
Others	10,470	10,635
Total distribution plant	137,969	136,730
General plant	7,638	6,976
Total plant	186,738	182,951
Work in progress	21,231	15,122
Total net plant	$ 207,969	$ 198,073



Major capital asset additions during the year were as follows:

- $7 million for galvanized and cast iron water main replacement
- $4.5 million for major plant and system improvements
- $0.7 million for service lines and main extension

Debt Outstanding

As of June 30, 2012, the Division had $105.2 million in debt outstanding (including the current portion of revenue bonds), compared to $83.3 million last year, an increase of $21.9 million or 26.3 percent. The Division's weighted average cost of debt as of June 30, 2012 was 4.07 percent.

This increase in debt was attributable to the net result of scheduled repayment of bond debt during the fiscal year, a $25 million December 2011 debt issue, and the refunding of outstanding bonds.

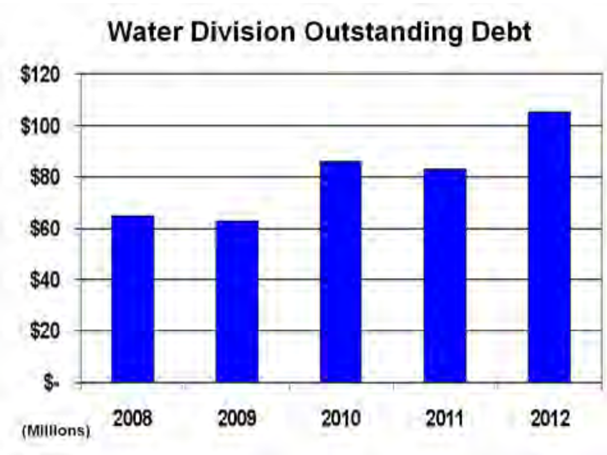
In April 2012, KUB issued $10.1 million in water system revenue refunding bonds, which when combined with an $0.8 million reoffering premium, refunded $10.7 million in outstanding water system bonds and covered the underwriter's discount and costs of issuance. The refunding will save $1.3 million in debt service over the life of the bonds ($1 million on a net present value basis).

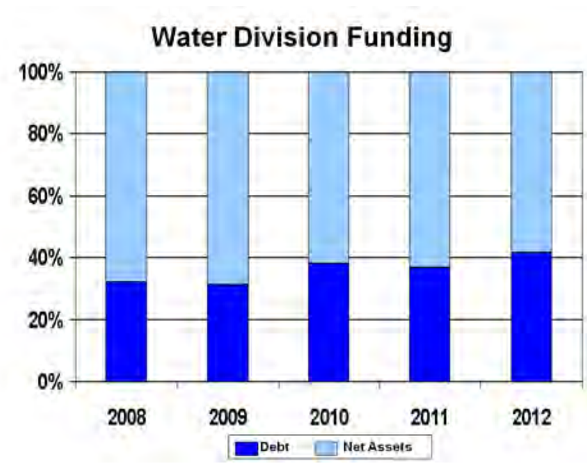
The Division's outstanding debt is rated by Standard & Poor's and Moody's Investors Service. As of June 30, 2012, the Division's revenue bonds were rated AA+ by Standard & Poor's and Aa2 by Moody's Investors Service.

The following is a schedule of the Division's outstanding debt as of June 30, 2012.

Outstanding Debt
As of June 30

(in thousands of dollars)	**2012**	**2011**
Revenue bonds	$ 105,235	$ 83,295
Total outstanding debt	$ 105,235	$ 83,295





The Water Division's level of debt has increased from $65.1 million in fiscal year 2008 to $105.2 million in fiscal year 2012. As a result, the Division's debt ratio rose from 32.2 percent in 2008 to 41.6 percent in 2012. The increase in debt has been used to fund capital improvements for the water system.

Impacts on Future Financial Position

KUB does not expect any net increase in water system customers during the course of the next fiscal year.

A previously adopted five percent rate increase, to help fund Century II water projects, will be effective January 1, 2013.

KUB does not anticipate the issuance of new water system debt during the next fiscal year.

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

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 2013.

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, 2012 and 2011. 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 Assets
June 30, 2012 and 2011

	2012	2011
Assets		
Current assets:		
Cash and cash equivalents	$ 17,884,010	$ 15,803,356
Short-term investments	1,500,000	1,000,000
Short-term contingency fund investments	3,000,434	2,741,841
Other current assets	281,732	532,133
Accrued interest receivable	7,307	4,666
Accounts receivable, less allowance of uncollectible accounts of $57,071 in 2012 and $67,438 in 2011	4,499,387	4,481,186
Inventories	890,897	1,015,798
Prepaid expenses	33,191	37,737
Total current assets	28,096,958	25,616,717
Restricted assets:		
Water bond fund	2,434,669	1,980,878
Other funds	16,830	30,427
Unused bond proceeds	13,803,726	208
Total restricted assets	16,255,225	2,011,513
Water plant in service	276,026,709	267,062,326
Less accumulated depreciation	(89,289,039)	(84,111,062)
	186,737,670	182,951,264
Retirement in progress	257,849	19,969
Construction in progress	20,973,112	15,102,075
Net plant in service	207,968,631	198,073,308
Other assets:		
Long-term contingency fund investments	6,993,404	6,274,369
Deferred loss on refunding bonds	304,091	325,604
Other	466,956	658,840
Total other assets	7,764,451	7,258,813
Total assets	$ 260,085,265	$ 232,960,351

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

Knoxville Utilities Board Water Division
Statements of Net Assets
June 30, 2012 and 2011

		2012		2011
Capitalization and Liabilities				
Current liabilities:				
Current portion of revenue bonds and revenue notes	$	3,160,000	$	2,440,000
Sales tax collections payable		227,526		216,643
Accounts payable		1,574,400		1,369,000
Accrued expenses		1,237,230		1,651,191
Customer deposits plus accrued interest		702,356		656,803
Accrued interest on revenue bonds		1,381,236		1,167,467
Total current liabilities		8,282,748		7,501,104
Other liabilities:				
Accrued compensated absences		1,623,913		1,639,725
Customer advances for construction		-		1,890
Other		463,202		16,511
Total other liabilities		2,087,115		1,658,126
Long-term debt:				
Water revenue bonds		102,075,000		80,855,000
Total long-term debt		102,075,000		80,855,000
Total liabilities		112,444,863		90,014,230
Net assets				
Invested in capital assets, net of related debt		102,644,856		115,339,134
Restricted for:				
Debt service		1,053,433		813,411
Other		16,830		30,427
Unrestricted		43,925,283		26,763,149
Total net assets		147,640,402		142,946,121
Total liabilities and net assets	$	260,085,265	$	232,960,351

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

Knoxville Utilities Board Water Division
Statements of Revenues, Expenses and Changes in Net Assets
Years Ended June 30, 2012 and 2011

	2012	2011
Operating revenues	$ 37,475,750	$ 36,415,692
Operating expenses		
Treatment	3,439,473	3,706,394
Distribution	11,805,687	11,774,777
Customer service	1,402,123	1,493,716
Administrative and general	4,542,353	4,208,531
Provision for depreciation and amortization	5,768,349	5,541,635
Taxes and tax equivalents	2,882,492	2,816,753
Total operating expenses	29,840,477	29,541,806
Operating income	7,635,273	6,873,886
Non-operating revenues (expenses)		
Contributions in aid of construction	470,062	562,921
Interest and dividend income	200,362	234,293
Interest expense	(3,947,812)	(3,564,274)
Write-down of plant for costs recovered through contributions	(470,062)	(562,921)
Other	(106,608)	(161,116)
Total non-operating revenues (expenses)	(3,854,058)	(3,491,097)
Change in net assets before capital contributions	3,781,215	3,382,789
Capital contributions	913,066	362,927
Change in net assets	4,694,281	3,745,716
Net assets, beginning of year	142,946,121	139,200,405
Net assets, end of year	$ 147,640,402	$ 142,946,121

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

Knoxville Utilities Board Water Division
Statements of Cash Flows
Years Ended June 30, 2012 and 2011

	2012	2011
Cash flows from operating activities:		
Cash receipts from customers	$ 36,742,833	$ 35,979,259
Cash receipts from other operations	1,408,234	802,169
Cash payments to suppliers of goods or services	(12,620,580)	(12,225,936)
Cash payments to employees for services	(9,398,310)	(9,736,007)
Payment in lieu of taxes	(2,220,441)	(2,102,941)
Net cash provided by operating activities	13,911,736	12,716,544
Cash flows from capital and related financing activities:		
Net proceeds from bond issuance	24,978,728	-
Principal paid on revenue bonds and notes payable	(2,440,000)	(2,380,000)
Decrease (increase) in unused bond proceeds	(13,803,518)	14,244,526
Interest paid on revenue bonds and notes payable	(3,734,043)	(3,568,815)
Acquisition and construction of water plant	(15,543,797)	(13,823,535)
Changes in water bond fund, restricted	(453,791)	32,650
Customer advances for construction	(1,890)	1,889
Proceeds received on disposal of plant	7,653	-
Cash received from developers and individuals for capital purposes	470,062	562,921
Net cash used in capital and related financing activities	(10,520,596)	(4,930,364)
Cash flows from investing activities:		
Purchase of investment securities	(1,578,061)	(2,887,680)
Maturities of investment securities	100,434	161,411
Interest received	200,362	234,293
Other property and investments	(33,221)	(134,825)
Net cash provided by (used in) investing activities	(1,310,486)	(2,626,801)
Net increase (decrease) in cash and cash equivalents	2,080,654	5,159,379
Cash and cash equivalents, beginning of year	15,803,356	10,643,977
Cash and cash equivalents, end of year	$ 17,884,010	$ 15,803,356
Reconciliation of operating income to net cash provided by operating activities		
Operating income	$ 7,635,273	$ 6,873,886
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization expenses	6,063,201	5,857,857
Changes in operating assets and liabilities:		
Accounts receivable	(19,727)	(223,078)
Inventories	124,902	70,086
Prepaid expenses	4,545	(5,563)
Other assets	217,654	(63,848)
Sales tax collections payable	10,883	6,148
Accounts payable and accrued expenses	(224,373)	123,915
Customer deposits plus accrued interest	45,553	55,395
Other liabilities	53,825	21,746
Net cash provided by operating activities	$ 13,911,736	$ 12,716,544
Noncash capital activities:		
Acquisition of plant assets through developer contributions	$ 913,066	$ 362,927

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

1. Description of Business

Knoxville Utilities Board (KUB), comprised of the Electric Division, Water Division, Gas Division, and Wastewater Division (Divisions), is reported as a component unit enterprise fund in the financial statements of the City of Knoxville. KUB's responsibility is to oversee the purchase, production, distribution, and processing of electricity, water, natural gas, and wastewater services. A seven-member Board of Commissioners governs KUB. The Board has all powers to construct, acquire, expand, or operate the Divisions. It has full control and complete jurisdiction over the management and operation of the Divisions. The Water Division (Division) provides services to certain customers in Knox County and in two surrounding counties in East Tennessee. The Division's accounts are maintained in conformity with the Uniform System of Accounts of the National Association of Regulatory Utility Commissioners (NARUC) and the Governmental Accounting Standards Board (GASB), as applicable. The financial statements present only the Water Division and do not purport to, and do not, present fairly the consolidated financial position of Knoxville Utilities Board at June 30, 2012 and 2011, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

2. Significant Accounting Policies

Basis of Accounting

KUB follows the provisions of Statement No. 34 (Statement 34) of the Governmental Accounting Standards Board *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments.* Statement 34 established standards for external financial reporting for all state and local governmental entities, which includes a statement of net assets; a statement of revenues, expenses and changes in net assets; and a statement of cash flows. It requires the classification of net assets into three components – invested in capital assets, net of related debt; restricted; and unrestricted. These classifications are defined as follows:

- Invested in capital assets, net of related debt – This component of net assets 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. 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 invested in capital assets, net of related debt. Rather, that portion of the debt is included in the same net assets component as the unspent proceeds.

- Restricted – This component of net assets consists of restrictions placed on net asset use through external constraints imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or restrictions imposed by law through constitutional provisions or enabling legislation.

- Unrestricted net assets – The component of unrestricted net assets consists of net assets that do not meet the definition of “restricted” or “invested in capital assets, net of related debt.”

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 assets. Net assets (i.e., total assets net of total liabilities) are segregated into invested in capital assets, net of related debt; restricted for capital activity and debt service; and unrestricted components.

As allowed by the Governmental Accounting Standards Board (GASB) Statement No. 20*, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting,* KUB's policy is to apply only those Financial Accounting Standards Board statements, related interpretations, Accounting Principles Board opinions and accounting research bulletins issued on or prior to November 30, 1989 that do not conflict with Governmental Accounting Standards.

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 assets does not include depreciation for transportation equipment of $294,852 in 2012 and $316,222 in 2011. Interest costs are expensed as incurred.

Operating Revenue

Operating revenue consists primarily of charges for services provided by the principal operations of the KUB Water Division. Operating revenue is recorded when the service is rendered, on a cycle basis, and includes an estimate of unbilled revenue. Revenues are reported net of bad debt expense of $98,393 in 2012 and $150,456 in 2011.

Non-operating Revenue

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

Expense

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

Contributions in Aid of Construction and Capital Contributions

Contributions in aid of construction are cash collections from customers or others for a particular purpose, generally the construction of new facilities to serve new customers in excess of the investment KUB is willing to make for a particular incremental revenue source. KUB reduces the plant account balances to which contributions relate by the actual amount of the contribution and recognizes the contributions as non operating revenue in accordance with FAS 71, *"Accounting for the Effects of Certain Types of Regulation"*.

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 33, *"Accounting and Financial Reporting for Nonexchange Transactions"*, such contributions are recognized as revenues and capital assets upon receipt.

Inventories

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

Pension Plan

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

Investments

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

Self-Insurance

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

Estimates

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

Restricted and Designated Assets
Certain assets are restricted by bond resolutions for the construction of utility plant and debt repayment. In addition, management has designated additional assets 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.

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 18, 2012, the date these financial statements were issued, for items that should potentially be recognized or disclosed.

Reclassifications
Certain reclassifications have been made to the 2011 balances to conform to the 2012 presentation.

3. Deposits and Investments

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

Information related to the carrying value and bank balances of deposits (except as noted below), and the carrying value and fair value of investments at June 30, 2012, is as follows:

	Carrying Value	Bank Balance
Deposits		
Deposits in financial institutions	$ 17,900,840	$ 24,017,262
Investments		
Certificates of Deposits	20,203,503	20,203,503
State Treasurer's Investment Pool	3,017,701	3,017,701
Agency Bonds	4,471,427	4,471,427
	$ 45,593,471	$ 51,709,893

Classification of deposits and investments:

Depository Account		**Bank Balance**
Insured	$	37,297
Collateralized:		
Collateral held by pledging bank's trust department in KUB's name		4,471,427
Collateral held by pledging bank's trust department not in KUB's name*		47,201,169
Total deposits and investments	$	51,709,893

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

Classification of deposits and investments per statement of net assets:

		2012
Current assets		
Cash and cash equivalents	$	17,884,010
Short-term investments		1,500,000
Short-term contingency fund investments		3,000,434
Other assets		
Long-term contingency fund investments		6,968,350
Restricted assets		
Unused bond proceeds		13,789,178
Water bond fund		2,434,669
Other funds		16,830
	$	45,593,471

The above amounts do not include accrued interest of $39,602

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

	Deposit and Investment Maturities (in Years)					
		Fair Value		**Less Than 1**		**1-5**
Supersweep NOW and Other Deposits	$	24,017,262	$	24,017,262	$	-
State Treasurer's Investment Pool		3,017,701		3,017,701		-
Agency Bonds		4,471,427		779,387		3,692,040
Certificates of deposits		20,203,503		16,927,193		3,276,310
	$	51,709,893	$	44,741,543	$	6,968,350

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

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

4. Accounts Receivable

Accounts receivable consists of the following:

		2012		2011
Wholesale and retail customers				
Billed services	$	2,711,003	$	2,752,639
Unbilled services		1,604,591		1,502,173
Other		240,864		293,812
Allowance for uncollectible accounts		(57,071)		(67,438)
	$	4,499,387	$	4,481,186

5. Accounts Payable and Accruals

Accounts payable and accruals were composed of the following:

		2012		2011
Trade accounts	$	1,574,400	$	1,369,000
Salaries and wages		186,559		139,362
Self-insurance liabilities		237,628		282,785
Other current liabilities		813,043		1,229,044
	$	2,811,630	$	3,020,191

6. Long-Term Obligations

Long-term debt consists of the following:

	Balance June 30, 2011	Additions	Payments	Balance June 30, 2012	Amounts Due Within One Year
Q-2004 - 2.0 - 5.0%	$ 11,990,000	$ -	$ 11,990,000	$ -	$ -
R-2005 - 3.5 - 5.0%	10,000,000	-	-	10,000,000	-
S-2005 - 3.5 - 5.0%	8,345,000	-	380,000	7,965,000	390,000
T-2007 - 4.0 - 5.5%	25,000,000	-	-	25,000,000	-
U-2009 - 3.0 - 4.5%	25,000,000	-	-	25,000,000	-
V-2010 - 2.0 - 2.5%	2,960,000	-	740,000	2,220,000	2,220,000
W-2011 - 2.0 - 4.0%	-	25,000,000	-	25,000,000	550,000
X-2012 - 3.0 - 5.0%	-	10,050,000	-	10,050,000	-
Total debt	$ 83,295,000	$ 35,050,000	$ 13,110,000	$ 105,235,000	$ 3,160,000

Other liabilities consist of the following:

	Balance June 30, 2011	Increase	Decrease	Balance June 30, 2012	Amounts Due Within One Year
Accrued compensated absences	$ 1,639,725	$ 996,075	$ (1,011,887)	$ 1,623,913	$ 750,000
Customer advances for construction	1,890	-	(1,890)	-	-
Other	(220,601)	1,048,008	(364,205)	463,202	25,000
	$ 1,421,014	$ 2,044,083	$ (1,377,982)	$ 2,087,115	$ 775,000

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

Fiscal Year	Total Principal	Interest	Grand Total
2013	$ 3,160,000	$ 4,256,679	$ 7,416,679
2014	3,040,000	4,225,565	7,265,565
2015	3,165,000	4,113,740	7,278,740
2016	3,265,000	3,992,371	7,257,371
2017	3,435,000	3,853,684	7,288,684
2018 - 2022	19,435,000	16,887,464	36,322,464
2023 - 2027	23,510,000	12,749,959	36,259,959
2028 - 2032	26,800,000	7,484,076	34,284,076
2033 - 2037	13,425,000	2,561,626	15,986,626
2038 - 2040	6,000,000	480,000	6,480,000
Total	$ 105,235,000	$ 60,605,164	$ 165,840,164

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, 2012, these bond covenants had been satisfied.

During fiscal year 2004, KUB's Water Division issued Series Q 2004 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 the remaining maturities of principal and interest on the Series N 1998 bonds, as such amounts mature. During fiscal year 2012, Series Q 2004 bonds were defeased with the issuance of Series X 2012.

During fiscal year 2006, KUB's Water Division issued Series R 2005 bonds for the purpose of funding water system capital improvements. KUB's Water Division also issued Series S 2005 bonds to retire certain existing debt and fund water system capital improvements. Concurrent with the issuance of these bonds, KUB transferred funds to an irrevocable trust to pay a portion of the Series P 2001 bonds, as such amounts mature.

During fiscal year 2008, KUB's Water Division issued Series T 2007 bonds to fund water system capital improvements.

During fiscal year 2010, KUB's Water Division issued Series U 2009 bonds to fund water system capital improvements. KUB's Water Division also issued Series V 2010 bonds to retire Series O 2001 bonds.

During fiscal year 2012, KUB's Water Division issued Series W 2011 bonds to fund water system capital improvements. KUB's Water Division also issued Series X 2012 bonds to retire Series Q 2004 bonds.

The outstanding principal balances on defeased bond issues were $23 million at June 30, 2012.

7. Lease Commitments

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

2013	$ 3,058
2014	2,717
2015	3,464
2016	899
Total operating minimum lease payments	$ 10,138

8. Capital Assets

Capital asset activity for the year ended June 30, 2012, was as follows:

	Beginning 6/30/2011	Increase	Decrease	Ending 6/30/2012
Production Plant	$ 727,863	-	-	$ 727,863
Pumping & Treatment Plant	58,672,165	3,449,110	(33,511)	62,087,764
Distribution Plant				
Distribution Mains	116,191,404	3,431,545	(18,582)	119,604,367
Transmission Mains	25,546,081	-	-	25,546,081
Services & Meters	26,369,105	1,026,241	(182,258)	27,213,088
Other Accounts	20,080,774	366,988	(2,506)	20,445,256
Total Distribution Plant	$ 188,187,364	$ 4,824,774	$ (203,346)	$ 192,808,792
Total General Plant	19,474,934	1,596,757	(669,401)	20,402,290
Total Water Plant	$ 267,062,326	$ 9,870,641	$ (906,258)	$ 276,026,709
Less Accumulated Depreciation	(84,111,062)	(5,930,450)	752,473	(89,289,039)
Net Plant Assets	$ 182,951,264	$ 3,940,191	$ (153,785)	$ 186,737,670
Work In Progress	15,122,044	15,002,267	(8,893,350)	21,230,961
Total Net Plant	$ 198,073,308	$ 18,942,458	$ (9,047,135)	$ 207,968,631

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 Assets. The liability is KUB's best estimate based on available information. At June 30, 2012, the amount of these liabilities was $237,628 resulting from the following changes:

	2012	2011
Balance, beginning of year	$ 282,785	$ 287,937
Current year claims and changes in estimates	1,632,866	1,893,930
Claims payments	(1,678,023)	(1,899,082)
Balance, end of year	$ 237,628	$ 282,785

10. Pension Plan

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

At December 31, 2011, the Plan had approximately 652 retirees and beneficiaries currently receiving benefits and 56 terminated employees entitled to benefits but not yet receiving them. Of the approximately 873 current employees in the Plan, 730 were fully vested at December 31, 2011. 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 has frozen the Plan such that persons employed or re-employed by KUB on or after January 1, 2011, shall not be eligible to participate, but that eligible employees hired prior to January 1, 2011, who have not separated from service, shall continue as Participants and accrue benefits under the Plan.

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

Career Equity Program (CEP)

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

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

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

All employees participating in the City Division Plan A as of June 30, 1999, were eligible to participate in KUB's Plan A or the CEP program. Participants of Plan A are covered by Social Security. Plan A is a closed plan and is not available to KUB employees hired after July 1, 1999. Participation in Plan A requires employee contributions of 3 percent of the first $4,800 of annual earnings and 5 percent of annual earnings in excess of $4,800. Plan A provides for early retirement benefits with 25 years of service and normal retirement benefits at age 62 or older.

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

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

Funding Policy
For the Plan year ended December 31, 2011, a contribution of $3,593,282 is required to be made in the Plan sponsor's fiscal year ending June 30, 2013. The Water Division's portion of this contribution is $467,127. The annual required contribution was determined as part of the January 1, 2011 valuation using the Individual Entry Age Normal funding method. The objective under this method is to fund each participant's benefits under the Plan as payments which are level as a percentage of salary, starting on the original participation date (employment date) and continuing until the assumed retirement, termination, disability or death. For the Plan year ended December 31, 2011, the Plan's actuarial funded ratio was 104.5 percent.

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

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

As of the actuarial report for the Plan year ended December 31, 2011, contributions of $3,593,282 and $3,244,057 for 2011 and 2010, respectively, are required to be made during the Plan sponsor's fiscal years ending June 30, 2013 and 2012, respectively. Of these amounts, $467,127 and $421,727 are attributable to the Water Division.

Subsequent to June 30, 2012, the actuarial report for the Plan year ending December 31, 2012 was completed.

For the Plan year ending December 31, 2012, a contribution of $5,502,677 is required to be made in the Plan sponsor's fiscal year ending June 30, 2014. The Water Division's portion of this contribution is $715,348. For the Plan year ending December 31, 2012, the Plan's actuarial funded ratio was 94.1 percent.

11. Defined Contribution Plan

KUB has a defined contribution 401(k) employee retirement savings plan covering eligible KUB employees. Employees hired prior to January 1, 2011 may participate and receive a matching contribution of 50 percent of their own contribution up to a maximum match of 3 percent. Employees hired on or after January 1, 2011 have an enhanced 401(k) Plan due to the closure of the Defined Benefit Pension Plan. They may participate and receive a matching contribution of 50 percent of their own contribution up to a maximum match of 3 percent. They also receive a nonelective KUB contribution of from 3 percent to 6 percent, depending on years of service, whether they contribute or not.

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

12. Other Post-Employment Benefits (OPEB)

The Governmental Accounting Standards Board (GASB) established new standards for the measurement, recognition, and reporting of other post-employment benefits (OPEB). OPEB includes post-employment benefits other than pension, which, for KUB, is presently limited to post-employment health care. GASB 45 requires the recognition of the accrued OPEB liability for the respective year, plus the disclosure of the total unfunded liability. GASB 45 was effective for KUB for the fiscal year beginning July 1, 2007.

KUB currently provides post-employment health care benefits to 633 former employees and 647 covered dependents. The cost of coverage is shared with retirees and beneficiaries. KUB recognizes its share of the cost of post-employment health care benefits as an expense as claims are paid.

In anticipation of GASB 45, KUB amended its Group Health Plan in 1999, eliminating post-employment health care benefits for all employees hired on or after July 1, 1999. As of June 30, 2012, 450 active employees were eligible for individual and dependent coverage at separation if the employee meets the Rule of 80 (age plus years of service) with a minimum of 20 years of service.
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 GASB 45 does not require pre-funding of the liability, KUB has determined that it is in the long-term economic interest of KUB and its ratepayers to establish a Trust to pre-fund KUB's OPEB liability.

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

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

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

Total contributions to the OPEB Trust for the fiscal year ended June 30, 2012 were $8.1 million (Division's share $1.1 million). The contribution to the Trust exceeded the annual required contribution (ARC), as determined by the Postretirement Benefit Plan's actuarial valuation for the year ended December 31, 2010, which was $4.6 million (Division's share $0.6 million). As of June 30, 2012, the employer's net OPEB obligation was $1.7 million (Division's share $ 0.2 million).

The ARC for the fiscal year ending June 30, 2013, as determined by the Plan's actuarial valuation for the year ended December 31, 2011 is $3.3 million (Division's share $0.4 million).

The actuarial valuation for the Plan for the year ending December 31, 2012 has been completed. The valuation determined that the Plan's actuarial accrued liability was $61.6 million (Division's share $8 million). The actuarial value of the Plan's assets was $37.9 million (Division's share $4.9 million). As a result, the Plan's unfunded actuarial accrued liability was $23.7 million (Division's share $3.1 million). The Plan's actuarial funded ratio was 62 percent. The valuation also determined that the employer's ARC is $3.3 million for the fiscal year ending June 30, 2014 (Division's share $0.4 million).

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, 2012 and 2011, are summarized as follows:

	2012	2011
City of Knoxville		
Amounts billed by the Division for utilities and related services	$ 3,360,826	$ 3,294,776
Payments by the Division in lieu of property tax	2,220,441	2,102,941
Payments by the Division for services provided	475,644	273,686
Other divisions of KUB		
Amounts billed to other divisions for utilities and related services provided	300,591	298,643
Interdivisional rental expense	155,703	187,380
Interdivisional rental income	83,714	88,092
Amounts billed to the Division by other divisions for utilities services provided	2,988,475	2,986,382

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

	2012	2011
Accounts receivable	$ 275,310	$ 277,024

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, 2012

Pension Plan

Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (b)	Unfunded Actuarial Accrued Liability (UAAL) (b-a)	Funded Ratio (a)/(b)	Annual Covered Payroll (c)	UAAL as a Percentage of Covered Payroll [(b)-(a)]/(c)
January 1, 2009	$ 183,447,296	$194,366,597	$ 10,919,301	94.4%	$ 49,602,223	22.01%
January 1, 2010	203,704,898	190,679,453	(13,025,445)	106.8%	48,228,428	(27.01%)
January 1, 2011	195,692,781	187,257,434	(8,435,347)	104.5%	47,405,874	(17.79%)
January 1, 2012	183,980,665	195,536,152	11,555,487	94.1%	48,836,721	23.66%

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%

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); $5,000,000 deductible per occurrence.

Travel Accident
Covers losses related to employees' business travel. Limits of coverage - $1,375,000 aggregate.

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

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

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

Knoxville Utilities Board Water Division
Supplemental Information - Schedule of Debt Maturities by Fiscal Year
June 30, 2012

Schedule 2

Continued on Next Page

	R-2005		S-2005		T-2007		U-2009		V-2010	
FY	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest
12-13		436,425	390,000	338,721		1,129,644		1,011,125	2,220,000	55,500
13-14	235,000	436,425	415,000	323,121	650,000	1,129,644	750,000	1,011,125		
14-15	255,000	428,200	425,000	306,521	675,000	1,103,644	800,000	988,625		
15-16	265,000	418,956	440,000	289,521	700,000	1,066,519	825,000	964,625		
16-17	280,000	409,019	465,000	267,521	750,000	1,028,019	875,000	931,625		
17-18	305,000	397,819	485,000	244,271	800,000	986,769	925,000	896,625		
18-19	320,000	385,619	500,000	224,871	825,000	942,769	950,000	859,625		
19-20	340,000	372,819	520,000	204,871	875,000	909,769	1,000,000	821,625		
20-21	355,000	359,219	545,000	183,421	900,000	874,769	1,050,000	781,625		
21-22	375,000	345,019	570,000	160,940	950,000	837,644	1,125,000	739,625		
22-23	405,000	329,550	590,000	137,428	1,000,000	798,456	1,175,000	694,625		
23-24	425,000	312,844	615,000	112,353	1,050,000	755,956	1,225,000	647,625		
24-25	450,000	294,781	640,000	86,215	1,100,000	711,331	1,300,000	598,625		
25-26	475,000	275,656	665,000	58,695	1,150,000	664,031	1,350,000	546,625		
26-27	500,000	255,469	700,000	30,100	1,200,000	610,844	1,425,000	492,625		
27-28	1,285,000	234,219			1,225,000	555,344	1,500,000	435,625		
28-29	1,360,000	178,000			1,250,000	501,750	1,575,000	375,625		
29-30	2,370,000	118,500			1,300,000	445,500	1,650,000	308,688		
30-31					2,750,000	387,000	1,750,000	238,563		
31-32					2,850,000	263,250	1,825,000	164,188		
32-33					3,000,000	135,000	1,925,000	86,625		
33-34										
34-35										
35-36										
36-37										
37-38										
38-39										
39-40										
	$ 10,000,000	$ 5,988,539	$ 7,965,000	$ 2,968,570	$ 25,000,000	$ 15,837,652	$ 25,000,000	$ 13,595,689	$ 2,220,000	$ 55,500

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, 2012 Schedule 2

Continued from Previous Page

	W-2011		X-2012		TOTAL		Grand
FY	Principal	Interest	Principal	Interest	Principal	Interest	Total
12-13	550,000	926,750		358,514	3,160,000	4,256,679	7,416,679
13-14	550,000	910,250	440,000	415,000	3,040,000	4,225,565	7,265,565
14-15	550,000	893,750	460,000	393,000	3,165,000	4,113,740	7,278,740
15-16	550,000	882,750	485,000	370,000	3,265,000	3,992,371	7,257,371
16-17	550,000	871,750	515,000	345,750	3,435,000	3,853,684	7,288,684
17-18	550,000	844,250	535,000	320,000	3,600,000	3,689,734	7,289,734
18-19	550,000	827,750	565,000	293,250	3,710,000	3,533,884	7,243,884
19-20	550,000	805,750	590,000	265,000	3,875,000	3,379,834	7,254,834
20-21	550,000	789,250	625,000	235,500	4,025,000	3,223,784	7,248,784
21-22	550,000	772,750	655,000	204,250	4,225,000	3,060,228	7,285,228
22-23	500,000	756,250	670,000	184,600	4,340,000	2,900,909	7,240,909
23-24	500,000	741,250	690,000	164,500	4,505,000	2,734,528	7,239,528
24-25	500,000	726,250	710,000	143,800	4,700,000	2,561,002	7,261,002
25-26	500,000	710,625	735,000	120,725	4,875,000	2,376,357	7,251,357
26-27	500,000	693,125	765,000	95,000	5,090,000	2,177,163	7,267,163
27-28	500,000	673,125	790,000	64,400	5,300,000	1,962,713	7,262,713
28-29	500,000	655,625	820,000	32,800	5,505,000	1,743,800	7,248,800
29-30	500,000	635,625			5,820,000	1,508,313	7,328,313
30-31	500,000	617,500			5,000,000	1,243,063	6,243,063
31-32	500,000	598,750			5,175,000	1,026,188	6,201,188
32-33	500,000	580,000			5,425,000	801,625	6,226,625
33-34	2,000,000	560,000			2,000,000	560,000	2,560,000
34-35	2,000,000	480,000			2,000,000	480,000	2,480,000
35-36	2,000,000	400,000			2,000,000	400,000	2,400,000
36-37	2,000,000	320,000			2,000,000	320,000	2,320,000
37-38	2,000,000	240,000			2,000,000	240,000	2,240,000
38-39	2,000,000	160,000			2,000,000	160,000	2,160,000
39-40	2,000,000	80,000			2,000,000	80,000	2,080,000
	$ 25,000,000	$ 18,153,125	$ 10,050,000	$ 4,006,089	$ 105,235,000	$ 60,605,164	$ 165,840,164

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Water Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2012
(Unaudited) Schedule 3

Rate Class	Base Charge	Number of Customers
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:	55,768

Commodity Charge

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

Additional Monthly Customer Charge

For	5/8" meter	$ 9.00
For	1" meter	23.10
For	1 1/2" meter	35.00
For	2" meter	51.00

Rate Class	Base Charge	Number of Customers
Residential Outside City rate	For water furnished to premises upon which any water faucet or other outlet is outside the corporate limits of the City of Knoxville, excluding premises within the boundaries of an area recognized as an industrial park:	13,219

Commodity Charge

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

Additional Monthly Customer Charge

For	5/8" meter	$ 10.40
For	1" meter	27.40
For	1 1/2" meter	41.40
For	2" meter	60.40

Knoxville Utilities Board Water Division
Supplemental Information - Schedule of Current Rates in Force
June 30, 2012
(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:	8,461

Commodity Charge

First	2	100 Cubic Feet Per Month at $0.50 Per 100 Cubic Feet
Next	8	100 Cubic Feet Per Month at $2.60 Per 100 Cubic Feet
Next	90	100 Cubic Feet Per Month at $3.10 Per 100 Cubic Feet
Next	300	100 Cubic Feet Per Month at $2.25 Per 100 Cubic Feet
Next	4,600	100 Cubic Feet Per Month at $1.60 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	$ 9.00
For	1" meter	23.10
For	1 1/2" meter	35.00
For	2" meter	51.00
For	3" meter	100.00
For	4" meter	165.00
For	6" meter	361.00
For	8" meter	635.00
For	10" meter	967.00
For	12" meter	1,431.00

Rate Class	Base Charge	Number of Customers
Non-Residential Outside City rate	For water furnished to premises upon which any water faucet or other outlet is outside the corporate limits of the City of Knoxville, excluding premises within the boundaries of an area recognized as an industrial park:	679

Commodity Charge

First	2	100 Cubic Feet Per Month at $0.60 Per 100 Cubic Feet
Next	8	100 Cubic Feet Per Month at $3.10 Per 100 Cubic Feet
Next	90	100 Cubic Feet Per Month at $3.75 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 $1.95 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	$ 10.40
For	1" meter	27.40
For	1 1/2" meter	41.40
For	2" meter	60.40
For	3" meter	119.00
For	4" meter	199.00
For	6" meter	433.00
For	8" meter	762.00
For	10" meter	1,160.00
For	12" meter	1,719.00

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board
Schedule of Unaccounted For Water
June 30, 2012

(All amounts in Gallons)

A	**Water Treated and Purchased:**		
B	Water Pumped (potable)	12,228,300,000	
C	Water Purchased	0	
D	**Total Water Treated and Purchased (Sum Lines B and C)**		12,228,300,000
E	**Accounted for Water:**		
F	Water Sold	8,322,081,944	
G	Metered for Consumption (in house usage)	263,746,143	
H	Fire Department Usage	68,549,050	
I	Flushing	4,680,190	
J	Tank Cleaning/Filling	1,660,000	
K	Street Cleaning	155,400	
L	Bulk Sales	592,513	
M	Water Bill Adjustments	0	
N	**Total Accounted for Water (Sum Lines F thru M)**		8,661,465,240
O	**Unaccounted for Water (Line D minus Line N)**		3,566,834,760
P	**Percent Unaccounted For (Line O divided by Line D times 100)**		29.169%
Q	Other (explain)	1,140,700	

Explain Other: Amount of water sold but not yet billed.

All amounts included in this schedule are supported by documentation on file at the water system. If no support in on file for a line item or if the line item is not applicable, a "0" is shown.

Knoxville Utilities Board Water Division
Supplemental Information –
Schedule of Expenditures of Federal Awards by Grant
June 30, 2012 Schedule 5

KUB was awarded two grants from Tennessee Emergency Management Agency (as a flow through from FEMA) for reimbursement for costs related to storms in 2011. The schedule below shows the expenditures for the current fiscal year.

Program Name	Federal/State Agency	CFDA Number	Contract Number	Beginning Deferred	Cash Receipts	Expenditures	Adjustments	Ending Deferred
U.S. Department of Homeland Security	Tennessee Emergency Management	97.036	34101-0000009205	$ -	$ -	$ 32,701	$ -	$ 32,701
U.S. Department of Homeland Security	Tennessee Emergency Management	97.036	34101-0000009832	$ -	$ 2,498	$ 3,331	$ -	$ 833
		Total Program 97.036		$ -	$ 2,498	$ 36,032	$ -	$ 33,534
		Total Federal Awards		$ -	$ 2,498	$ 36,032	$ -	$ 33,534

NOTE 1 - BASIS OF PRESENTATION

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

Knoxville Utilities Board Water Division
Supplemental Information –
Schedule of Findings and Questioned Costs
June 30, 2012 Schedule 6

Summary of Audit Results

Financial Statements

Type of auditors report issued:	Unqualified	
Internal control over financial reporting:		
Material weakness(es) identified?	___Yes	✓ No
Significant deficiencies identified that are not considered to be material weakness(es)?	___Yes	✓ None reported
Noncompliance material to financial statements noted?	___Yes	✓ No

Federal Awards

Internal control over major programs:		
Material weakness(es) identified?	___Yes	✓ No
Significant deficiencies identified that are not considered to be material weakness(es)?	___Yes	✓ None reported
Type of auditor's report issued on compliance for major programs:	Unqualified	
Any audit findings disclosed that are required to be reported in Accordance with Section 510(a) of Circular A-133?	___Yes	✓ None reported

Major programs:	CFDA Number	Name of Federal Program
	97.036	U.S. Department of Homeland Security

Dollar threshold used to distinguish between type A And type B programs	$300,000	
Auditee qualified as low-risk auditee?	___Yes	✓ No

Findings – Financial Statements Audit

None

Findings and Questioned Costs – Major Federal Award Programs Audit

None

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• Business Advisors

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Report on Internal Control Over Financial Reporting and On Compliance And Other Matters Based On An Audit Of Financial Statements Performed In Accordance With *Government Auditing Standards*

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

We have audited the financial statements of the Knoxville Utilities Board, (an independent agency and reported as a component unit for financial purposes only by the City of Knoxville), Water Division, as of and for the year ended June 30, 2012, which collectively comprise the Knoxville Utilities Board's basic financial statements and have issued our report thereon dated October 18, 2012. 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.

In accordance with *Government Auditing Standards*, the report dated October 18, 2012, has been reissued due to the omission of two federal program contracts on the schedule of expenditures of federal, state and other awards. Since program CFDA 97.036 was considered major, additional audit procedures were performed. The changes to the previously issued report dated October 18, 2012 encompasses the addition of program CFDA 97.036 contract number 34101-0000009205 and contract number 34101-0000009832 to the schedule of expenditures of federal, state and other awards and to the schedule of findings and questioned costs.

Internal Control Over Financial Reporting

Management of the Knoxville Utilities Board is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered Knoxville Utilities Board's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Knoxville Utilities Board's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Knoxville Utilities Board's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Knoxville Utilities Board's financial statements are free of 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*.

This report is intended solely for the information and use of the Knoxville Utilities Board's audit committee, board of commissioners, and others within the entity, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Rodefer Moss & Co, PLLC

Knoxville, Tennessee
October 18, 2012
(Except as noted in paragraph 2 above,
as to which the date is October 22, 2013)

• Certified Public Accountants
• Business Advisors

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Independent Auditors' Report On Compliance With Requirements That Could Have A Direct And Material Effect On Each Major Program And On Internal Control Over Compliance In Accordance With OMB CIRCULAR A-133

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

Compliance

We have audited the Knoxville Utilities Board's, (an independent agency and reported as a component unit for financial purposes only by the City of Knoxville) compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the Knoxville Utilities Board's major federal programs for the year ended June 30, 2012. Knoxville Utilities Board's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the Knoxville Utilities Board's management. Our responsibility is to express an opinion on the Knoxville Utilities Board's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Knoxville Utilities Board's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Knoxville Utilities Board's compliance with those requirements.

In our opinion, the Knoxville Utilities Board, complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2012.

In accordance with *Government Auditing Standards*, the report dated October 18, 2012, has been reissued due to the omission of two federal program contracts on the schedule of expenditures of federal, state and other awards. Since program CFDA 97.036 was considered major, additional audit procedures were performed. The changes to the previously issued report dated October 18, 2012 encompasses the addition of program CFDA 97.036 contract number 34101-0000009205 and contract number 34101-0000009832 to the schedule of expenditures of federal, state and other awards and to the schedule of findings and questioned costs.

Internal Control over Compliance

Management of the Knoxville Utilities Board is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Knoxville Utilities Board's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Knoxville Utilities Board's internal control over compliance.

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

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

This report is intended solely for the information and use of the Knoxville Utilities Board's audit committee, board of commissioners, others within the entity, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Rodefer Moss & Co, PLLC

Knoxville, Tennessee
October 18, 2012
(Except as noted in paragraph 4 above,
as to which the date is October 22, 2013)

Knoxville Utilities Board
Wastewater Division

Financial Statements and Supplemental Information

June 30, 2012 and 2011

Knoxville Utilities Board Wastewater Division
Index
June 30, 2012 and 2011

Page(s)

Independent Auditors' Report 1-2

Management's Discussion and Analysis 3-19

Financial Statements

Statements of Net Assets 20-21

Statements of Revenues, Expenses and Changes in Net Assets 22

Statements of Cash Flows 23

Notes to Financial Statements 24-38

Required Supplementary Information – Schedule of Funding Progress 39

Supplemental Information:

Schedule 1 – Schedule of Insurance in Force 40

Schedule 2 – Schedule of Debt Maturities by Fiscal Year 41-42

Schedule 3 – Schedule of Current Rates in Force 43-46

Schedule 4 – Schedule of Expenditures of Federal Awards 47

Schedule 5 – Schedule of Findings and Questioned Costs 48

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* 49-50

Report of Independent Auditors Report on Compliance with Requirements that could have a Direct Material Effect on each Major Program and on Internal Control over Compliance in Accordance with *OMB Circular A-133* 51-52

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Independent Auditors' Report

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

We have audited the accompanying consolidated financial statements of the Knoxville Utilities Board, Wastewater Division, an independent agency and reported as a component unit for financial reporting purposes only by the City of Knoxville, Tennessee, as of and for the years ended June 30, 2012 and 2011. These financial statements are the responsibility of Knoxville Utilities Board's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Knoxville Utilities Board, Wastewater Division, as of June 30, 2012 and 2011, and the respective changes in financial position, and cash flows, for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 18, 2012, on our consideration of the Knoxville Utilities Board'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* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 19 and Schedule of Funding Progress on page 39 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Knoxville Utilities Board's financial statements as a whole. The supplemental schedules on pages 40 through 46 are presented for the purpose of additional analysis and are not a required part of the financial statements. The accompanying schedule of expenditures of federal awards on page 47 is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local*

Governments, and Non-Profit Organizations, and is also not a required part of the financial statements. The schedule of expenditures of federal awards is the responsibility of management and was derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole. The supplemental schedules have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on them.

In accordance with *Government Auditing Standards*, the report on our consideration of the Board's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters dated October 18, 2012, has been reissued due to the omission of two federal program contracts on the schedule of expenditures of federal, state and other awards. Since program CFDA 97.036 was considered major, additional audit procedures were performed. The changes to the previously issued report dated October 18, 2012 encompasses the addition of program CFDA 97.036 contract number 34101-0000009205 and contract number 34101-0000009832 to the schedule of expenditures of federal, state and other awards and to the schedule of findings and questioned costs.

Rodefer Moss & Co, PLLC

Knoxville, Tennessee
October 18, 2012
(Except as noted in the last paragraph above,
as to which the date is October 22, 2013)

Knoxville Utilities Board (KUB), comprised of the Electric Division, Water Division, Gas Division, and Wastewater Division (Divisions), is reported as a component unit enterprise fund in the financial statements of the City of Knoxville. KUB's responsibility is to oversee the purchase, production, distribution, and processing of electricity, water, natural gas, and wastewater services. A seven-member Board of Commissioners governs KUB. The Board has all powers to construct, acquire, expand, or operate the Divisions. It has full control and complete jurisdiction over the management and operation of the Divisions. The Wastewater Division (Division) provides services to certain customers in Knox County and in two surrounding counties in East Tennessee. The Division's accounts are maintained in conformity with the Uniform System of Accounts of the National Association of Regulatory Utility Commissioners (NARUC) and the Governmental Accounting Standards Board (GASB), as applicable. The financial statements present only the Wastewater Division and do not purport to, and do not, present fairly the consolidated financial position of Knoxville Utilities Board at June 30, 2012 and 2011, 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, 2012 activities, resulting changes and current known facts, and should be read in conjunction with the Division’s financial statements.

Wastewater Division Highlights

System Highlights

The wastewater service area covers 242 square miles and includes 69,200 wastewater customers. KUB maintains 1,325 miles of services mains, 68 pump stations, and 4 treatment plants to treat 15.4 billion gallons of wastewater on an annual basis. Rated capacity for the wastewater system is 66 million gallons. The average daily flow is 42.2 million gallons daily.

Financial Highlights

The Division’s net assets increased $12 million or 5.3 percent, compared to a $9.4 million increase last fiscal year.

Operating revenue increased $4.7 million or 7.2 percent, the result of a 12 percent rate increase effective on April 2011 customer bills.

Operating expenses increased $1.3 million or 3.3 percent. Operating and maintenance (O&M) expenditures decreased $0.3 million or 1 percent. Depreciation expense rose $1.5 million or 13 percent. Taxes and tax equivalents increased $0.1 million or 3.1 percent.

Non-Operating revenues decreased $1.5 million from the prior year. Lower interest rates on longer-term investments resulted in a $0.1 million decrease in interest income. Interest expense increased $1.3 million or 7.5 percent, due to the issuance of $70 million in bonds in December 2010.

Capital contributions increased $0.6 million, the result of a rise in donated assets from developers compared to the previous fiscal year.

Total plant assets (net) increased $47.8 million or 9.1 percent over the end of the last fiscal year.

Long-term debt represented 62 percent of the Division’s capital structure as of June 30, 2012, as compared to 63.6 percent last year. The decline is attributed to a decrease in long-term debt, the combined result of the April 2012 refunding of $18 million in debt, which reduced principal by $0.9 million, and the scheduled repayment of debt during the fiscal year. Capital structure equals long-term debt (which includes the current portion of revenue bonds and notes, as applicable, due to be retired the next fiscal year) plus net assets.

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 and maximum debt coverage are 1.74.

Division Highlights

The wastewater system added approximately 400 customers during fiscal year 2012.

The Division refunded $18 million of long-term bonds at lower interest rates in April 2012. This refunding resulted in a savings of $2.7 million over the term of the debt (or $2.1 million on a net present value basis).

The typical residential wastewater customer's average monthly bill was $42.30 at fiscal year end, which is consistent with last year's monthly bill.

Although KUB is making upgrades to its Kuwahee and Fourth Creek wastewater treatment facilities in order to comply with the requirements of the Consent Decree (see below), KUB's treatment plants continue to meet high standards of operation. Each of KUB's four wastewater treatment plants won an award from the National Association of Clean Water Agencies for outstanding permit compliance in 2011.

KUB also received a National Biosolids Partnership certification in December 2011 following a rigorous review process and independent audit. (Biosolids are nutrient-rich organic matter produced by wastewater treatment that can be recycled as fertilizer).

Consent Decree

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

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

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

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

KUB's funding plan for the Consent Decree includes long-term bonds and a series of rate increases phased in over the term of the order. Bond proceeds fund all wastewater capital projects, the majority of which are related to the Consent Decree. As of June 30, 2012, the Wastewater Division had issued $360 million in bonds to fund system capital improvements since the inception of the Consent Decree. The KUB Board of Commissioners approved two 50 percent rate increases, which went into effect in April 2005 and January 2007, respectively. The Board also approved an 8 percent rate increase, which was effective in September 2008, and a 12 percent rate increase, which was effective in April 2011. The Board also adopted a 12 percent rate increase to be effective October 2012. 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 203 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 2012, the Wastewater Division incurred $60.5 million in total expenditures related to Consent Decree requirements, including $3.7 million for operating costs and $56.8 million in capital improvements which included the rehabilitation or replacement of 29 miles of wastewater main. During the fiscal year, $20.4 million was spent on sewer mini-basin rehab and replacement. Trunk line replacement and rehabilitation accounted for $17 million of capital expenditures during the fiscal year. Upgrades currently in progress at the Kuwahee and Fourth Creek treatment facilities accounted for $11.8 million of fiscal year 2012 capital expenditures.

As of June 30, 2012, the Wastewater Division had completed its eighth full year under the Consent Decree, spending $371.5 million on capital investments to meet Consent Decree requirements. KUB remains on time and on budget in meeting the requirements of the Consent Decree.

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Division Cash Budget Appropriations

KUB’s Board of Commissioners adopted a Wastewater Division budget of $115.2 million for fiscal year 2012. At year end, the Division was $1.6 million under budget as O&M expenses were $1.5 million less than anticipated. Capital spending was on budget. Cash operating receipts were on target. Bond proceeds of $27.5 million were transferred to the general fund to pay for capital expenditures during fiscal year 2012. The Division’s general fund balance was $8.5 million higher than budgeted. The numbers below are presented on a cash basis.

Wastewater Division Cash Report
As of June 30, 2012

(in thousands of dollars)	FY 2012 Budget	FY 2012 Actual FYTD	Dollar Variance*	Percent Variance
Beginning Balance General Fund	$ 31,855	$ 31,855		
Operating Receipts	72,281	72,319	38	0.1%
Disbursements				
Operation & Maintenance Expense	26,286	24,762	1,524	5.8%
Capital Expenditures	59,003	59,020	(17)	- %
Debt Service & Taxes	29,861	29,766	95	0.3%
Total Disbursements	115,150	113,548	1,602	1.4%
Bond Proceeds	27,458	34,305	6,847	24.9%
Net Flow-throughs and Transfers	10	66	56	100%
Ending General Fund Balance	$ 16,454	$ 24,997	$ 8,543	51.9%

**(-) indicates a decrease to cash*

KUB, Wastewater Division, Financial Statements

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

Statement of Net Assets

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

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

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

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

Statement of Revenues, Expenses and Changes in Net Assets

The Division reports its revenues and expenses (both operating and non-operating) on the Statement of Revenues, Expenses and Changes in Net Assets. 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 assets for the reporting period. Net assets at the beginning of the period are increased or decreased, as applicable, by the change in net assets for the reporting period.

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

Statement of Cash Flows

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

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

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

Condensed Financial Statements

Statement of Net Assets

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

Statements of Net Assets
As of June 30

(in thousands of dollars)	**2012**	**2011**
Current and other assets	$ 68,295	$ 110,880
Capital assets, net	574,384	526,622
Total assets	642,679	637,502
Current and other liabilities	19,419	18,231
Long-term debt outstanding	383,705	391,675
Total liabilities	403,124	409,906
Net assets		
Invested in capital assets, net of related debt	183,964	129,502
Restricted	1,756	1,700
Unrestricted	53,835	96,394
Total net assets	$ 239,555	$ 227,596

Normal Impacts on Statement of Net Assets

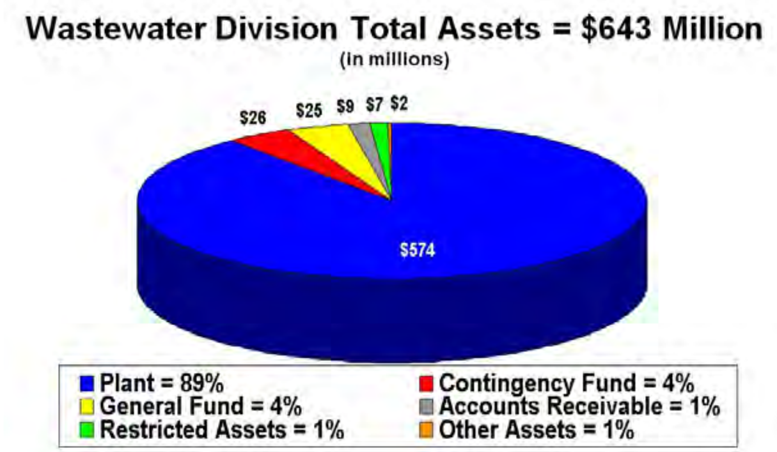
The following is a description of activities which will normally impact the comparability of the Statement of Net Assets presentation.

- Change in net assets (from Statement of Revenues, Expenses and Changes in Net Assets): impacts (increase/decrease) current and other assets and/or capital assets and unrestricted net assets.
- Issuing debt for capital: increases current and other assets 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 assets and increases invested in capital assets, net of related debt.
- Principal payment on debt: (a) reduces current and other assets and reduces long-term debt and (b) reduces unrestricted net assets and increases invested in capital assets, net of related debt.
- Reduction of capital assets through depreciation: reduces capital assets and invested in capital assets, net of related debt.

Current Year Impacts and Analysis

Current and Other Assets
Current and other assets decreased $42.6 million or 38.4 percent. General fund cash decreased $6.9 million, due to the use of cash to fund a portion of capital expenditures during the year. A large portion of capital improvements was funded with the remaining proceeds of a $70 million bond issue from the previous fiscal year, which accounted for $34.3 million of the overall reduction in current and other assets.

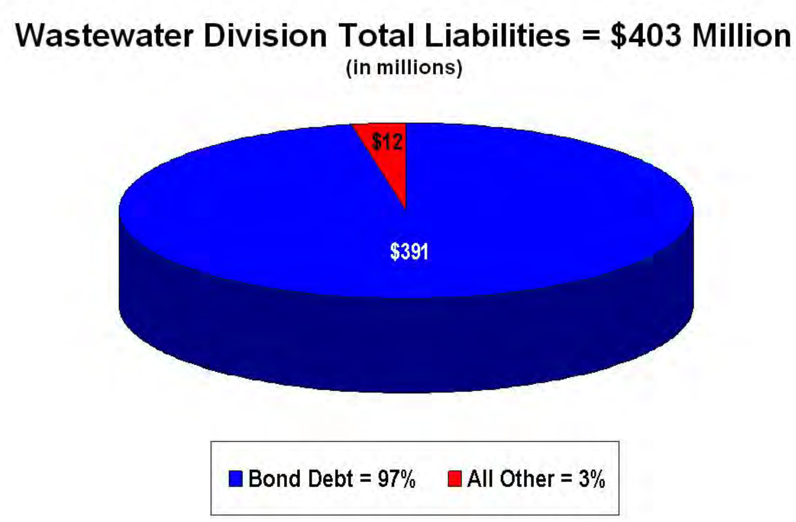
Capital Assets
Capital assets increased $47.8 million or 9.1 percent, the result of capital expenditures, net of depreciation. Major plant additions (including construction work in progress) during the year included $45 million for major system improvements related to PACE 10 and $11.8 million for Composite Correction Plan projects, both of which were required under the Consent Decree.



Current and Other Liabilities
Current and other liabilities increased $1.2 million, which was the combined result of a $1.5 million rise in accounts payable, a $0.3 million increase in the current portion of bond debt to be repaid during the next fiscal year, and a $0.6 million reduction in the Division's share of liability for other post-employment health benefits.

The Consent Decree requires KUB to fund a Supplemental Environmental Program (SEP) in the amount of $2 million over the course of 8 years to fund repair or replacement of defective private laterals or removal of illicit connections. A $1.7 million liability was accrued in May 2006 for the SEP. During the current and previous fiscal years, KUB has completely funded $2 million, thereby reducing the liability to zero.

Long-Term Debt
Long-term debt decreased $8 million or 2 percent, due to the scheduled repayment of bond debt during the fiscal year and a $0.9 million reduction in principal as a result of the April 2012 bond refunding.



Net Assets
Invested in capital assets, net of debt, increased $54.5 million or 42.1 percent, due to a $12 million increase in net assets (as reported on the Statement of Revenues, Expenses and Changes in Net Assets) and the combined effect of a $47.8 million increase in capital assets and the $8 million decrease in debt. Unrestricted assets decreased $42.6 million partially due to the expending of $34.3 million in bond proceeds from the prior year. Restricted net assets were consistent with the previous fiscal year.

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Statement of Revenues, Expenses and Changes in Net Assets

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

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

(in thousands of dollars)	**2012**	**2011**
Operating revenues	$ 70,502	$ 65,775
Operating expenses		
Treatment	9,256	9,371
Collection	7,441	7,588
Customer service	1,945	2,092
Administrative and general	6,278	6,126
Depreciation and amortization	12,911	11,421
Taxes and tax equivalents	3,625	3,516
Total operating expenses	41,456	40,114
Operating income	29,046	25,661
Interest income	562	683
Interest expense	(19,314)	(17,970)
Other income/(expense)	(202)	(194)
Change in net assets before capital contributions	10,092	8,180
Capital contributions	1,867	1,224
Change in net assets	$ 11,959	$ 9,404

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

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

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

- Operating expenses (treatment, collection system expense, customer service, administrative and general) are normally impacted by changes in areas including, but not limited to, labor cost (staffing, wage rates), active employee and retiree health insurance costs, chemicals, and wastewater system maintenance.

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

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

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

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

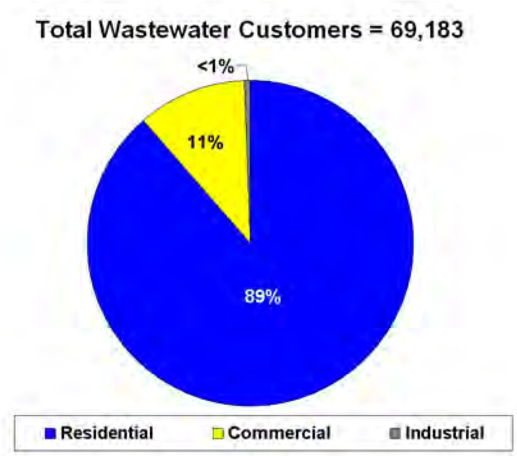
- Other income/(expense) is impacted by miscellaneous non-operating revenues and expenses.

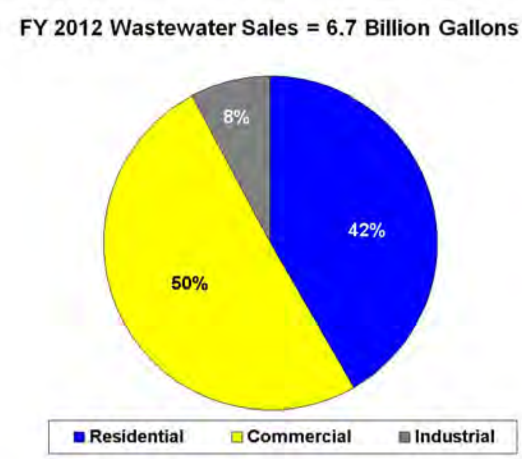
- Capital contributions are impacted by a donation of facilities/infrastructure to KUB by developers and governmental agencies. The contributions are recognized as revenue and recorded as plant in service based on the fair market value of the asset(s).

Current Year Impacts and Analysis

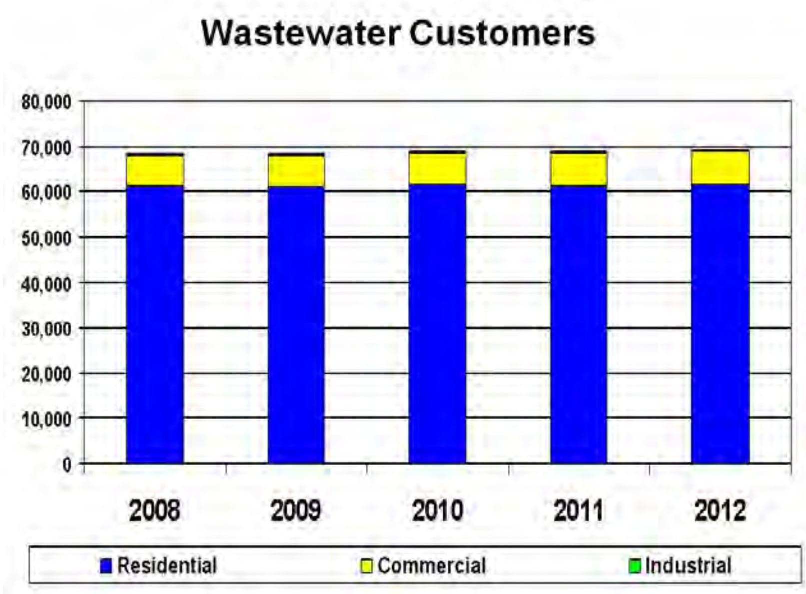
The Division's net assets increased $12 million, representing an increase of $2.6 million compared to earnings of $9.4 million last fiscal year.

Operating revenue increased $4.7 million or 7.2 percent for the fiscal year ending June 30, 2012, reflecting additional revenue from the 12 percent April 2011 rate increase. Rebates on bond interest payments from the federal government for federally taxable Build America Bonds (BABs) are reported as revenue in accordance with GASB. KUB recognized $2 million in revenue for BABs rebates in fiscal year 2012.

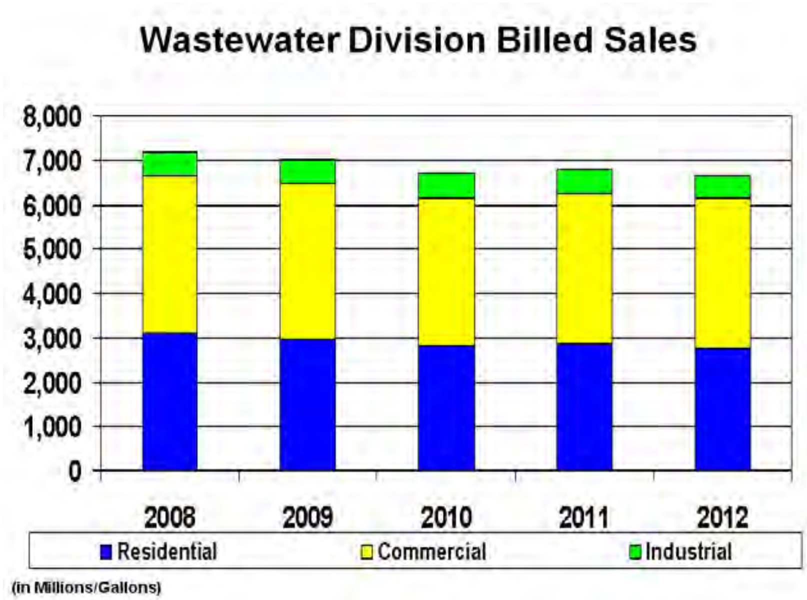




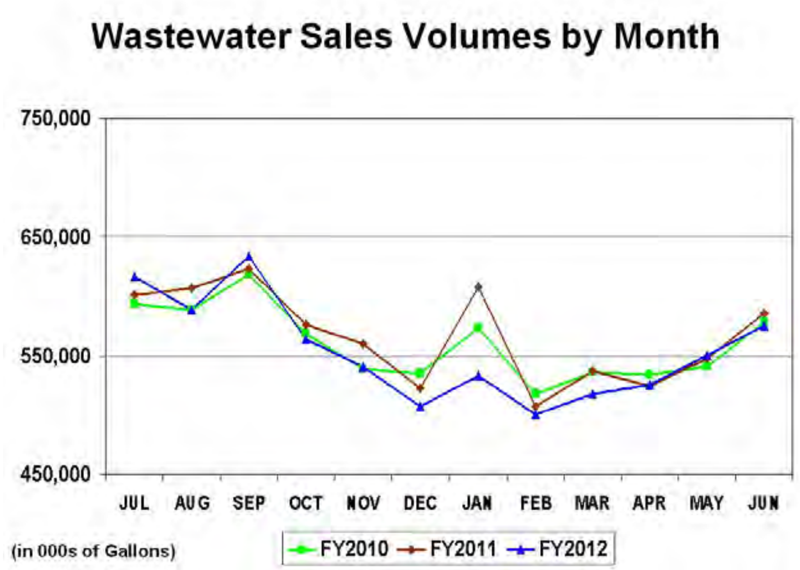
Residential customers accounted for 89 percent of wastewater customers and 42 percent of total billed sales for the year. Commercial customers accounted for the largest portion of total sales for the year.



The Division has added 800 customers over the past five years, representing annual growth of 0.3 percent. Operating revenue has grown at an annual rate of 3.8 percent over the same period, reflecting the rate increases necessary to support the capital requirements of the Consent Decree.



As reflected above, billed wastewater sales have consistently declined over the past five years, reflecting declining water usage due to more efficient appliances, conservation efforts, and the economic recession.



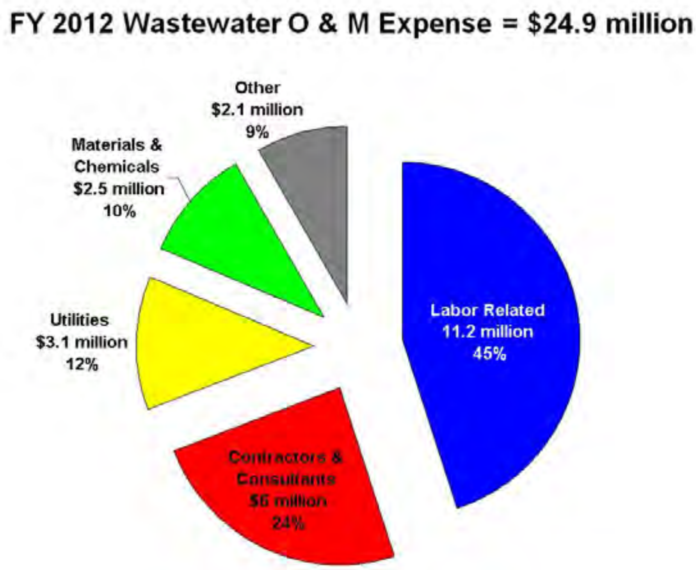
Wastewater billed sales were consistently below prior years' levels for the majority of fiscal year 2012, due to lower water sales (summer usage does not reflect watering credit adjustments on residential customers' bills).

Operating Expenses

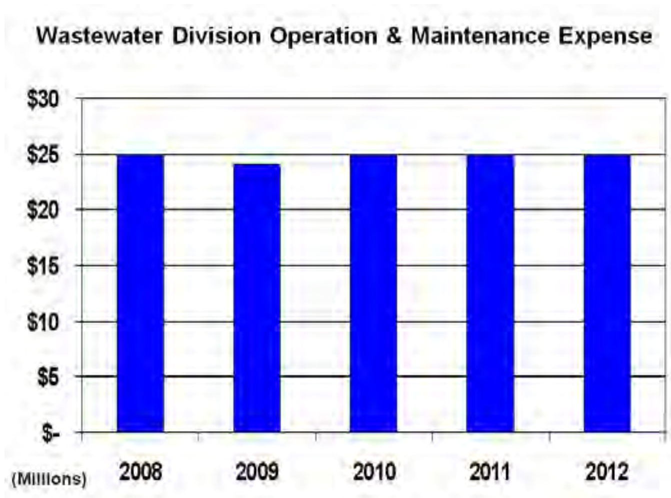
Operating expenses increased $1.3 million or 3.3 percent compared to the prior year.

- Treatment expenses were down $0.1 million, the result of lower labor-related expenses.
- Collection system expenses decreased $0.1 million, the net result of a $0.4 million rise in blockage abatement costs and a $0.2 million reduction in expense for street cuts.
- Customer service expenses decreased $0.1 million, reflecting the Division's share of a reduction in labor-related expenses.
- Administrative and general expenses were up $0.2 million, partially due to a $0.1 million increase in damage claims.

(Graph on following page)



O&M expense has grown at a rate of 0.3 percent per year over the past five years. Expense growth over this period has been relatively stable, reflecting KUB cost management efforts over this time period.



- Depreciation expense increased $1.5 million or 13 percent, the result of a full year of depreciation on $48.2 million of wastewater system assets placed in service during fiscal year 2011, and a partial year of depreciation on $62 million added during fiscal year 2012. The Division also retired $1.8 million of assets during the fiscal year.

- Taxes and tax equivalents increased $0.1 million.

Other Income and Expense

Interest income decreased $0.1 million, the result of lower longer-term interest rates.

Interest expense increased $1.3 million or 7.5 percent, due to a full year of interest on $70 million in revenue bonds issued in fiscal year 2011.

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

Capital contributions increased $0.6 million compared to last fiscal year as a result of assets received from developers and other governmental entities during the fiscal year, including the new Cherokee Farm development of the University of Tennessee.

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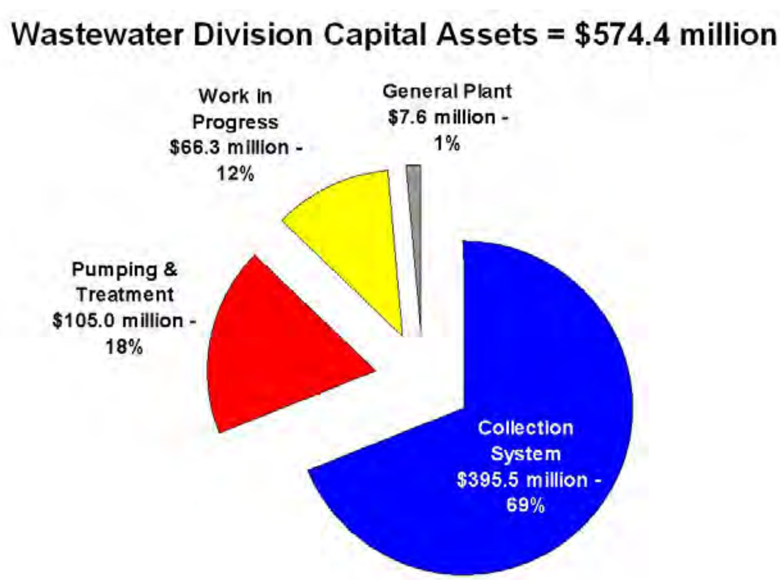
Capital Assets and Debt Administration

Capital Assets

As of June 30, 2012, the Division had $574.4 million invested in a variety of capital assets, as reflected in the schedule below, which represents a net increase (including additions, retirements, and depreciation) of $47.8 million or 9.1 percent over the end of the last fiscal year.

Capital Assets
As of June 30
(Net of Depreciation)

(in thousands of dollars)		**2012**		**2011**
Pumping and treatment plant	$	104,955	$	94,142
Collection plant:				
Mains		328,495		315,274
Others		67,000		43,232
Total collection plant		395,495		358,506
General plant		7,619		6,621
Total plant		508,069		459,269
Work in progress		66,315		67,353
Total net plant	$	574,384	$	526,622



Major capital asset additions during the year were as follows:

- $45 million related to PACE 10 projects.
    - $20.4 million for sewer mini-basin rehab and replacement
    - $17 million for sewer trunk line replacement and rehabilitation
    - $3.2 million for pump station design and construction
    - $2.7 million for storage tank design and construction

- $11.8 million for Composite Correction Plan projects.
    - $9.3 million for upgrades to the Kuwahee Wastewater Treatment Plant
    - $2.5 million for upgrades at the Fourth Creek Facility

Debt Outstanding

As of June 30, 2012, the Division had $390.7 million in debt outstanding (including the current portion of revenue bonds), compared to $398.4 million last year, which is a decrease of $7.7 million or 1.9 percent. The Division's weighted average cost of debt as of June 30, 2012 was 4.86 percent (the effective weighted average cost of debt is 4.35 percent, which reflects the Build America Bond rebate for a portion of the outstanding debt).

KUB refunded $18 million in outstanding bonds issued in 2004 at lower interest rates. KUB issued $17.1 million in revenue refunding bonds, which when combined with a reoffering premium of $1.3 million, retired the $18 million in outstanding bonds and covered the underwriter's discount and costs of issuance.

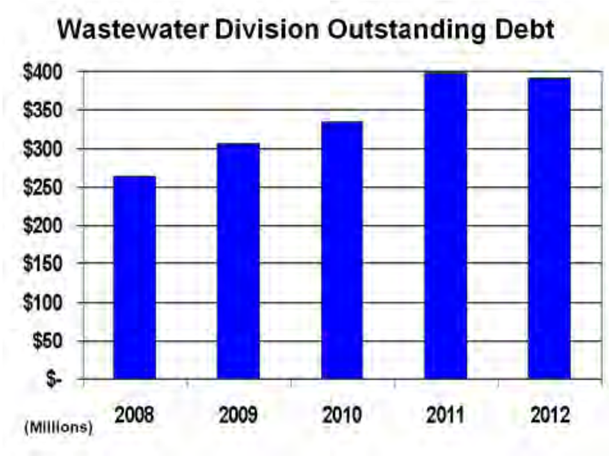
The Division's outstanding debt is rated by Standard & Poor's and Moody's Investors Service. As of June 30, 2012, the Division's revenue bonds were rated AA+ by Standard & Poor's and Aa2 by Moody's Investors Service.

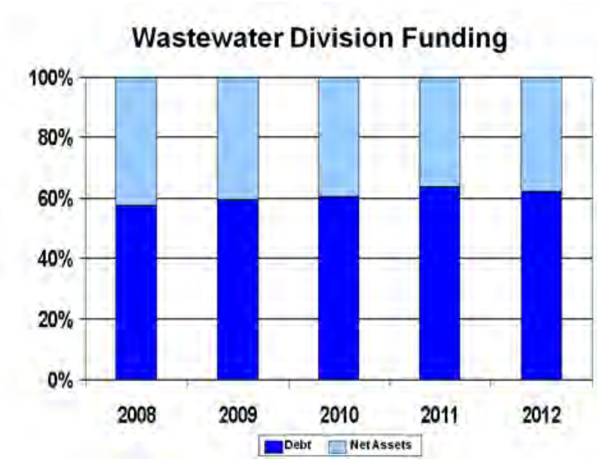
The following is a schedule of the Division's outstanding debt as of June 30, 2012.

Outstanding Debt
As of June 30

(in thousands of dollars)	**2012**	**2011**
Revenue bonds	$ 390,745	$ 398,405
Total outstanding debt	$ 390,745	$ 398,405

The Division's outstanding debt level has increased from $263.5 million in 2008 to $390.7 million by fiscal year end 2012. The majority of the debt proceeds have been used to fund capital requirements under the Consent Decree. The Division's debt to capitalization ratio has increased from 57.4 percent to 62 percent over the same time period.





Impacts on Future Financial Position

KUB does not anticipate any net increase in wastewater customers in fiscal year 2013.

The KUB Board of Commissioners adopted a 12 percent rate increase to be effective October 1, 2012. The rate increase will raise the typical residential wastewater customer's monthly bill $5.20.

KUB also expects to issue $65 million of long-term revenue bonds during fiscal year 2013 to help fund capital projects required by the Consent Decree.

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 2013.

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, 2012 and 2011. 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 Assets
June 30, 2012 and 2011

	2012	2011
Assets		
Current assets:		
Cash and cash equivalents	$ 14,997,191	$ 27,855,468
Short-term investments	10,000,000	4,000,000
Short-term contingency fund investments	11,099,010	10,005,173
Other current assets	223,135	545,042
Accrued interest receivable	30,917	11,735
Accounts receivable, less allowance of uncollectible accounts of $105,622 in 2012 and $136,545 in 2011	8,594,708	8,569,875
Inventories	121,008	171,715
Prepaid expenses	43,275	49,534
Total current assets	45,109,244	51,208,542
Restricted assets:		
Wastewater bond fund	6,484,629	6,544,021
Other funds	718	18,543
Unused bond proceeds	-	34,271,999
Total restricted assets	6,485,347	40,834,563
Wastewater plant in service	647,343,880	587,122,219
Less accumulated depreciation	(139,274,178)	(127,853,008)
	508,069,702	459,269,211
Retirement in progress	131,554	9,742
Construction in progress	66,183,184	67,343,328
Net plant in service	574,384,440	526,622,281
Other assets:		
Long-term contingency fund investments	15,279,785	16,502,725
Deferred loss on refunding bonds	606,449	683,537
Supplemental environmental project	-	150,000
Other	813,866	1,500,654
Total other assets	16,700,100	18,836,916
Total assets	$ 642,679,131	$ 637,502,302

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

Knoxville Utilities Board Wastewater Division
Statements of Net Assets
June 30, 2012 and 2011

	2012	2011
Capitalization and Liabilities		
Current liabilities:		
Current portion of revenue bonds	$ 7,040,000	$ 6,730,000
Accounts payable	3,571,664	2,079,891
Accrued expenses	1,480,178	1,849,582
Customer deposits plus accrued interest	733,584	682,976
Accrued interest on revenue bonds	4,729,302	4,862,171
Total current liabilities	17,554,728	16,204,620
Other liabilities:		
Accrued compensated absences	1,447,257	1,491,207
Customer advances for construction	342,000	348,000
Supplemental environmental project	-	150,000
Other	75,317	37,156
Total other liabilities	1,864,574	2,026,363
Long-term debt:		
Wastewater revenue bonds	383,705,000	391,675,000
Total long-term debt	383,705,000	391,675,000
Total liabilities	403,124,302	409,905,983
Net assets		
Invested in capital assets, net of related debt	183,963,788	129,501,981
Restricted for:		
Debt service	1,755,328	1,681,850
Other	717	18,542
Unrestricted	53,834,996	96,393,946
Total net assets	239,554,829	227,596,319
Total liabilities and net assets	$ 642,679,131	$ 637,502,302

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

Knoxville Utilities Board Wastewater Division
Statements of Revenues, Expenses and Changes in Net Assets
Years Ended June 30, 2012 and 2011

	2012	2011
Operating revenues	$ 70,502,494	$ 65,774,599
Operating expenses		
Treatment	9,255,855	9,370,566
Collection	7,441,286	7,588,032
Customer service	1,944,802	2,091,714
Administrative and general	6,278,420	6,125,879
Provision for depreciation and amortization	12,911,050	11,421,466
Taxes and tax equivalents	3,624,508	3,516,085
Total operating expenses	41,455,921	40,113,742
Operating income	29,046,573	25,660,857
Non-operating revenues (expenses)		
Contributions in aid of construction	247,356	303,275
Interest and dividend income	561,662	682,690
Interest expense	(19,313,566)	(17,970,455)
Write-down of plant for costs recovered through contributions	(247,356)	(303,275)
Other	(202,824)	(193,747)
Total non-operating revenues (expenses)	(18,954,728)	(17,481,512)
Change in net assets before capital contributions	10,091,845	8,179,345
Capital contributions	1,866,665	1,224,385
Change in net assets	11,958,510	9,403,730
Net assets, beginning of year	227,596,319	218,192,589
Net assets, end of year	$ 239,554,829	$ 227,596,319

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

Knoxville Utilities Board Wastewater Division
Statements of Cash Flows
Years Ended June 30, 2012 and 2011

	2012	2011
Cash flows from operating activities:		
Cash receipts from customers	$ 68,553,022	$ 62,493,764
Cash receipts from other operations	2,133,675	1,626,153
Cash payments to suppliers of goods or services	(15,694,798)	(18,468,437)
Cash payments to employees for services	(8,436,800)	(9,912,679)
Payment in lieu of taxes	(3,002,025)	(2,859,071)
Net cash provided by operating activities	43,553,074	32,879,730
Cash flows from capital and related financing activities:		
Net proceeds from bond issuance	-	69,485,860
Principal paid on revenue bonds and notes payable	(6,730,000)	(5,600,000)
Decrease (increase) in unused bond proceeds	34,236,295	(34,236,295)
Interest paid on revenue bonds and notes payable	(19,446,436)	(17,328,768)
Acquisition and construction of wastewater plant	(59,403,083)	(50,049,461)
Changes in wastewater bond fund, restricted	59,392	(880,392)
Customer advances for construction	(6,000)	348,000
Proceeds received on disposal of plant	27,513	-
Cash received from developers and individuals for capital purposes	247,356	303,275
Net cash used in capital and related financing activities	(51,014,963)	(37,957,781)
Cash flows from investing activities:		
Purchase of investment securities	(6,234,955)	(8,683,543)
Maturities of investment securities	364,059	410,946
Interest received	561,662	682,690
Other property and investments	(87,154)	(112,806)
Net cash (used in) investing activities	(5,396,388)	(7,702,713)
Net (decrease) in cash and cash equivalents	(12,858,277)	(12,780,764)
Cash and cash equivalents, beginning of year	27,855,468	40,636,232
Cash and cash equivalents, end of year	$ 14,997,192	$ 27,855,468
Reconciliation of operating income to net cash provided by operating activities		
Operating income	$ 29,046,573	$ 25,660,857
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization expenses	13,189,107	11,691,177
Changes in operating assets and liabilities:		
Accounts receivable	(24,834)	(1,698,476)
Inventories	50,707	(3,703)
Prepaid expenses	6,259	(7,522)
Other assets	268,074	167,732
Accounts payable and accrued expenses	928,418	(2,788,022)
Customer deposits plus accrued interest	50,608	(113,703)
Other liabilities	38,162	(28,610)
Net cash provided by operating activities	$ 43,553,074	$ 32,879,730
Noncash capital activities:		
Acquisition of plant assets through developer contributions	$ 1,866,665	$ 1,224,385

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

1. Description of Business

Knoxville Utilities Board (KUB), comprised of the Electric Division, Water Division, Gas Division, and Wastewater Division (Divisions), is reported as a component unit enterprise fund in the financial statements of the City of Knoxville. KUB's responsibility is to oversee the purchase, production, distribution, and processing of electricity, water, natural gas, and wastewater services. A seven-member Board of Commissioners governs KUB. The Board has all powers to construct, acquire, expand, or operate the Divisions. It has full control and complete jurisdiction over the management and operation of the Divisions. The Wastewater Division (Division) provides services to certain customers in Knox County and in two surrounding counties in East Tennessee. The Division's accounts are maintained in conformity with the Uniform System of Accounts of the National Association of Regulatory Utility Commissioners (NARUC) and the Governmental Accounting Standards Board (GASB), as applicable. The financial statements present only the Wastewater Division and do not purport to, and do not, present fairly the consolidated financial position of Knoxville Utilities Board at June 30, 2012 and 2011, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

2. Significant Accounting Policies

Basis of Accounting

KUB follows the provisions of Statement No. 34 (Statement 34) of the Governmental Accounting Standards Board *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments.* Statement 34 established standards for external financial reporting for all state and local governmental entities, which includes a statement of net assets; a statement of revenues, expenses and changes in net assets; and a statement of cash flows. It requires the classification of net assets into three components – invested in capital assets, net of related debt; restricted; and unrestricted. These classifications are defined as follows:

- Invested in capital assets, net of related debt – This component of net assets 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. If there are significant unspent related debt proceeds at year end, the portion of the debt attributable to the unspent proceeds is not included in the calculation of invested in capital assets, net of related debt. Rather, that portion of the debt is included in the same net assets component as the unspent proceeds.

- Restricted – This component of net assets consists of restrictions placed on net asset use through external constraints imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or restrictions imposed by law through constitutional provisions or enabling legislation.

- Unrestricted net assets – This component of net assets consists of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt."

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 assets. Net assets (i.e., total assets net of total liabilities) are segregated into invested in capital assets, net of related debt; restricted for capital activity and debt service; and unrestricted components.

As allowed by the Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting,* KUB's policy is to apply only those Financial Accounting Standards Board statements, related interpretations, Accounting Principles Board opinions and accounting research bulletins issued on or prior to November 30, 1989 that do not conflict with Governmental Accounting Standards.

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 assets does not include depreciation for transportation equipment of $278,058 in 2012 and $269,711 in 2011. Interest costs are expensed as incurred.

Operating Revenue

Operating revenue consists primarily of charges for services provided by the principal operations of the KUB Wastewater Division. Operating revenue is recorded when the service is rendered, on a cycle basis, and includes an estimate of unbilled revenue. Revenues are reported net of bad debt expense of $215,679 in 2012 and $304,234 in 2011.

Non-operating Revenue

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

Expense

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

Contributions in Aid of Construction and Capital Contributions

Contributions in aid of construction are cash collections from customers or others for a particular purpose, generally the construction of new facilities to serve new customers in excess of the investment KUB is willing to make for a particular incremental revenue source. KUB reduces the plant account balances to which contributions relate by the actual amount of the contribution and recognizes the contributions as non operating revenue in accordance with FAS 71, *"Accounting for the Effects of Certain Types of Regulation"*.

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 33, *"Accounting and Financial Reporting for Nonexchange Transactions"*, such contributions are recognized as revenues and capital assets upon receipt.

Inventories

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

Pension Plan

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

Investments

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

Self-Insurance

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

Estimates

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

Restricted and Designated Assets
Certain assets are restricted by bond resolutions for utility plant construction and debt repayment. In addition, management has designated additional assets 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.

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 18, 2012, the date these financial statements were issued, for items that should potentially be recognized or disclosed.

Reclassifications
Certain reclassifications have been made to the 2011 balances to conform to the 2012 presentation.

3. Deposits and Investments

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

Information related to the carrying value and bank balances of deposits (except as described below), and the carrying value and fair value of investments at June 30, 2012, is as follows:

	Carrying Value	Bank Balance
Deposits		
Deposits in financial institutions	$ 14,997,909	$ 20,135,468
Investments		
Certificates of Deposits	25,516,989	25,516,989
State Treasurer's Investment Pool	-	-
Agency Bonds	17,266,926	17,266,926
	$ 57,781,824	$ 62,919,383

Classification of deposits and investments:

Depository Account		**Bank Balance**
Insured	$	48,774
Collateralized:		
Collateral held by pledging bank's trust department in KUB's name		17,266,926
Collateral held by pledging bank's trust department not in KUB's name*		45,603,683
Total deposits and investments	$	62,919,383

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

Classification of deposits and investments per statement of net assets:

		2012
Current assets		
Cash and cash equivalents	$	14,997,191
Short-term investments		10,000,000
Short-term contingency fund investments		11,079,030
Other assets		
Long-term contingency fund investments		15,220,256
Restricted assets		
Wastewater bond fund		6,484,629
Other funds		718
	$	57,781,824

The above amounts do not include accrued interest of $79,509.

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

	Deposit and Investment Maturities (in Years)					
		Fair Value		**Less Than 1**		**1-5**
Supersweep NOW and Other Deposits	$	20,135,468	$	20,135,468	$	-
State Treasurer's Investment Pool		-		-		-
Agency Bonds		17,266,926		3,390,131		13,876,795
Certificates of deposits		25,516,989		24,193,509		1,323,480
	$	62,919,383	$	47,719,108	$	15,200,275

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

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

4. Accounts Receivable

Accounts receivable consists of the following:

	2012	2011
Wholesale and retail customers		
Billed services	$ 4,344,993	$ 4,723,227
Unbilled services	3,114,882	3,115,708
Other	1,240,455	867,485
Allowance for uncollectible accounts	(105,622)	(136,545)
	$ 8,594,708	$ 8,569,875

5. Accounts Payable and Accruals

Accounts payable and accruals were composed of the following:

	2012	2011
Trade accounts	$ 3,571,664	$ 2,079,891
Salaries and wages	134,724	75,187
Self-insurance liabilities	341,126	369,796
Other current liabilities	1,004,328	1,404,599
	$ 5,051,842	$ 3,929,473

6. Long-Term Obligations

Long-term debt consists of the following:

	Balance June 30, 2011	Additions	Payments	Balance June 30, 2012	Amounts Due Within One Year
2004 A - 4.0 - 4.75%	$ 18,000,000	$ -	$ 18,000,000	$ -	-
2005 A - 4.0 - 5.0%	140,000,000	-	-	140,000,000	-
2005 B - 3.0 - 5.0%	20,170,000	-	730,000	19,440,000	760,000
2007 - 4.0 - 5.0%	75,000,000	-	-	75,000,000	-
2008 - 4.0 - 6.0%	41,800,000	-	3,300,000	38,500,000	3,400,000
2010 - 6.3 - 6.5%	30,000,000	-	-	30,000,000	-
2010B - 2.0 - 3.0%	3,435,000	-	1,700,000	1,735,000	1,735,000
2010C - 1.18 - 6.1%	70,000,000	-	1,000,000	69,000,000	1,075,000
2012A - 2.0 - 4.0%	-	17,070,000	-	17,070,000	70,000
Total debt	$ 398,405,000	$ 17,070,000	$ 24,730,000	$ 390,745,000	$ 7,040,000

Other liabilities consist of the following:

	Balance June 30, 2011	Increase	Decrease	Balance June 30, 2012	Amounts Due Within One Year
Accrued compensated absences	$ 1,491,207	$ 1,232,966	$ (1,276,916)	$ 1,447,257	$ 500,000
Customer advances for construction	348,000	-	(6,000)	342,000	10,000
Supplemental environmental project	150,000	-	(150,000)	-	-
Other	37,156	188,002	(149,841)	75,317	25,000
	$ 2,026,363	$ 1,420,968	$ (1,582,757)	$ 1,864,574	$ 535,000

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

Fiscal Year	Principal	Total Interest	Grand Total
2013	$ 7,040,000	$ 19,013,004	$ 26,053,004
2014	7,270,000	18,806,811	26,076,811
2015	7,550,000	18,537,459	26,087,459
2016	7,930,000	18,165,819	26,095,819
2017	8,310,000	17,827,044	26,137,044
2018-2022	47,115,000	83,482,558	130,597,558
2023-2027	53,695,000	71,790,773	125,485,773
2028-2032	59,885,000	58,569,951	118,454,951
2033-2037	76,025,000	41,789,488	117,814,488
2038-2042	85,925,000	21,422,576	107,347,576
2043-2045	30,000,000	3,800,000	33,800,000
Total	$ 390,745,000	$ 373,205,483	$ 763,950,483

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, 2012, those bond covenants had been satisfied.

In fiscal year 2004, KUB's Wastewater Division issued Series 2004A bonds to fund wastewater system capital improvements. During fiscal year 2012, Series 2004A was defeased with the issuance of Series 2012A.

During fiscal year 2006, KUB's Wastewater Division issued Series 2005A bonds for the purpose of funding wastewater system capital improvements and to pay off a previously issued revenue anticipation note (line of credit), which was used to fund capital improvements to the wastewater system. KUB's Wastewater Division also issued Series 2005B bonds in part to retire certain existing debt and fund wastewater system capital improvements. Concurrent with the issuance of these bonds, KUB transferred funds to an irrevocable trust to pay a portion of the Series 1998 bonds and Series 2001A bonds, as such amounts mature.

During fiscal year 2008, KUB's Wastewater Division issued Series 2007 bonds in part to pay off the outstanding balance on a previously issued revenue anticipation note (line of credit), and to fund wastewater system capital improvements.

During fiscal year 2009, KUB's Wastewater Division issued Series 2008 bonds to fund wastewater system capital improvements.

During fiscal year 2010, KUB's Wastewater Division issued Series 2010 bonds to fund capital improvements. These bonds were issued as federally taxable Build America Bonds with a 35 percent interest payment rebate to be received from the United States Government for each interest payment. KUB's Wastewater Division also issued Series 2010B bonds to retire Series 2001 bonds.

During fiscal year 2011, KUB's Wastewater Division issued Series 2010C bonds to fund wastewater system capital improvements. These bonds were issued as federally taxable Build

America Bonds with a 35 percent interest payment rebate to be received from the United States Government for each interest payment.

During fiscal year 2012, KUB's Wastewater Division issued Series 2012A bonds to retire Series 2004A bonds.

The outstanding principal balances on defeased bond issues were $40.9 million at June 30, 2012.

7. Lease Commitments

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

2013	$	4,940
2014		4,389
2015		5,596
2016		1,453
Total operating minimum lease payments	$	16,378

8. Capital Assets

Capital asset activity for the year ended June 30, 2012, was as follows:

		Beginning 6/30/2011		Increase		Decrease		Ending 6/30/2012
Pumping & Treatment Plant	$	151,051,423	$	14,154,849	$	(189,254)	$	165,017,018
Collection Plant								
Mains and Metering		369,217,960		20,708,730		(597,048)		389,329,642
Other Accounts		46,891,465		24,996,499		(4,837)		71,883,127
Total Collection Plant	$	416,109,425	$	45,705,229	$	(601,885)	$	461,212,769
Total General Plant		19,961,371		2,112,705		(959,983)		21,114,093
Total Wastewater Plant	$	587,122,219	$	61,972,783	$	(1,751,122)	$	647,343,880
Less accumulated depreciation		(127,853,008)		(13,060,179)		1,639,009		(139,274,178)
Net Plant Assets	$	459,269,211	$	48,912,604	$	(112,113)	$	508,069,702
Work In Progress		67,353,070		59,404,242		(60,442,574)		66,314,738
Total Net Plant	$	526,622,281	$	108,316,846	$	(60,554,687)	$	574,384,440

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 Assets. The liability is KUB's best estimate based on available information. At June 30, 2012, the amount of these liabilities was $341,126 resulting from the following changes:

	2012	2011
Balance, beginning of year	$ 369,796	$ 369,070
Current year claims and changes in estimates	3,626,016	3,867,098
Claims payments	(3,654,686)	(3,866,372)
Balance, end of year	$ 341,126	$ 369,796

10. Pension Plan

Description of Plan

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

At December 31, 2011, the Plan had approximately 652 retirees and beneficiaries currently receiving benefits and 56 terminated employees entitled to benefits but not yet receiving them. Of the approximately 873 current employees in the Plan, 730 were fully vested at December 31, 2011. 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 has frozen the Plan such that persons employed or re-employed by KUB on or after January 1, 2011, shall not be eligible to participate, but that eligible employees hired prior to January 1, 2011, who have not separated from service, shall continue as Participants and accrue benefits under the Plan.

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

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

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

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

All employees participating in the City Division Plan A as of June 30, 1999 were eligible to participate in KUB's Plan A or the CEP program. Participants of Plan A are covered by Social Security. Plan A is a closed plan and is not available to KUB employees hired after July 1999. Participation in Plan A requires employee contributions of 3 percent of the first $4,800 of annual earnings and 5 percent of annual earnings in excess of $4,800. Plan A provides for early retirement benefits with 25 years of service and normal retirement benefits at age 62 or older.

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

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

Funding Policy

For the Plan year ended December 31, 2011, a contribution of $3,593,282 is required to be made in the Plan sponsor's fiscal year ending June 30, 2013. The Wastewater Division's portion of this contribution is $754,589. The annual required contribution was determined as part of the January 1, 2011 valuation using the Individual Entry Age Normal funding method. The objective under this method is to fund each participant's benefits under the Plan as payments which are level as a percentage of salary, starting on the original participation date (employment date) and continuing until the assumed retirement, termination, disability or death. For the Plan year ended December 31, 2011, the Plan's actuarial funded ratio was 104.5 percent.

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

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

As of the actuarial report for the Plan year ended December 31, 2011, contributions of $3,593,282 and $3,244,057 for 2011 and 2010, respectively, are required to be made during the Plan sponsor's fiscal years ending June 30, 2013 and 2012, respectively. Of these amounts, $754,589 and $551,490 are attributable to the Wastewater Division.

Subsequent to June 30, 2012, the actuarial report for the Plan year ending December 31, 2012 was completed.

For the Plan year ending December 31, 2012, a contribution of $5,502,677 is required to be made in the Plan sponsor's fiscal year ending June 30, 2014. The Wastewater Division's portion of this contribution is $1,155,562. For the Plan year ending December 31, 2012, the Plan's actuarial funded ratio was 94.1 percent.

11. Defined Contribution Plan

KUB has a defined contribution 401(k) employee retirement savings plan covering eligible KUB employees. Employees hired prior to January 1, 2011 may participate and receive a matching contribution of 50 percent of their own contribution up to a maximum match of 3 percent. Employees hired on or after January 1, 2011 have an enhanced 401(k) Plan due to the closure of the Defined Benefit Pension Plan. They may participate and receive a matching contribution of 50 percent of their own contribution up to a maximum match of 3 percent. They also receive a nonelective KUB contribution of from 3 percent to 6 percent, depending on years of service, whether they contribute or not.

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

12. Other Post-Employment Benefits (OPEB)

The Governmental Accounting Standards Board (GASB) established new standards for the measurement, recognition, and reporting of other post-employment benefits (OPEB). OPEB includes post-employment benefits other than pension, which, for KUB, is presently limited to post-employment health care. GASB 45 requires the recognition of the accrued OPEB liability for the respective year, plus the disclosure of the total unfunded liability. GASB 45 was effective for KUB for the fiscal year beginning July 1, 2007.

KUB currently provides post-employment health care benefits to 633 former employees and 647 covered dependents. The cost of coverage is shared with retirees and beneficiaries. KUB recognizes its share of the cost of post-employment health care benefits as an expense as claims are paid.

In anticipation of GASB 45, KUB amended its Group Health Plan in 1999, eliminating post-employment health care benefits for all employees hired on or after July 1, 1999. As of June 30, 2012, 450 active employees were eligible for individual and dependent coverage at separation if the employee meets the Rule of 80 (age plus years of service) with a minimum of 20 years of service.

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 GASB 45 does not require pre-funding of the liability, KUB has determined that it is in the long-term economic interest of KUB and its ratepayers to establish a Trust to pre-fund KUB's OPEB liability.

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

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

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

Total contributions to the OPEB Trust for the fiscal year ended June 30, 2012 were $8.1 million (Division's share $1.3 million). The contribution to the Trust exceeded the annual required contribution (ARC), as determined by the Postretirement Benefit Plan's actuarial valuation for the year ended December 31, 2010, which was $4.6 million (Division's share $0.8 million). As of June 30, 2012, the employer's net OPEB obligation was $1.7 million (Division's share $0.3 million).

The ARC for the fiscal year ending June 30, 2013, as determined by the Plan's actuarial valuation for the year ended December 31, 2011 is $3.3 million (Division's share $0.7 million).

The actuarial valuation for the Plan for the year ending December 31, 2012 has been completed. The valuation determined that the Plan's actuarial accrued liability was $61.6 million (Division's share $13 million). The actuarial value of the Plan's assets was $37.9 million (Division's share $8 million). As a result, the Plan's unfunded actuarial accrued liability was $23.7 million (Division's share $5 million). The Plan's actuarial funded ratio was 62 percent. The valuation also determined that the employer's ARC is $3.3 million for the fiscal year ending June 30, 2014 (Division's share $0.7 million).

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, 2012 and 2011 are summarized as follows:

	2012	2011
City of Knoxville		
Amounts billed by the Division for utilities and related services	$ 704,749	$ 658,183
Payments by the Division in lieu of property tax	3,002,025	2,859,071
Payments by the Division for services provided	421,662	756,303
Other divisions of KUB		
Amounts billed to other divisions for utilities and related services provided	312,212	312,296
Interdivisional rental expense	164,829	201,856
Interdivisional rental income	90,385	91,525
Amounts billed to the Division by other divisions for utilities services provided	2,860,227	3,076,452

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

	2012	2011
Accounts receivable	$ 16,444	$ 24,428

14. Other Commitments and Contingencies

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

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

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

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

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

KUB's funding plan for the Consent Decree includes long-term bonds and a series of rate increases phased in over the term of the order. Bond proceeds fund all wastewater capital projects, the majority of which are related to the Consent Decree. As of June 30, 2012, the Wastewater Division had issued $360 million in bonds to fund system capital improvements since the inception of the Consent Decree. The KUB Board of Commissioners approved two 50 percent rate increases, which went into effect in April 2005 and January 2007, respectively. The Board also approved an 8 percent rate increase, which was effective in September 2008, and a 12 percent rate increase, which was effective in April 2011. The Board also adopted a 12 percent rate increase to be effective October 2012. KUB anticipates additional bond issues and rate increases over the next decade to help fund wastewater capital improvements.

Knoxville Utilities Board Wastewater Division
Required Supplementary Information – Schedule of Funding Progress
June 30, 2012

Pension Plan

Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (b)	Unfunded Actuarial Accrued Liability (UAAL) (b-a)	Funded Ratio (a)/(b)	Annual Covered Payroll (c)	UAAL as a Percentage of Covered Payroll [(b)-(a)]/(c)
January 1, 2009	$ 183,447,296	$ 194,366,597	$ 10,919,301	94.4%	$ 49,602,223	22.01%
January 1, 2010	203,704,898	190,679,453	(13,025,445)	106.8%	48,228,428	(27.01%)
January 1, 2011	195,692,781	187,257,434	(8,435,347)	104.5%	47,405,874	(17.79%)
January 1, 2012	183,980,665	195,536,152	11,555,487	94.1%	48,836,721	23.66%

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%

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); $5,000,000 deductible per occurrence.

Travel Accident
Covers losses related to employees' business travel. Limits of coverage - $1,375,000 aggregate.

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

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

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

Knoxville Utilities Board Wastewater Division
Supplemental Information – Schedule of Debt Maturities by Fiscal Year
June 30, 2012 **Schedule 2**

Continued on Next Page

	2005A		2005B		2007		2008		2010			2010B	
FY	**Principal**	**Interest**	**Principal**	**Interest**	**Principal**	**Interest**	**Principal**	**Interest**	**Principal**	**Interest**	**Rebate***	**Principal**	**Interest**
12-13		6,490,438	760,000	838,735		3,463,013	3,400,000	1,938,937		1,910,000	668,500	1,735,000	52,050
13-14		6,490,438	1,285,000	808,335		3,463,013	4,125,000	1,802,937		1,910,000	668,500		
14-15		6,490,438	1,350,000	744,085		3,463,013	4,300,000	1,637,938		1,910,000	668,500		
15-16		6,490,438	1,410,000	676,585		3,463,013	4,450,000	1,379,938		1,910,000	668,500		
16-17		6,490,438	1,470,000	620,185		3,463,013	4,600,000	1,157,438		1,910,000	668,500		
17-18		6,490,438	1,525,000	561,385	2,725,000	3,463,013	1,950,000	927,438		1,910,000	668,500		
18-19		6,490,438	1,595,000	498,860	2,900,000	3,354,012	2,025,000	829,938		1,910,000	668,500		
19-20		6,490,438	1,655,000	433,066	3,125,000	3,234,387	2,075,000	723,625		1,910,000	668,500		
20-21		6,490,438	1,725,000	363,556	3,175,000	3,101,575	2,150,000	619,875		1,910,000	668,500		
21-22		6,490,438	1,800,000	290,244	3,300,000	2,962,669	2,225,000	507,000		1,910,000	668,500		
22-23		6,490,438	1,880,000	212,844	3,525,000	2,817,469	2,300,000	395,750		1,910,000	668,500		
23-24	3,800,000	6,490,438	695,000	130,594	1,125,000	2,658,843	2,400,000	269,250		1,910,000	668,500		
24-25	4,150,000	6,300,438	730,000	100,188	1,175,000	2,608,219	2,500,000	131,250		1,910,000	668,500		
25-26	4,350,000	6,092,938	765,000	68,250	1,225,000	2,555,344				1,910,000	668,500		
26-27	4,575,000	5,875,438	795,000	34,781	1,300,000	2,498,688				1,910,000	668,500		
27-28	5,725,000	5,675,281			1,225,000	2,438,562				1,910,000	668,500		
28-29	6,000,000	5,424,813			1,275,000	2,381,906				1,910,000	668,500		
29-30	7,850,000	5,162,313			1,300,000	2,322,938				1,910,000	668,500		
30-31	8,225,000	4,769,813			1,375,000	2,262,812				1,910,000	668,500		
31-32	8,650,000	4,379,125			1,400,000	2,200,938				1,910,000	668,500		
32-33	9,075,000	3,968,250			1,475,000	2,137,938				1,910,000	668,500		
33-34	9,525,000	3,514,500			1,550,000	2,067,875				1,910,000	668,500		
34-35	10,000,000	3,038,250			1,625,000	1,998,125				1,910,000	668,500		
35-36	10,500,000	2,538,250			1,700,000	1,925,000				1,910,000	668,500		
36-37	11,025,000	2,013,250			1,800,000	1,848,500				1,910,000	668,500		
37-38	11,600,000	1,462,000			1,850,000	1,767,500				1,910,000	668,500		
38-39	12,175,000	998,000			1,825,000	1,684,250				1,910,000	668,500		
39-40	12,775,000	511,000			1,825,000	1,602,125				1,910,000	668,500		
40-41					15,200,000	1,520,000				1,910,000	668,500		
41-42					16,000,000	760,000				1,910,000	668,500		
42-43									10,000,000	1,910,000	668,500		
43-44									10,000,000	1,260,000	441,000		
44-45									10,000,000	630,000	220,500		
Total	$ 140,000,000	$ 139,608,915	$ 19,440,000	$ 6,381,693	$ 75,000,000	$ 75,487,753	$ 38,500,000	$ 12,321,314	$ 30,000,000	$ 61,100,000	$ 21,385,000	$ 1,735,000	$ 52,050

*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.
The series 2010 rebate payments will total $22,816,704 over the life of the bonds. The net cost of issuing the series 2010 bonds is $42,373,879.
The series 2010c rebate payments will total $26,804,650 over the life of the bonds. The net cost of issuing the series 2010c bonds is $49,780,063.

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, 2012 **Schedule 2**

Continued from Previous Page

FY	2010C Principal	2010C Interest	2010C Rebate*	2012A Principal	2012A Interest	TOTALS Principal	TOTALS Interest	Grand Total (P + I)	Grand Total (Less Rebates)
12-13	1,075,000	3,746,738	1,311,358	70,000	573,093	7,040,000	19,013,004	26,053,004	24,073,146
13-14	1,075,000	3,728,463	1,304,962	785,000	603,625	7,270,000	18,806,811	26,076,811	24,103,349
14-15	1,100,000	3,704,060	1,296,422	800,000	587,925	7,550,000	18,537,459	26,087,459	24,122,537
15-16	1,250,000	3,673,920	1,285,872	820,000	571,925	7,930,000	18,165,819	26,095,819	24,141,447
16-17	1,400,000	3,634,545	1,272,090	840,000	551,425	8,310,000	17,827,044	26,137,044	24,196,454
17-18	1,500,000	3,584,425	1,254,548	985,000	528,325	8,685,000	17,465,024	26,150,024	24,226,976
18-19	1,550,000	3,525,625	1,233,968	970,000	498,775	9,040,000	17,107,648	26,147,648	24,245,180
19-20	1,600,000	3,460,990	1,211,346	950,000	467,250	9,405,000	16,719,756	26,124,756	24,244,910
20-21	1,650,000	3,394,270	1,187,994	1,085,000	434,000	9,785,000	16,313,714	26,098,714	24,242,220
21-22	1,700,000	3,325,465	1,163,912	1,175,000	390,600	10,200,000	15,876,416	26,076,416	24,244,004
22-23	1,750,000	3,246,925	1,136,424	1,165,000	343,600	10,620,000	15,417,026	26,037,026	24,232,102
23-24	1,850,000	3,162,575	1,106,902	1,250,000	297,000	11,120,000	14,918,700	26,038,700	24,263,298
24-25	1,950,000	3,065,450	1,072,908	1,140,000	247,000	11,645,000	14,362,545	26,007,545	24,266,137
25-26	2,375,000	2,961,125	1,036,394	1,190,000	201,400	9,905,000	13,789,057	23,694,057	21,989,163
26-27	2,500,000	2,830,738	990,758	1,235,000	153,800	10,405,000	13,303,445	23,708,445	22,049,187
27-28	2,600,000	2,688,488	940,970	1,280,000	104,400	10,830,000	12,816,731	23,646,731	22,037,261
28-29	2,725,000	2,536,388	887,736	1,330,000	53,200	11,330,000	12,306,307	23,636,307	22,080,071
29-30	2,850,000	2,376,975	831,942			12,000,000	11,772,226	23,772,226	22,271,784
30-31	2,975,000	2,210,250	773,588			12,575,000	11,152,875	23,727,875	22,285,787
31-32	3,100,000	2,031,750	711,112			13,150,000	10,521,813	23,671,813	22,292,201
32-33	3,250,000	1,845,750	646,012			13,800,000	9,861,938	23,661,938	22,347,426
33-34	3,375,000	1,650,750	577,762			14,450,000	9,143,125	23,593,125	22,346,863
34-35	3,550,000	1,448,250	506,882			15,175,000	8,394,625	23,569,625	22,394,243
35-36	3,700,000	1,235,250	432,338			15,900,000	7,608,500	23,508,500	22,407,662
36-37	3,875,000	1,009,550	353,342			16,700,000	6,781,300	23,481,300	22,459,458
37-38	4,050,000	773,175	270,612			17,500,000	5,912,675	23,412,675	22,473,563
38-39	4,225,000	526,125	184,144			18,225,000	5,118,375	23,343,375	22,490,731
39-40	4,400,000	268,400	93,940			19,000,000	4,291,525	23,291,525	22,529,085
40-41						15,200,000	3,430,000	18,630,000	17,961,500
41-42						16,000,000	2,670,000	18,670,000	18,001,500
42-43						10,000,000	1,910,000	11,910,000	11,241,500
43-44						10,000,000	1,260,000	11,260,000	10,819,000
44-45						10,000,000	630,000	10,630,000	10,409,500
Total	$ 69,000,000	$ 71,646,415	$ 25,076,238	$ 17,070,000	$ 6,607,343	$ 390,745,000	$ 373,205,483	$ 763,950,483	$ 717,489,245

*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.
The series 2010 rebate payments will total $22,816,704 over the life of the bonds. The net cost of issuing the series 2010 bonds is $42,373,879.
The series 2010c rebate payments will total $26,804,650 over the life of the bonds. The net cost of issuing the series 2010c bonds is $49,780,063.

See accompanying Report of Independent Auditors on Supplemental Information.

Knoxville Utilities Board Wastewater Division
Supplemental Information – Schedule of Current Rates in Force
June 30, 2012
(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:	52,818

Commodity Charge

First	0 to 2	100 Cubic Feet Per Month at $0.50 Per 100 Cubic Feet
Over	2	100 Cubic Feet Per Month at $8.10 Per 100 Cubic Feet

Additional Monthly Customer Charge

5/8" meter	$ 17.00
3/4" meter	25.00
1" meter	31.00
1 1/2" meter	42.00
2" meter	60.00

Rate Class	Base Charge	Number of Customers
Non-Residential Inside City rate	For wastewater service furnished to premises entirely within the corporate limits of the City of Knoxville:	6,338

Commodity Charge

First	0 to 2	100 Cubic Feet Per Month at $0.50 Per 100 Cubic Feet
Next	8	100 Cubic Feet Per Month at $8.30 Per 100 Cubic Feet
Next	90	100 Cubic Feet Per Month at $7.40 Per 100 Cubic Feet
Next	300	100 Cubic Feet Per Month at $6.30 Per 100 Cubic Feet
Next	4,600	100 Cubic Feet Per Month at $5.20 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.

Additional Monthly Customer Charge

5/8" meter	$ 17.00
3/4" meter	25.00
1" meter	31.00
1 1/2" meter	42.00
2" meter	60.00
3" meter	104.00
4" meter	169.00
6" meter	360.00
8" meter	625.00
10" meter	947.00
12" meter	1,396.00

Knoxville Utilities Board Wastewater Division
Supplemental Information – Schedule of Current Rates in Force
June 30, 2012
(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:	7,117

Commodity Charge

First	0 to 2	100 Cubic Feet Per Month at $0.60 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	$ 20.30
3/4" meter	28.30
1" meter	34.30
1 1/2" meter	49.30
2" meter	67.30

Rate Class	Base Charge	Number of Customers
Non-Residential Outside City rate	For wastewater service furnished to premises entirely or partly outside the corporate limits of the City of Knoxville:	237

Commodity Charge

First	0 to 2	100 Cubic Feet Per Month at $0.60 Per 100 Cubic Feet
Next	8	100 Cubic Feet Per Month at $9.20 Per 100 Cubic Feet
Next	90	100 Cubic Feet Per Month at $8.10 Per 100 Cubic Feet
Next	300	100 Cubic Feet Per Month at $7.00 Per 100 Cubic Feet
Next	4,600	100 Cubic Feet Per Month at $5.80 Per 100 Cubic Feet
Next	5,000	100 Cubic Feet Per Month at $4.80 Per 100 Cubic Feet

See accompanying Report of Independent Auditors on Supplemental Information.

Additional Monthly Customer Charge

5/8" meter	$	20.30
3/4" meter		28.30
1" meter		34.30
1 1/2" meter		49.30
2" meter		67.30
3" meter		117.30
4" meter		186.30
6" meter		394.30
8" meter		688.30
10" meter		1,039.30
12" meter		1,534.30

Knoxville Utilities Board Wastewater Division
Supplemental Information –
Schedule of Expenditures of Federal Awards by Grant
June 30, 2012 Schedule 4

KUB was awarded two grants from Tennessee Emergency Management Agency (as a flow through from FEMA) for reimbursement for costs related to storms in 2011. The schedule below shows the expenditures for the current fiscal year.

Program Name	Federal/State Agency	CFDA Number	Contract Number	Beginning Deferred	Cash Receipts	Expenditures	Adjustments	Ending Deferred
U.S. Department of Homeland Security	Tennessee Emergency Management	97.036	34101-0000009205	$ -	$ -	$ 285,111	$ -	$ 285,111
U.S. Department of Homeland Security	Tennessee Emergency Management	97.036	34101-0000009832	$ -	$ 6,501	$ 8,668	$ -	$ 2,167
		Total Program 97.036		$ -	$ 6,501	$ 293,779	$ -	$ 287,278
		Total Federal Awards		$ -	$ 6,501	$ 293,779	$ -	$ 287,278

NOTE 1 - BASIS OF PRESENTATION

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

Knoxville Utilities Board Wastewater Division
Supplemental Information –
Schedule of Findings and Questioned Costs
June 30, 2012 — Schedule 5

Summary of Audit Results

Financial Statements

Type of auditors report issued:	Unqualified	
Internal control over financial reporting:		
Material weakness(es) identified?	___Yes	✓ No
Significant deficiencies identified that are not considered to be material weakness(es)?	___Yes	✓ None reported
Noncompliance material to financial statements noted?	___Yes	✓ No

Federal Awards

Internal control over major programs:		
Material weakness(es) identified?	___Yes	✓ No
Significant deficiencies identified that are not considered to be material weakness(es)?	___Yes	✓ None reported
Type of auditor's report issued on compliance for major programs:	Unqualified	
Any audit findings disclosed that are required to be reported in Accordance with Section 510(a) of Circular A-133?	___Yes	✓ None reported
Major programs:	CFDA Number	Name of Federal Program
	97.036	U.S. Department of Homeland Security
Dollar threshold used to distinguish between type A And type B programs	$300,000	
Auditee qualified as low-risk auditee?	___Yes	✓ No

Findings – Financial Statements Audit

None

Findings and Questioned Costs – Major Federal Award Programs Audit

None

• Certified Public Accountants
• Business Advisors

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Report on Internal Control Over Financial Reporting and On Compliance And Other Matters Based On An Audit Of Financial Statements Performed In Accordance With *Government Auditing Standards*

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

We have audited the financial statements of the Knoxville Utilities Board, (an independent agency and reported as a component unit for financial purposes only by the City of Knoxville), Wastewater Division, as of and for the year ended June 30, 2012, which collectively comprise the Knoxville Utilities Board's basic financial statements and have issued our report thereon dated October 18, 2012. 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.

In accordance with *Government Auditing Standards*, the report dated October 18, 2012, has been reissued due to the omission of two federal program contracts on the schedule of expenditures of federal, state and other awards. Since program CFDA 97.036 was considered major, additional audit procedures were performed. The changes to the previously issued report dated October 18, 2012 encompasses the addition of program CFDA 97.036 contract number 34101-0000009205 and contract number 34101-0000009832 to the schedule of expenditures of federal, state and other awards and to the schedule of findings and questioned costs.

Internal Control Over Financial Reporting

Management of the Knoxville Utilities Board is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered Knoxville Utilities Board's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Knoxville Utilities Board's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Knoxville Utilities Board's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Knoxville Utilities Board's financial statements are free of 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*.

This report is intended solely for the information and use of the Knoxville Utilities Board's audit committee, board of commissioners, and others within the entity, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Rodefer Moss & Co, PLLC

Knoxville, Tennessee
October 18, 2012
(Except as noted in paragraph 2 above,
as to which the date is October 22, 2013)

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• Business Advisors

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Independent Auditors' Report On Compliance With Requirements That Could Have A Direct And Material Effect On Each Major Program And On Internal Control Over Compliance In Accordance With OMB CIRCULAR A-133

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

Compliance

We have audited the Knoxville Utilities Board's, (an independent agency and reported as a component unit for financial purposes only by the City of Knoxville) compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the Knoxville Utilities Board's major federal programs for the year ended June 30, 2012. Knoxville Utilities Board's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the Knoxville Utilities Board's management. Our responsibility is to express an opinion on the Knoxville Utilities Board's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Knoxville Utilities Board's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Knoxville Utilities Board's compliance with those requirements.

In our opinion, the Knoxville Utilities Board, complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2012.

In accordance with *Government Auditing Standards*, the report dated October 18, 2012, has been reissued due to the omission of two federal program contracts on the schedule of expenditures of federal, state and other awards. Since program CFDA 97.036 was considered major, additional audit procedures were performed. The changes to the previously issued report dated October 18, 2012 encompasses the addition of program CFDA 97.036 contract number 34101-0000009205 and contract number 34101-0000009832 to the schedule of expenditures of federal, state and other awards and to the schedule of findings and questioned costs.

Internal Control over Compliance

Management of the Knoxville Utilities Board is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Knoxville Utilities Board's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Knoxville Utilities Board's internal control over compliance.

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

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

This report is intended solely for the information and use of the Knoxville Utilities Board's audit committee, board of commissioners, others within the entity, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Rodefer Moss & Co, PLLC

Knoxville, Tennessee
October 18, 2012
(Except as noted in paragraph 4 above,
as to which the date is October 22, 2013)