

MANAGEMENT'S DISCUSSION AND ANALYSIS

The City of Knoxville is including this Management Discussion and Analysis (MD & A) to enhance the reader's understanding of the City's financial position. This section is intended to be an easily readable analysis of the City's financial activities based on currently known facts, decisions or conditions. This analysis focuses on current year activities and should be read in conjunction with the Transmittal Letter that begins on page "i" and with the financial statements that follow. All amounts are expressed in thousands, unless otherwise specified, for the results of operations for the Fiscal Year ending June 30, 2004.

DISCUSSION OF BASIC FINANCIAL STATEMENTS

Like previous comprehensive annual financial reports, there are three sections to the City's new financial report – *Introductory, Financial and Statistical*. However, with the implementation of the new reporting model, some changes have been made. The first section, *The Introductory Section*, contains the City's Letter of Transmittal, a facsimile of the Certificate of Achievement, an organization chart, and a list of officials. Next, *The Financial Section* is composed of the independent auditor's opinion, Management's Discussion and Analysis, basic financial statements, informational notes, required supplemental information, and various combining and individual fund statements. Finally, *The Statistical Section* discloses data designed to further enhance the readers understanding of the City's financial health.

The heart of this financial document lies within *The Financial Section*. Here the City presents government-wide statements, funds statements, notes of explanation, required supplementary information, combining statements, information regarding capital assets used in the operation of governmental funds and other various schedules. The government-wide statements provide a thumbnail sketch of the City's entire operations, and the funds statements provide relevant information on the various funds. Further detail and explanation of pertinent information and operations is provided in the financial statements and in the notes that follow in this section.

GOVERNMENT-WIDE STATEMENTS

Government-wide statements are provided on a full accrual basis. Activities are considered either as those of Primary Government (the government as legally defined) or those of Component Units (legally separate entities for which the primary government is financially accountable). Public utility and transportation services are performed by the Component Units. Activities are delineated as noted:

Primary Government

1. Governmental Activities
2. Business-Type Activities

Component Units

1. Knoxville Utilities Board
2. Metropolitan Knoxville Airport Authority
3. Knoxville Area Transit

STATEMENT OF NET ASSETS

The Statement of Net Assets presents the consolidated financial condition of the City at a moment of time. This statement presents assets, liabilities and total net assets categorized as either primary government or component units. Primary government activities are further delineated as either governmental or business-type. Under GASB Statement 34, the City presents a valuation of its infrastructure assets and its debt structure on one page.

STATEMENT OF ACTIVITIES

The focus of the Statement of Activities is to present the City's combined operational activities over the past fiscal year. Governmental and business-type items are presented with the total revenues and

expenses. Those activities of the governmental funds are financed primarily by local taxes, user fees, charges for services, or subsidized by direct appropriations from the City's General Fund. Business-type operations, by their very nature, recover costs by either user fees and/or operational transfers.

GOVERNMENTAL FUNDS STATEMENTS

Governmental funds statements are provided on a modified accrual basis. The City's major funds are presented in their own columns and the remaining funds are combined with a column titled "Other Governmental Funds." (Other Governmental Funds are also noted as Nonmajor Governmental Funds or Special Revenue Funds.) Governmental funds are noted as follows:

Major Governmental Funds

1. General
2. Debt Service
3. Capital Projects

Non-Major Governmental Funds/ Other/ Special Revenue Funds

1. State Street Aid
2. Community Development Block Grants
3. Abandoned Vehicles
4. City Inspections
5. City Court
6. Community Improvement
7. Miscellaneous Grants
8. Animal Control
9. Miscellaneous Special Revenue Funds
10. Miscellaneous Community Development Funds
11. Storm Water
12. Solid Waste
13. City Judges' Retirement
14. Coster Redevelopment
15. Krutch Park Trust
16. Knoxville Civic Revitalization
17. City Choice Plus

A budgetary comparison statement for the General Fund (Statement of Revenues, Expenditures, and Changes in Fund Balances) is presented in the Fund Financial Statements section of the Basic Financial Statements. Budgetary comparison schedules for the debt service and capital projects funds (Schedule of Revenues, Expenditures, and Changes in Fund Balances) are found in the Combining and Individual Fund Statements and Schedules section. Readers who wish to obtain information on non-major funds can do so in the Combining Statements section of this report.

BALANCE SHEET

The Balance Sheet provides a picture of the financial (but not capital) assets associated with governmental activities, liabilities normally expected to be paid from current financial resources and the net fund balance.

STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES

The Statement of Revenues, Expenditures and Changes in Fund Balances is used for reporting all transactions, events and inter-fund activity that increase or decrease fund balances.

Because Government-Wide Statements are provided on a full accrual basis and Governmental Funds Statements are provided on a modified accrual basis, it is necessary to provide a reconciliation. Reconciliation statements are provided following both the Balance Sheet and the Statement of Revenues, Expenditures and Changes in Fund Balances. Also, a Statement of Revenues, Expenditures and Changes in Fund Balances – Budget and Actual – GAAP Basis for the General Fund is provided in this section.

PROPRIETARY FUNDS STATEMENTS

Proprietary funds statements are provided on a full accrual basis. Proprietary funds are noted as follows:

Business-Type Activities

1. Knoxville Convention Center
2. Other Business-Type Activities/
Nonmajor Enterprise Funds
 - a. Metro Parking Fund
 - b. Public Assembly Facilities Fund

Governmental Activities/ Internal Service Funds

1. Office Services Fund
2. Fleet Maintenance Fund
3. Risk Management Fund
4. Employee Health Insurance Fund
5. Equipment Replacement Fund
6. City Buildings Fund

STATEMENT OF NET ASSETS

Like the government-wide statement, the Proprietary Fund Statement of Assets reports all assets and liabilities, including capital assets and long-term liabilities. Proprietary funds are required to list their net assets according to their availability for use in operations.

STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN NET ASSETS

This statement isolates operating revenues and operating expenses from other changes in net assets to allow for the measurement of how sufficiently a given activity is self-supporting. Non-operating items are also included immediately following operating income/loss.

STATEMENT OF CASH FLOWS

The cash flow statement is provided to allow for the assessment of the adequacy of a proprietary fund's cash flows.

FIDUCIARY COMPONENT UNIT STATEMENTS

Fiduciary activities are excluded from the government-wide statements because the resources reported in fiduciary funds are not available to support the government's programs and activities. The City Employees' Pension Fund is the City of Knoxville's sole fiduciary component unit.

STATEMENT OF FIDUCIARY NET ASSETS

Unlike proprietary funds, fiduciary funds are not required to list their net assets based on their availability for use in operations.

STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS

This statement notes all changes in net assets without distinguishing earnings related changes from other types of changes. These changes to net assets are simply noted as additions and deletions.

NOTES TO FINANCIAL STATEMENTS AND OTHER INFORMATION

Completing the document are notes to the financial statements which provide additional information to provide a more informed understanding of the information provided in the government-wide and fund financial statements. Following the notes, this document provides required supplementary information regarding Knoxville's progress in funding its obligation to provide pension benefits to its employees. The combining statements for nonmajor governmental funds, nonmajor enterprise funds and internal service funds, schedules for the Debt Service and Capital Projects Funds, schedules regarding Capital Assets, and other supplementary information are also provided for further clarification.

CONDENSED COMPARATIVE DATA & OVERALL ANALYSIS

GOVERNMENT-WIDE STATEMENTS

Our analysis below focuses on the total primary government, which includes both governmental and business-type activities.

STATEMENT OF NET ASSETS AT JUNE 30, 2004

A condensed version of the Statement of Net Assets at June 30, 2004 follows:

**Condensed Financial Information
Statement of Net Assets
Primary Government
For Fiscal Year Ending June 30**

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2004	2003 restated	2004	2003 restated	2004	2003 restated
Current and other assets:						
Cash and investments	\$106,845	\$77,494	\$4,854	\$6,033	\$111,699	\$83,527
Other assets	129,425	119,274	2,611	2,567	132,036	121,841
Capital assets	<u>242,575</u>	<u>232,777</u>	<u>178,807</u>	<u>183,676</u>	<u>421,382</u>	<u>416,453</u>
Total assets	\$478,845	\$429,545	\$186,272	\$192,276	\$665,117	\$621,821
Other liabilities	\$120,467	\$113,678	\$1,239	\$3,597	\$121,706	\$117,275
Noncurrent liabilities	<u>106,626</u>	<u>82,988</u>	<u>157,737</u>	<u>162,389</u>	<u>264,363</u>	<u>245,377</u>
Total liabilities	\$227,093	\$196,666	\$158,976	\$165,986	\$386,069	\$362,652
Net assets:						
Invested in capital assets, net of debt	\$157,139	\$155,214	\$21,070	\$52,821	\$178,209	\$208,035
Restricted	26,801	16,999	0	0	26,801	16,999
Unrestricted	<u>67,800</u>	<u>60,666</u>	<u>6,226</u>	<u>(26,531)</u>	<u>74,026</u>	<u>34,135</u>
Total net assets	\$251,740	\$232,879	\$27,296	\$26,290	\$279,036	\$259,169

Governmental Activities

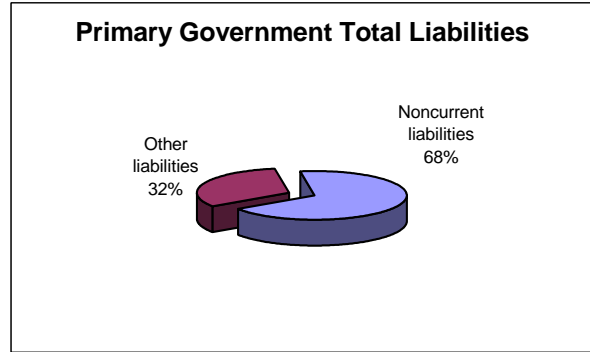
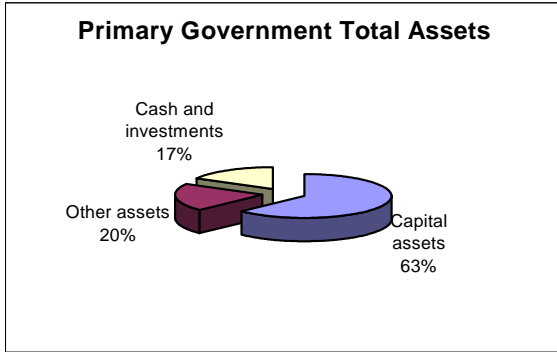
Under Governmental Activities, assets have increased by eleven percent and liabilities have increased fifteen percent over 2003 levels, resulting in an increase of eight percent in total net assets.

Business-Type Activities

Under Business-Type Activities, assets have decreased by three percent and liabilities have decreased four percent over 2003 levels, resulting in an increase of four percent in total net assets. The Knoxville Convention Center represents the largest portion of both the capital assets and noncurrent liabilities in this category. Permanent bond financing for the convention complex totals \$156.1 million with a final maturity of June 30, 2032.

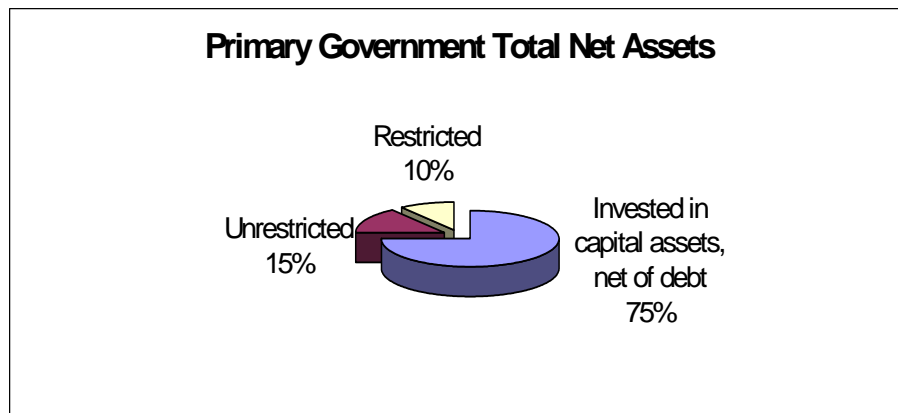
Total Primary Government

The City's capital assets, including land and buildings, equipment, furniture and fixtures, infrastructure and construction in progress account for 63% of \$665 million in total assets. Taxes and governmental receivables constitute 20%. Current liquidity, as shown by cash and investments, composes the remaining 17% in total assets.



Sixty-eight percent of the total government liabilities are in long-term debt outstanding. Of this long-term debt, approximately \$160 million, or 61% was used to finance the new convention complex.

A portion of the City's total net assets is restricted for specific purposes. These restrictions represent legal or contractual limitations on how the assets may be expended. Within the governmental activities category are system development charges, bond proceeds, taxes and other collections limited to repayment of debt. Within the business-type activities are bond proceeds and debt service reserves. The unrestricted net assets of the City's governmental activities represent 15% of total net assets.



STATEMENT OF ACTIVITIES FOR THE YEAR ENDED JUNE 30, 2004

A summary version of the Statement of Activities follows.

Condensed Financial Information
Primary Government
Changes in Net Assets
For Fiscal Year Ending June 30

	Governmental Activities		Business-Type Activities		Total Government	
	2004	2003 restated	2004	2003 restated	2004	2003 restated
Revenues:						
Program revenues:						
Charges for services	\$17,162	\$12,206	\$6,557	\$7,001	\$23,719	\$19,207
Operating grants & contributions	9,033	8,770	0	0	9,033	8,770
Capital grants & contributions	890	1,574	0	11,998	890	13,572
General revenues:						
Taxes	151,034	158,527	6357	0	157,391	158,527
Interest	1,037	1,908	57	81	1,094	1,989
Other	3,257	4,472	4	241	3,261	4,713
Total revenues	\$182,413	\$187,457	\$12,975	\$19,321	\$195,388	\$206,778
Expenses:						
General government	\$13,200	\$10,331	\$0	\$0	\$13,200	\$10,331
Public safety	66,325	67,423	0	0	66,325	67,423
Highways and streets	27,910	28,920	0	0	27,910	28,920
Solid waste	9,209	9,729	0	0	9,209	9,729
Recreation	6,542	4,217	0	0	6,542	4,217
Economic development	6,924	7,872	0	0	6,924	7,872
Capital & grant projects	5,791	6,273	0	0	5,791	6,273
Interest on long-term debt	3,199	4,706	0	0	3,199	4,706
Other	13,412	13,721	23,009	25,034	36,421	38,755
Total expenses	\$152,512	\$153,192	\$23,009	\$25,034	\$175,521	\$178,226
Increase (decrease) in net assets before transfers	\$29,901	\$34,265	(\$10,034)	(\$5,713)	\$19,867	\$28,552
Transfers	(11,040)	(8,356)	11,040	8,356	0	0
Changes in net assets	18,861	25,909	1,006	2,643	19,867	28,552
Beginning net assets	232,879	288,662	26,290	23,647	259,169	312,309
Prior period adjustment	0	(81,692)	0	0	0	(81,692)
Ending net assets	\$251,740	\$232,879	\$27,296	\$26,290	\$279,036	\$259,169

Governmental Activities

As shown on the Government-Wide Statement of Activities for the year ending June 30, 2004, other than the activity noted as Other, primarily representing various grant projects, only the City Court was self-supporting. The City Court generated revenue in excess of its current expenditures. Any excess revenue above and beyond actual expenditures in the City Court is transferred to the General Fund to finance general operations. Federal grant revenue proceeds of \$2.0 million were earmarked for the City's Community Development division. Public safety operations and capital project outlays accounted for approximately 44% and 4% respectively of the City's total governmental operations of \$152.5 million. All other City of Knoxville sections and operations are financed by either local and state taxes, grants, or various shared revenues.

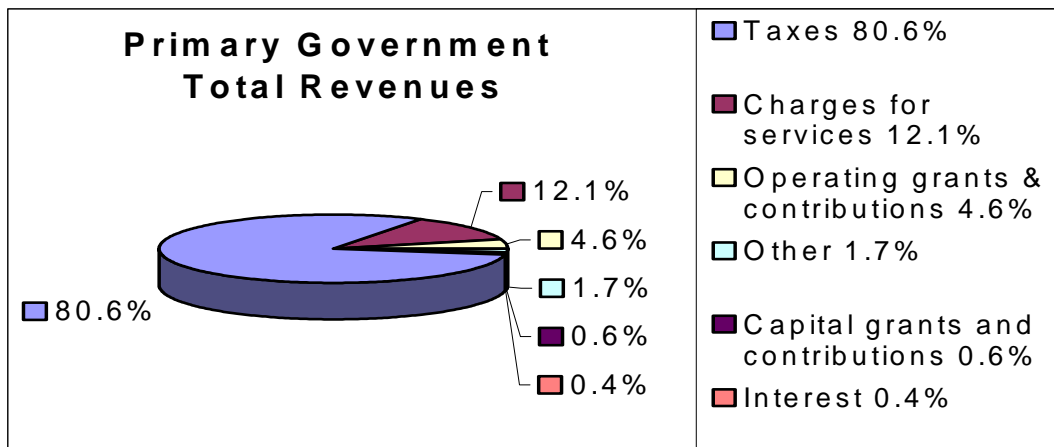
Comparative beginning net assets in the 2003 statement of activities have been adjusted by \$81.7 million to correctly recognize property taxes that met recognition requirements as a receivable under generally accepted accounting principals, but that should have been included as deferred revenue on the statement of net assets because the levy date was after the end of the fiscal year. Tax revenues were increased by \$1.6 million. As a result, the effect on 2004 beginning net assets was a decrease of \$80.1 million.

Business-type Activities

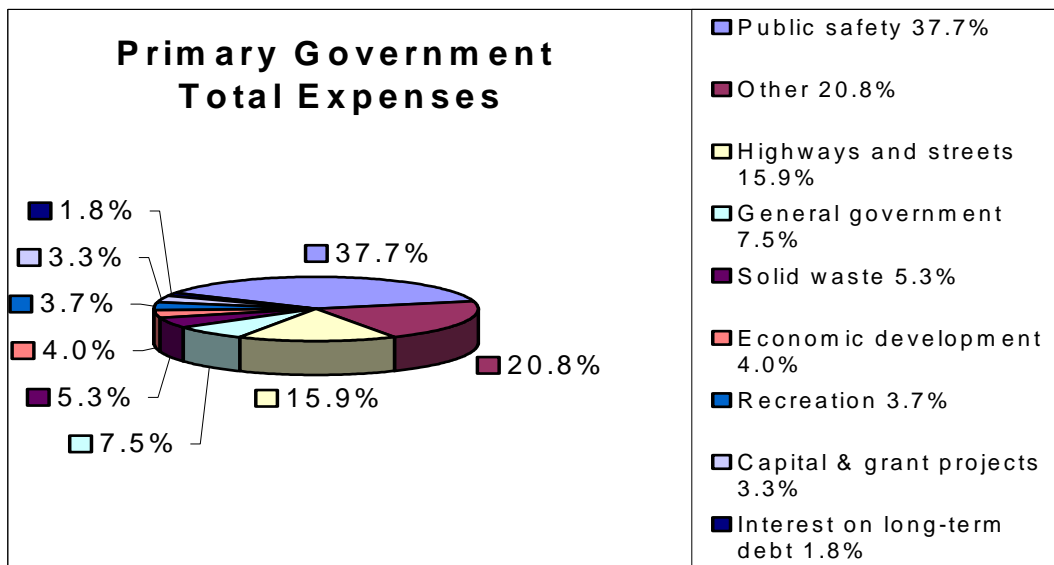
The City's business-type activities include public parking and public assembly facilities. The City also operates the current Knoxville Convention Center and the Knoxville Municipal Auditorium complexes. Home of the University of Tennessee's main campus, Knoxville attracts thousands of visitors yearly for various sporting events. Neyland Stadium, the nation's second largest on campus football stadium, attracts over one hundred thousand loyal fans per home game. Proximity to outdoor recreational facilities such as the lake region and The Great Smoky Mountains National Park makes the Knoxville area an ideal tourist destination. With this in mind, local governmental leaders deemed it necessary to build a new convention center to take advantage of Knoxville's unique geographic location. Although current expenses exceed revenues for these activities, the local economy benefits greatly by the impact of lodging, restaurant, and various recreational consumer spending.

Total Government

Primary Government Revenues exceeded \$195 million. The largest portion of these revenues (80.6%) is from taxes.



Total primary government expenses totaled slightly more than \$175 million, 37.7% of which was directed toward public safety.



COMPONENT UNITS

The Government Accounting Standards Board (GASB 14) requires that certain organizations affiliated with the primary government be reported as component units. Component units are legally separate organizations for which the elected officials of the primary government are financially accountable. The nature and significance of component units are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete. The component units for the City of Knoxville include the Knoxville Utilities Board, the Metropolitan Knoxville Airport Authority, and the Knoxville Area Transit Fund. A summary of the City's component unit operations follows:

**Condensed Financial Information
Component Units
For Fiscal Year Ending June 30**

	Knoxville Utililites Board		Metropolitan Knoxville Airport Authority		Knoxville Area Transit		Total	
	2004	2003	2004	2003	2003	2003	2004	2003
Program Revenues	\$526,856	\$496,355	\$22,355	\$30,774	\$19,584	\$16,321	\$568,795	\$543,450
Program Expenses	506,234	468,235	27,610	27,417	17,852	14,648	551,696	510,300
Total General Revenues	2,484	3,718	162	564	637	414	3,283	4,696
Change in Net Assets	23,106	31,838	(5,093)	3,921	2,369	2,087	20,382	37,846
Net Assets at Year End	\$609,793	\$586,687	\$94,297	\$99,390	\$17,212	\$14,843	\$721,302	\$700,920

GOVERNMENTAL FUNDS STATEMENTS

BALANCE SHEET AT JUNE 30, 2004

The Government fund balance as of June 30, 2004 is \$99.5 million. Of this total governmental fund balance, the general fund balance is approximately \$20.2 million, of which \$18.2 is unreserved. This general fund balance of \$20,192 is nine percent more than last year's ending balance of \$18,498.

STATEMENT OF REVENUE, EXPENDITURES & CHANGES IN FUND BALANCES FOR THE YEAR ENDED JUNE 30, 2004

The following schedule presents a summary of total governmental funds, which includes general fund, debt service fund, capital projects fund and other governmental funds for this fiscal year ended June 30, 2004, and the amount and percentage of increases and decreases in relation to prior year revenues.

**Condensed Financial Information
Total Governmental Funds - Revenues
For Fiscal Year Ending June 30**

<u>Revenues</u>	<u>June 30, 2004</u>	<u>June 30, 2003</u>	<u>Percent of Total 2004</u>	<u>Increase (Decrease) from 2003</u>	<u>Percent of Increase (Decrease)</u>
Taxes, assessments, interest & penalties	\$135,130	\$133,667	74.36%	\$1,463	1.09%
Licenses, permits and inspection charges	2,110	1,838	1.16%	272	14.80%
Intergovernmental revenue	30,995	31,210	17.10%	(215)	-0.69%
Charges for services	4,906	4,240	2.70%	666	15.71%
Fines and forfeitures	3,302	2,315	1.82%	987	42.63%
Other	<u>5,276</u>	<u>9,187</u>	<u>2.90%</u>	<u>(3,911)</u>	<u>-42.57%</u>
Total	\$181,719	\$182,457	100.00%	(\$738)	-0.40%

A comparison of revenues between FY 02/03 and FY 03/04 shows the total general government revenues decreased by approximately \$738 thousand or 0.4%. The largest dollar change occurs in the "Other" category of revenue.

The increase in the tax category is due to slightly higher assessed values, and an increase in the overall collection rate. The latter has been a point of emphasis in recent years. Midway through FY 02/03 the City increased the cost for building permits. In FY 03/04 we were able to capture a full year of the increased fees. This accounts for the jump in license and permit revenue.

The decline within the intergovernmental category is attributable to reductions in state shared revenue enacted by the state legislature. These reductions materially affect such items as state shared sales taxes and the City's share of the Hall Income Tax, the latter being a tax on dividends, including capital gains distributions, and interest earnings, and have a smaller impact on several other revenues. The General Fund is the fund most impacted by the reductions. The City began receiving, in FY 03/04, a portion of the incremental sales tax growth generated within the designated Tourism Development Zone. This money is used to help pay a portion of the debt on the City's Convention Center. The amount generated from this source in the past year was approximately \$1.3 million, which was just slightly less than the other losses in the intergovernmental revenue category.

Charges for service were up when compared to FY 02/03. The increase occurs primarily in two areas. The first is in the Stormwater Fund, in which revenues from charges increase by \$144,000. This is attributable to the implementation of new Stormwater fees. The second area of increase is in City Court costs, classified here as charges. The latter is up due to an increase in the number of citations being written and processed. This also accounts for the increase seen in fines and forfeitures.

The "Other" revenue category shows a decline for various reasons. Income from parking meters, reported in this category, continued to decline due to ongoing construction in the downtown area resulting in the availability of fewer parking spaces. The decline in interest rates resulted in a major

reduction in interest revenues. This was coupled with a reduction in available funds from investment, primarily in the capital funds, also served to lower interest earnings.

The following schedule presents a more detailed summary of the general fund, special revenue fund, capital projects fund and debt service fund expenditures for the fiscal year ended June 30, 2004, and the percentage of increases and decreases in relation to prior year amounts.

Condensed Financial Information
Total Governmental Funds - Expenditures
For Fiscal Years Ending 06/30/04 and 06/30/03

<u>Expenditures</u>	<u>FY 03/04</u>	<u>FY 02/03</u>	<u>Percent of Total FY 03/04</u>	<u>Increase (Decrease) from 02/03</u>	<u>Percentage Change from 02/03</u>
Administration	\$1,839	\$1,838	1.05%	\$1	0.05%
Finance	3,415	3,868	2.20%	(453)	-11.71%
Law	1,451	1,413	0.80%	38	2.69%
Information systems	2,700	2,781	1.46%	(81)	-2.91%
Legislative	744	1,104	0.63%	(360)	-32.61%
City court	661	669	0.38%	(8)	-1.20%
Civil service	1,126	863	0.49%	263	30.48%
Elections	103	27	0.02%	76	281.48%
Police	39,193	40,698	23.15%	(1,505)	-3.70%
Fire	24,423	23,356	13.29%	1,067	4.57%
Emergency management	272	274	0.16%	(2)	-0.73%
Public service	14,519	16,202	9.22%	(1,683)	-10.39%
Streets	2,608	2,622	1.49%	(14)	-0.53%
Engineering	6,676	6,140	3.49%	536	8.73%
Solid waste disposal	9,193	9,675	5.50%	(482)	-4.98%
Development services	2,687	3,949	2.25%	(1,262)	-31.96%
Parks and recreation	5,977	5,967	3.39%	10	0.17%
Metropolitan Planning Commission	693	729	0.41%	(36)	-4.94%
Knoxville Zoological Park	855	900	0.51%	(45)	-5.00%
Community agency grants	1,973	2,789	1.59%	(816)	-29.26%
Community Action Committee	438	460	0.26%	(22)	-4.78%
Waterfront operations	560	520	0.30%	40	7.69%
Mass transit	5,518	5,506	3.13%	12	100.00%
Community development	2,307	1,979	1.13%	328	16.57%
Other	5,344	4,752	4.05%	592	12.46%
Capital and grant projects	23,317	19,547	17.44%	3,770	19.29%
Debt service:					
Principal retirement	19,304	12,158	6.92%	7,146	58.78%
Interest on bonds and notes	2,973	4,796	2.73%	(1,823)	-38.01%
Payment on City-County bldg lease	0	179	0.52%	(179)	-100.00%
Other services and charges	139	27	0.21%	112	414.81%
Total Expenditures	\$181,008	\$175,788	108.16%	5,220	2.97%

Overall general government expenditures for FY 03/04 increased by more than \$5 million or 2.97% when compared to FY 02/03. This increase is primarily due to increases in capital expenditures and debt retirement. These increases were partially offset by spending for on-going operations.

A significant cost change, which is reflected in the expenditures of most departments, is the increased costs of health care and risk management expenses. The latter shows in increases for worker's compensation costs, and liability and property insurance premiums. For example, the City's health care premiums increased by 15% beginning in January 2004. This followed a 26% increase in January 2003.

Expenditures for debt service show an overall increase of \$5.3 million due to the payoff of a line of credit. This line was part of a major debt refunding and new money issue. A portion of the new money was used to retire the outstanding line.

PROPRIETARY FUNDS STATEMENTS

STATEMENT OF NET ASSETS AT JUNE 30, 2004

The Knoxville Convention Center, noted under Business-type Activities, and equipment replacement and fleet maintenance, noted under governmental activities, represent the largest portion of the assets associated with Proprietary Funds.

STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN NET ASSETS FOR THE YEAR ENDED JUNE 30, 2004

A summary of the revenues, expenses, and interfund transfers indicates that there is an increase in total proprietary fund net assets, including internal service funds, of \$3.4 million after transfers.

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED JUNE 30, 2004

The three main business type activities of the City are the Convention Center, the Main and State Street parking garages, and the Public Assembly Facilities operations. As expected, operations experienced a net operating loss. Both parking garages operate at a profit, if interest on debt is excluded. Main Avenue garage has debt outstanding, and a subsidy is required to cover a portion of the debt service.

Public Assembly Facilities also operated at a loss. This is due the inclusion of Chilhowee Park. This park is not expected to generate a profit due to the public nature of the area. The Auditorium/Coliseum does generate positive cash flow from operations.

The following table shows revenues, expenses, net interfund transfers, net income and net assets at year end for the various proprietary funds.

**Condensed Financial Information
Proprietary Funds
For Fiscal Year Ending June 30**

Proprietary Funds	Revenues		Expenses		Net Interfund Transfers	
	2004	2003	2004	2003	2004	2003
I. Business-type Activities						
A. Knoxville Convention Center	\$10,119	\$4,359	\$18,563	\$20,328	\$9,442	\$6,585
B. Other (Non-major enterprise funds)						
1. Metro Parking	1,021	998	738	847	0	120
2. Public Assembly Facilities	1,835	1,966	3,613	3,686	1,598	1,651
II. Governmental Activities						
A. Internal Service Funds						
1. Office Services	478	423	462	439	0	0
2. Fleet Maintenance	9,666	10,167	8,851	9,132	0	86
3. Risk Management	5,874	4,863	6,653	6,935	990	1,855
4. Employee Health Insurance	11,582	9,597	11,709	10,166	1,005	856
5. Equipment Replacement	2,155	1,933	2,080	2,221	129	226
6. City Buildings	1,350	1,385	1,207	1,245	0	0
TOTAL	\$44,080	\$35,691	\$53,876	\$54,999	\$13,164	\$11,379

	Capital Contributions		Change in Net Assets		Net Assets at Year End	
	2004	2003	2004	2003	2004	2003
I. Business-type Activities						
A. Knoxville Convention Center	\$0	\$11,436	\$998	\$2,052	\$12,023	\$11,025
B. Other (Non-major enterprise funds)						
1. Metro Parking	0	0	283	271	6,839	6,556
2. Public Assembly Facilities	0	562	(180)	493	8,804	8,984
II. Governmental Activities						
A. Internal Service Funds						
1. Office Services	0	0	16	(16)	22	6
2. Fleet Maintenance	0	40	815	1,161	15,966	15,151
3. Risk Management	0	0	211	(217)	216	5
4. Employee Health Insurance	0	0	878	287	2,656	1,778
5. Equipment Replacement	0	0	204	(62)	12,011	11,807
6. City Buildings	0	0	143	140	283	140
TOTAL	\$0	\$12,038	\$3,368	\$4,109	\$58,820	\$55,452

FIDUCIARY COMPONENT UNIT STATEMENTS

The Pension Trust Fund is reported as the sole fiduciary component unit. The City's defined benefit plan consists of contributions for general government, uniformed, utility and school board employees. The following table notes the contribution rates:

	Condensed Financial Information Pension Trust Fund Contribution Rates		
	FY 03/04 Contribution Rates	FY 04/05 Contribution Rates	Estimated FY 05/06 Contribution Rates
General Government Employees:			
Defined Contribution (G1)	1.50%	3.91%	7.25%
Defined Benefit (G2)	0.00%	2.41%	5.75%
Police and Fire Employees	5.16%	9.49%	11.00%
Board of Education Employees	0.00%	0.00%	0.00%

**STATEMENT OF FIDUCIARY NET ASSETS AT JUNE 30, 2004 and
STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS FOR THE YEAR ENDED JUNE 30, 2004**

The City's Pension Fund remains fully funded at year-end. The fund, like similar funds, was hard hit by the decline in the stock market. It is expected that net outflows will exceed contributions, before investment income, in the near term. The loss in investments will result in increased contributions by the City in the future. These increases have been budgeted.

BUDGET VARIANCES IN THE GENERAL FUND

The following table shows the Budget Appropriation Changes for the previous two years.

	Budget Appropriation Changes For Fiscal Year Ending June 30									
	Encumbrances		Capital and Redevelopment		Contractual Services		Other		Total	
	2004	2003	2004	2003	2004	2003	2004	2003	2004	2003
Governmental Activities:										
Abandoned Vehicles	\$0	\$0	\$0	\$0	\$0	\$0	\$114	\$0	\$114	\$0
General Fund	2,136	2,777	0	2,458	100	585	519	917	2,755	6,737
Debt Services	0	0	0	0	0	0	8,225	375	8,225	375
Capital Projects	0	0	(1,232)	4,338	0	0	0	2,090	(1,232)	6,428
City Court	2	0	0	0	0	0	960	776	962	776
Community Dev. Block Grant	0	0	0	0	0	0	1,815	0	1,815	0
State Street Aid	0	0	0	0	0	0	8	0	8	0
Storm Water	45	0	0	0	0	0	4	34	49	34
Solid Waste	2,700	3,906	0	0	0	0	0	0	2,700	3,906
TOTAL	\$4,883	\$6,683	(\$1,232)	\$6,796	\$100	\$585	\$11,645	\$4,192	\$15,396	\$18,256
Business-type Activities										
Knoxville Convention Center	\$194	\$1	\$0	\$0	\$0	(\$200)	\$0	\$0	\$194	(\$199)
Metro Parking Fund	0	0	5	0	0	0	0	0	5	0
Public Assembly Facilities Fund	371	0	0	0	0	0	0	0	371	0
Office Services Fund	0	0	0	0	34	0	0	0	34	0
Fleet Maintenance	504	1,623	0	0	0	0	0	0	504	1,623
Risk Management	181	201	0	0	0	0	0	0	181	201
Employee Health Insurance	56	0	0	0	0	0	0	0	56	0
Equipment Replacement	202	145	0	0	0	0	75	577	277	722
Other	24	148	0	0	0	0	89	48	113	196
TOTAL	\$1,532	\$2,118	\$5	\$0	\$34	(\$200)	\$164	\$625	\$1,735	\$2,543
Total Budgetary Changes	\$6,415	\$8,801	(\$1,227)	\$6,796	\$134	\$385	\$11,809	\$4,817	\$17,131	\$20,799

City Council members approved several amendments to the originally adopted budget throughout the year, totaling \$16.2 million. Forty percent of these amendments, or \$6.4 million, related to the validation of prior year's contractual encumbrances, of which \$2.7 million was for the City's refuse collection contract. Other budget amendments provided additional grant funding for various non-profit agencies, and various capital projects.

CAPITAL ASSET AND LONG-TERM DEBT ACTIVITY

As of June 30, 2004 the primary government of the City had invested \$421.4 million in capital assets as reflected by the following table. The total amount represents an overall increase primarily due to continued improvements and expansion in infrastructure. The City has ongoing paving programs as well as other maintenance programs designed to preserve and increase the life of existing assets. This accounts for the growth in the past year. There are several major projects that are just beginning which will increase future assets, primarily the construction of a new downtown parking garage.

Capital Assets at Year-End (Net of Depreciation)

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2004	2003	2004	2003	2004	2003
Land and site improvements	\$39,369	\$38,166	\$6,042	\$6,042	\$45,411	\$44,208
Buildings and improvements	38,952	38,924	206,457	206,110	245,409	245,034
Equipment, furniture & fixtures	53,673	55,439	3,006	3,006	56,679	58,445
Infrastructure	176,314	173,825	0	0	176,314	173,825
Construction in progress	50,100	32,574	0	17	50,100	32,591
Less accumulated depreciation	(115,833)	(106,151)	(36,698)	(31,499)	(152,531)	(137,650)
Total	\$242,575	\$232,777	\$178,807	\$183,676	\$421,382	\$416,453

The following table reconciles the change in capital assets. Included in this table are the total activities for both the government and business-type activities of the total primary government. Further detail can be provided by referring to Note 7 of the Notes to Financial Statements, as well as the section concerning Capital Assets Used in the Operation of Governmental Funds.

Change in Capital Assets

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2004	2003	2004	2003	2004	2003
Beginning balance	\$338,928	\$312,191	\$215,175	\$182,101	\$554,103	\$494,292
Additions	27,927	32,025	347	193,521	28,274	225,546
Deletions	(8,447)	(5,288)	(17)	(160,447)	(8,464)	(165,735)
Balance before depreciation	358,408	338,928	215,505	215,175	573,913	554,103
Accumulated depreciation	(115,833)	(106,151)	(36,698)	(31,499)	(152,531)	(137,650)
Balance after depreciation	\$242,575	\$232,777	\$178,807	\$183,676	\$421,382	\$416,453

Debt Administration:

As of the year-end, the City's Total Primary Government had \$262.7 million in debt outstanding. Included in this amount is \$1.4 million, representing the City's portion in the joint construction of a new City/County animal shelter. During FY 03/04, the City issued \$34 million in new debt. Proceeds from this debt have been used to retire an outstanding line of credit, and will also be used to construct a new parking garage in the downtown area. The balance of the proceeds will fund various other city projects. At the same time the City did a high to low coupon refunding. The present value savings from this refunding were approximately \$4.5 million, with estimated annual savings of approximately \$300,000. The City also retired approximately \$14 million in debt, which results, upon comparison to FY 02/03, an increase of approximately \$21.6 million in total outstanding debt.

Outstanding Debt at Year - End

	<u>Governmental Activities</u>		<u>Business-Type Activities</u>		<u>Total Primary Government</u>	
	2004	2003	2004	2003	2004	2003
Current						
Bonds, notes and capital leases due within one year	\$10,901	\$9,342	\$3,569	\$2,926	\$14,470	\$12,268
Noncurrent						
Bonds, notes and capital leases due in more than one year	95,725	73,646	154,168	159,463	249,893	233,109
Subtotal	\$106,626	\$82,988	\$157,737	\$162,389	\$264,363	\$245,377
Unamortized premiums, discounts and gains on refunding	(2,114)	0	447	466	(1,667)	466
TOTAL	\$104,512	\$82,988	\$158,184	\$162,855	\$262,696	\$245,843

The City currently maintains a Fitch/ICBA rating of AA+, which was the same as last year's rating. Standard and Poor's rates the City's general obligation bonds AA while the City carries a Moody's rating of Aa2. For additional information on the long-term debt of the City, please refer to Note 9 of the Notes to Financial Statements, as well as in the Schedule of Long-Term Bonds and Notes Payable.

OTHER POTENTIALLY SIGNIFICANT MATTERS

Like most local governments, the largest source of revenue for the City of Knoxville is taxes. This category constitutes \$111.1 million or 84.6% of the total revenue to the General Fund. Within this category of revenue, the largest amount comes from property taxes. In turn, property taxes are divided among realty, personality, and public utility. The growth rate for assessed value on real estate has been fairly moderate during the mid to late 1990's and early 2000's. We expect this moderate growth to continue into the new fiscal year, with the forecast for overall growth in real property being 1.76%. Within this grouping the highest anticipated growth is in commercial property. Residential property growth is expected to be slightly lower than the overall average, while the value of industrial property is expected to decline. For FY 04/05 the projected assessed value of real property is \$2.52 billion. Personal property growth has been higher than real property in the recent past and we expect that to continue in the new year. This growth is, however, more than offset by a reduction in the equalization ratio, which will effectively lower assessed values below the FY 02/03 level. The equalization ratio also impacts taxes on public utilities. We are also forecasting no growth in this segment, but a lowering in the total assessed values due to the change in the equalization ratio. Historically, the city has collected an average of 93.6 % of real property taxes.

Local option sales tax revenues make up approximately \$30.5 million or 21.2% of total General Fund revenues. Knoxville, like the rest of the nation, has witnessed a slower growth in sales based revenues during the past year. We have, however, fared better than most cities in the state and region. We expect a modest upturn in the economy in FY 04/05, which will be reflected in sales tax growth. The second largest revenue category to the General Fund is intergovernmental revenue, and accounts for \$17.2 million or 11.9% of total revenue. This category of revenue experienced a decline in FY 03/04, primarily due to a drop in proceeds from the Hall Income tax. No additional cuts were enacted in 2004 and we expect some growth in this category of revenue in the upcoming year. This growth is due to expected improvements in the overall economy, particularly in the state shared sales tax.

Other revenue sources include fines and forfeitures and miscellaneous revenue items. Revenues coming from the City Municipal Court system are expected to grow in the next fiscal year. The category of miscellaneous revenue includes interest earnings. The decrease in interest rates, combined with lower balances available for investment, will result in continued declines in this revenue source.

Health care benefits are accounted for in a separate internal service fund. The City's Employee Health Insurance Fund is funded by both employer and employee contributions. Premiums for medical care are projected to increase by 10% in January 2005, when the current contract is renewed. Therefore, the cost once borne by the City for employee's health costs must now be shared. Due to the skyrocketing cost of health benefits, individuals must now provide 10% of their coverage, family coverage is now increased to 30%, and retirees must provide 60% of the total premiums. The City is continuing to examine various methods, which may help lower these increases in the future. Particular emphasis will be given to wellness programs and disease prevention.

The City attempts to plan for future changes in revenues and expenditures. As part of this planning we believe it is appropriate to disclose some potential problem areas. The City is facing the prospect of limited revenue growth in the future. Of particular concern is the state revenue situation. The state continues to experience financial difficulty. In its budget for FY 02/03 the state imposed a nine percent reduction in state shared revenue. The reduction was not spread evenly among all shared revenues, but was higher in sales taxes and income taxes. This tends to hit the larger municipalities, including Knoxville, slightly harder. While no additional reductions were implemented in 2004, we do not expect these cuts to be restored and believe there is a possibility of additional cuts in the future. At this time we cannot assess the likelihood of such a scenario, but we will continue to evaluate our options should such an event occur. It is likely that services would be reduced in such a situation.

The City of Knoxville is also very dependent upon sales tax revenues. This tends to be somewhat less elastic than other taxes and will consequently be impacted less in an economic recovery. The continued increase in internet shopping also serves to lower growth in this revenue source. Changes in the communication industry, including the potential switch of direct phone service to the internet, also poses some issues in the future.

The City currently provides a defined benefit pension plan. The recent market performance has resulted in portfolio losses and has affected growth assumptions. This will require the City to increase its contributions to the retirement system in the upcoming year. This is factored into the upcoming budget.

On the plus side, we expect that the new Convention Center will have a significant economic impact on the City. The City received funds from the state in FY 03/04 to help offset future debt payments on the facility. The downtown area is also experiencing a rebirth, and should continue to grow in the future. The relocation of two major employers to the downtown area should further provide an economic stimulus to the area.

FINANCIAL CONTACT

The City's financial statements are designed to present users (citizens, taxpayers, customers, investors, and creditors) with a general overview of the City's finances and to demonstrate the City's accountability. If you have questions about the report or need additional financial information, please contact the City's Director of Finance and Accountability at 400 Main Avenue, Knoxville, Tennessee 37901.