

**CITY OF KNOXVILLE, TENNESSEE**  
**Notes to Financial Statements**  
**June 30, 2004**  
(amounts expressed in thousands)

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

***Reporting Entity***

The City of Knoxville, Tennessee is a municipal corporation governed by elected executive and legislative bodies, which consist of a Mayor and nine-member City Council. As required by accounting principles generally accepted in the United States of America (generally accepted accounting principles), these financial statements present the City of Knoxville, Tennessee (the primary government) and its component units, entities for which the government is considered to be financially accountable. A component unit is a legally separate entity that satisfies at least one of the following criteria: (1) elected officials of a primary government are financially accountable for the entity, (2) the nature and significance of the relationship between the entity and a primary government are such that to exclude the entity from the financial reporting entity would render the financial statements misleading or incomplete. Component units are generally presented discretely unless one of the following two circumstances are present, in which case they would be blended: (1) similar governing bodies and (2) scope of services provided are either directly or indirectly, exclusively or almost exclusively for the primary government.

All component units are discretely presented and are reported in separate columns in the combined financial statements to emphasize that they are legally separate from the City. The governing bodies of each of these component units are appointed by the City Council, except for the Pension Board. Pension Board directors are elected by eligible City employees. All component units have a June 30 year-end.

1. Knoxville Utilities Board (KUB) provides electric, gas and water and wastewater services to residents of the City and surrounding areas. KUB may not issue debt without the City's approval, although the City does not have any obligation for KUB debt.
2. Metropolitan Knoxville Airport Authority (MKAA) operates two airport facilities that serve Knoxville and the surrounding area. MKAA must obtain City approval to issue debt.
3. City of Knoxville Pension System (Pension) operates a defined benefit plan for employees of the City, KAT and MKAA. The Pension receives significant contributions from the City. Changes to the pension plan recommended by the Pension Board must be approved by the City.
4. Knoxville Area Transit (KAT) operates the public transportation system in Knoxville. The City approves the KAT budget. The City also provides significant operating subsidies to KAT.

Complete financial statements for each of the component units, except KAT for which separate financial statements are not issued, may be obtained from their respective administrative offices as follows:

Knoxville Utilities Board  
626 South Gay Street  
Knoxville, Tennessee 37929

Metropolitan Knoxville Airport Authority  
P. O. Box 15600  
Knoxville, Tennessee 37901

City of Knoxville Pension Board  
917B E Fifth Avenue  
Knoxville, Tennessee 37917

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**Notes to Financial Statements**

**June 30, 2004**

(amounts expressed in thousands)

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

***Joint Ventures***

The City is a participant in the following joint ventures with Knox County which are not considered part of the reporting entity as the City does not exercise financial accountability for their operations:

*Public Building Authority of the County of Knox and the City of Knoxville, Tennessee*  
*Metropolitan Planning Commission*

Complete financial statements of the joint ventures can be obtained from the City Finance Department, P. O. Box 1631, Knoxville, Tennessee 37901.

***Related and Jointly Governed Organizations***

The following related agencies provide services within the City:

*Knoxville's Community Development Corporation* - the Mayor appoints members to the governing board; however, the City exercises no budgetary control and provides no direct financial assistance.

*Knoxville Zoological Park, Chilhowee Park, and IJAMS Nature* - the City has management agreements with each of these entities (Note 15) but has no involvement in directing the respective entities' budgets, rates, debt obligations and board membership.

***Government-wide and Fund Financial Statements***

The government-wide financial statements, which consist of the statement of net assets and the statement of activities, report information on all nonfiduciary activities of the primary government and its component units. For the most part, the effect of interfund activity has been removed from the government-wide statements. Governmental activities, which are normally supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which are funded to a significant extent on user fees and charges. Each legally separate component unit, for which the primary government is financially accountable, is reported separately in the government-wide financial statements.

Direct expenses are those that are clearly identifiable with a specific function or segment. The statement of activities demonstrates the extent to which the direct expenses of each function or segment are offset by program revenues. Program revenues include charges to customers or applicants who purchase, use or directly benefit from the goods, services or privileges provided or given by the function or segment. Program revenues also include grants and contributions that are restricted for meeting the operational or capital requirements of a particular function or segment. Taxes and other non-program revenues are reported as general revenues.

Separate financial statements are provided for governmental funds and proprietary funds. Although they are excluded from the government-wide financial statements, separate financial statements are also provided for fiduciary funds. Each major governmental and enterprise fund is reported in a separate column in the financial statements.

***Measurement Focus, Basis of Accounting, and Basis of Presentation***

The government-wide financial statements and the proprietary fund and fiduciary fund financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are reported when earned and expenses are recorded when a liability is incurred. Property taxes are recognized as revenues in the year for which they are levied. Grants and other restricted revenues are recognized as revenue when all eligibility requirements imposed by the provider have been met.

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**CITY OF KNOXVILLE, TENNESSEE**

**Notes to Financial Statements**

**June 30, 2004**

(amounts expressed in thousands)

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

The financial statements of the discretely presented component units (Knoxville Utilities Board, Metropolitan Knoxville Airport Authority, and Knoxville Area Transit) that are included in the government-wide financial statements are accounted for on the same basis as the City's proprietary funds. Further, the accounts of Knoxville Utilities Board are maintained in conformity with the uniform system of accounts prescribed by the Federal Energy Regulatory Commission.

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized when they are both measurable and available. Revenues are considered to be available when they are collected within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the City considers revenues to be available if they are collected within 60 days of the end of the current fiscal year. Similar to the accrual basis of accounting, expenditures generally are recorded when a liability is incurred. However, debt service expenditures, as expenditures relating to long-term liabilities such as compensated absences and claims and judgments are recorded when payment is due.

Property taxes, shared revenues, licenses, interest and charges for services associated with the current fiscal year are considered to be susceptible to accrual and have been recognized as revenues of the current year. Other revenue items are considered to be measurable and available when the government receives cash.

The City reports the following major governmental funds:

**General Fund** – The general fund accounts for all financial resources except those required to be accounted for in another fund. It is the City's primary operating fund.

**Debt Service Fund** – The debt service fund accounts for the accumulation of resources for, and the payment of, interest and principal on general long-term debt.

**Capital Projects Fund** – The capital projects fund accounts for financial resources to be used for the acquisition or construction of major capital facilities (other than those financed by proprietary funds).

The City reports the following major proprietary fund:

**Knoxville Convention Center** – This fund accounts for the operations of the Knoxville Convention Center.

Additionally, the City reports the following fund type:

**Internal Service Funds** – Internal service funds account for replacement of capital assets, office services, fleet management, risk management, and employee health insurance services provided to other departments or agencies of the City, on a cost reimbursement basis.

As allowed by the Governmental Accounting Standards Board Statement of Governmental Accounting Standard No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting", the City'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 in both the government-wide and proprietary fund financial statements to the extent that those standards do not conflict or contradict guidance of the Governmental Accounting Standards Board.

As a general rule the effect of interfund activity has been eliminated from the government-wide financial statements. Exceptions to this general rule are payments-in-lieu of taxes and other charges between the Knoxville Utilities Board, the Knoxville Area Transit and various other functions of the City. Elimination of these charges would distort the direct costs and program revenues reported for the various functions concerned.

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**CITY OF KNOXVILLE, TENNESSEE**

**Notes to Financial Statements**

**June 30, 2004**

(amounts expressed in thousands)

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

Amounts reported as program revenues include 1) charges to customers or applicants for goods, services, or privileges provided, 2) operating grants and contributions, and 3) capital grants and contributions. Internally dedicated resources and all taxes are reported as general revenues.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the City's enterprise funds are charges to customers for sales and services. The Knoxville Utilities Board also recognizes as operating revenues the portion of tap fees intended to recover the cost of connecting new customers to the system. Operating expenses of the enterprise funds and internal service funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

When both restricted and unrestricted resources are available for use, the City's policy is to use restricted resources first and unrestricted sources as they are needed.

***Assets, liabilities, and net assets or equity***

***Deposits and investments***

The City pools idle cash from all funds (except the Pension Trust Fund, the Knoxville Utilities Board, and the Metropolitan Knoxville Airport Authority component units) for the purpose of increasing income through investment activities. Deficits in pooled cash are classified as due to other funds or due from other funds on the financial statements of the borrowing and advancing fund, respectively.

Except for certain money market investments that have a remaining maturity at the time of purchase of one year or less which are carried at amortized cost, investments are carried at fair value. Interest income on investments is allocated to all funds on the basis of average daily cash and investment balances.

Cash and cash equivalents are considered to be cash on hand, demand deposits and short-term investments with original maturities of three months or less from the date of acquisition.

***Receivables***

The City bills and collects its own property taxes. Property taxes are levied (based on the assessed valuation as of January 1) and become payable on October 1. Property taxes attach as a lien on the property as of January 1. Such taxes become delinquent on February 28. A lawsuit is filed against property owners for taxes that remain uncollected on March 1 of the year following the date such taxes become delinquent. Property tax revenues are recognized when levied to the extent that they result in current receivables; that is, are received within 60 days of the end of the fiscal year. An allowance for uncollectibles or deferred revenue is provided for remaining property tax receivables.

All trade receivables, including those of discretely presented component units are presented net of an allowance for uncollectibles. Because loans receivable are subject to grant restrictions, an amount equal to the loan has been provided as deferred revenue.

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**CITY OF KNOXVILLE, TENNESSEE**

**Notes to Financial Statements**

**June 30, 2004**

(amounts expressed in thousands)

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

***Inventories and prepaid items***

Inventories in proprietary fund types are stated at the lower of average cost or replacement value. Inventories in the governmental fund types are stated at cost. Proprietary fund inventories consist of expendable supplies held for consumption. Inventories of governmental funds are reported under the consumption method of accounting.

Prepaid items in both the government-wide and fund financial statements represent payments to vendors that reflect costs applicable to future periods.

***Restricted assets***

Certain unexpended debt proceeds, as well as resources set aside for debt repayment, are classified on the balance sheet as restricted. These funds are maintained in separate bank accounts and their use is limited by applicable debt covenants.

***Capital assets***

Capital assets, which include property, plant, equipment, and infrastructure assets (i.e., roads, bridges, sidewalks, and similar items), are reported in the applicable governmental or business-type activities columns in the government-wide financial statements. The City defines capital assets as those assets with an initial, individual cost of more than five thousand dollars and an estimated useful life in excess of two years. Capital assets are recorded at cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at fair value at the date of donation.

The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend an asset's life are not capitalized.

Major outlays for capital assets and improvements are capitalized in proprietary funds as projects are constructed. Interest incurred during construction phase of capital assets of business-type activities is included as part of the capitalized value of the assets constructed. Total interest expense incurred by the Knoxville Convention Center was \$4,958. Because there was no construction during 2004, no interest was capitalized. Total interest expense incurred by the Metropolitan Knoxville Airport Authority was \$4,287 of which \$18 was capitalized as part of construction.

Depreciation on property, plant and equipment in the enterprise funds and component units is provided using the straight-line method of accounting over the following useful lives:

Buildings	25 to 40 years
Improvements	5 to 20 years
Infrastructure	25 years
Equipment	3 to 10 years
Sewer lines	50 years

The original cost of KUB utility plant retired or otherwise disposed of and the cost of removal less salvage are charged to accumulated depreciation.

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**CITY OF KNOXVILLE, TENNESSEE**  
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**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

***Compensated absences***

City employees are granted vacation and sick leave in varying amounts. In the event of termination or retirement, an employee can be reimbursed twice the annual accrual of accumulated vacation, up to a maximum of 48 days. Employees are reimbursed up to 45 days of accumulated sick leave upon retirement or death only if the individual has accumulated 120 or more days. The cost of accumulated vacation and sick leave is accrued when incurred in the government-wide and proprietary fund financial statements. Vacation and sick leave that is payable as the result of employee resignation or retirement and is expected to be liquidated with expendable available resources is reported as an expenditure and a fund liability of the governmental fund that will pay it (i.e. the fund that pays the employee's salary or wages).

***Long-term obligations***

The City reports long-term debt and other long-term obligations in the applicable activities in the government-wide financial statements and the proprietary fund type fund financial statements. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium or discount. Issuance costs are reported as deferred charges.

***Master plans***

Master plans represent costs incurred in developing a long-term expansion plan for the Metropolitan Knoxville Airport Authority. Master plans are stated at cost and are included in other assets. Amortization is computed using the straight-line method over the plans' estimated useful lives of five years.

***Passenger facility charges***

The collection of passenger facility charges has been approved by the Federal Aviation Administration to be used for qualifying capital improvement projects of the Metropolitan Knoxville Airport Authority. Passenger facility charges, along with related interest earnings, are recorded as deferred until used or authorized for use under a Federal Aviation Administration-approved application to use. Once authorized to use, the passenger facilities charges are recognized as nonoperating revenue in the year collected by the air carriers. During 2004 all passenger facilities charges were authorized for use and at June 30, 2004 there was no deferred revenue related to passenger facilities charges.

***Fund equity***

In fund financial statements, governmental funds report reservations of fund balances for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans that can be changed by management.

***Environmental cleanup matters***

The Knoxville Utilities Board accrues environmental cleanup costs when those costs are believed to be both probable and 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.

***Use of estimates***

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that effect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.