

**COMPREHENSIVE ANNUAL FINANCIAL REPORT**  
**OF THE**  
**CITY OF KNOXVILLE, TENNESSEE**  
**FOR THE FISCAL YEAR ENDED**  
**JUNE 30, 2007**

**PREPARED BY:**

**CITY OF KNOXVILLE FINANCE DEPARTMENT**

**JAMES YORK,  
DIRECTOR OF FINANCE**

***INTRODUCTORY SECTION***



December 21, 2007

In compliance with the City of Knoxville Charter requirements, I am submitting the Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2007. This report discusses the financial results for the year, provides information on budgetary performance, and includes information on the financial condition of the City. I am also pleased to report that the financial condition of the City remains strong.

The report has been prepared in accordance with the principles and standards for financial reporting as set forth by the Governmental Accounting Standards Board (GASB) and complies with the requirements of GASB Statement Number 34. The report also meets the requirements of the Single Audit Act of 1984 and related Office of Management and Budget (OMB) Circular A-133. Due to the magnitude of the GASB 34 implementation, some of the schedules only reflect operating results since fiscal year ended June 30, 2002, the year the City implemented GASB Statement 34. Over time, these schedules will reflect the full ten year comparisons desired.

The City's financial statements have been audited by Pugh & Company, P.C., Certified Public Accountants, and prepared by the Finance Department. The City accepts the responsibility to ensure that all information included in the Comprehensive Annual Financial Report is complete and accurate. We believe the enclosed data completely and accurately presents the financial condition of the City.

This report, like previous reports, consists of three sections: Introductory, Financial, and Statistical. The *Introductory Section* includes the City's Letter of Transmittal, a listing of officials, an organization chart, and a facsimile of the Certificate of Achievement. 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* provides selected unaudited financial and demographic information on a multi-year basis.

Accounting principles generally accepted in the United States of America (GAAP) require that management provide a narrative introduction, overview and analysis to accompany the financial statements in the form of the Management's Discussion and Analysis (MD&A). This letter of transmittal is designed to complement the MD&A and should be read in conjunction with it. The City of Knoxville's MD&A can be found immediately following the report of the independent auditors.

### Profile of the Government

The City of Knoxville operates under the Mayor-Council form of government. Policy-making and legislative authority are vested in the nine member City Council, six of whom represent specific districts and three elected at large. The mayor and council members are elected on a non-partisan basis to four-year terms. The City Council is responsible, among other things, for passing ordinances, determining policies, and adopting the budget. The mayor is responsible for carrying out the policies and ordinances of the City Council, for overseeing the day-to-day operations of the City, and for appointing the heads of the City's departments.

This report covers all funds of the City of Knoxville. The City provides a full range of services, including, but not limited to, police and fire protection; solid waste collection and disposal; the construction and maintenance of highways, streets, and infrastructure; recreational activities; and cultural events. In addition, the City of Knoxville has financial accountability over the Knoxville Utilities Board (KUB), the Metropolitan Knoxville Airport Authority (MKAA), Knoxville Area Transit (KAT) and the City Employees'

Pension Fund. The financial statements of KUB, MKAA and KAT are included in the body of this report, noted as Component Units on the Government Wide Statements. The financial statements of the City Employees' Pension Fund are included in the Fiduciary funds section along with a minor employee benefit fund.

## Local Economy

The overall economic health of the metropolitan Knoxville area remains very positive. The City serves as the economic hub of the entire upper East Tennessee area, and its trade sector is one of the strongest in the state. The City of Knoxville located in Knox County has one of the lowest sales tax rates in the state. Authorized by state law to levy up to 2.75%, the combined city/county rate is only 2.25%. Approximately seventy-six percent of the taxable sales within the County occur inside the corporate limits of Knoxville. The following table displays local sales tax collections (in thousands) of the City over the past six years.

<u>Year</u>	<u>Collections</u>	<u>% Growth</u>
FY 01/02	\$28,819	-3.79%
FY 02/03	\$29,031	0.74%
FY 03/04	\$30,529	5.16%
FY 04/05	\$31,785	4.11%
FY 05/06	\$34,514	8.59%
FY 06/07	\$36,659	6.21%

The local sales tax is a situs based revenue. That is, the location of the point of sale determines the governmental entity receiving the proceeds. In recent years, there have been several situs reclassifications that have shifted revenues between the City of Knoxville and Knox County. In FY 01/02, the City of Knoxville suffered from a change, which shifted funds to the County, accompanied by a large one-time correction of prior revenues. In subsequent years, the shifts have been reversed. These shifts account for the large variations seen in the growth pattern for annual collections. Were it not for these reclassifications, the City and County would tend to mirror each other.

As discussed above, the City experienced 6.21% growth in local sales tax. This mirrors Knox County as a whole. Overall growth in state sales taxes, which factors out rate differentials, shows the overall state growth of 5.99%.

The presence of the University of Tennessee along with TVA lends stability to the area, making the local economy less cyclical than either the national or state economy. This contributes to a low unemployment rate, which averaged 3.4% (Knoxville MSA) in FY2007. This compares very favorably to the national unemployment rate of 4.3% and the seasonally adjusted state rate of 4.1% as well as the other major metropolitan areas of the state (Chattanooga – 3.9%, Memphis – 5.0%, and Nashville – 3.7%). Knoxville MSA had a labor force of 360,460 in 2007, and the economic development initiative *Jobs Now!* continues to work toward further increases. Job growth has been positive in the recent past and is forecast to continue in the near term, although some shifting among sectors is anticipated. Trade and service sectors are forecasted to grow at a strong rate, and the finance, real estate, communication, and transportation sectors are also expected to do well, while manufacturing is expected to decline.

Knoxville is at the intersection of two major interstate highways (I-40 and I-75) and near the terminus of a third interstate (I-81). Because of its central location in the eastern United States, the Knoxville area serves thousands of industrial and commercial customers in a concentrated eight-state area. It is within 500 miles of approximately one-half of the population of the United States. The County for many years has been known as one of the South's leading wholesale markets. Located within the County are 912 wholesale establishments, 1,595 retail establishments and 4,976 service establishments. County retail sales were reported at approximately \$6.47 billion in 2006. The average cost of living in the area is below the U.S. Average at 88.1% which contributes to the attractiveness of the area.

In addition to being a manufacturing and distribution center, the County ranks second among the five metropolitan counties of Tennessee in agricultural production. The County's principal crops are barley, tobacco, corn, wheat, hay, vegetables and fruits. Beef and milk production are important farming activities. Meat packing and preparation of other food products have shown a steady increase in the County in the last several years.

The area also benefits from the State's high ranking in Alexander Grant and Company's *General Manufacturing Climates*. The study has consistently ranked Tennessee as one of the top areas in the nation for manufacturing. A great deal of this industrial growth has taken place in the community's eleven industrial parks, which are zoned as part of a planned industrial development program.

Tourism also plays a vital role in the economic development of area. In 2003, travelers spent more than \$599 million in Knox County, ranking it fourth in the state for visitor expenditures. Knoxville supports an active tourism and convention trade. The 500,545 square foot convention center on the World's Fair Park site, which opened in June 2002, features spacious meeting rooms and a 400-seat lecture hall. Other facilities include a civic coliseum/auditorium, an exhibition hall/convention center, a 25,000-seat arena, and a conference center at the University of Tennessee. Knoxville's multitude of annual events include the Dogwood Arts Festival, Tennessee Valley Fair, Boomsday, Christmas in the City and many cultural activities.

Knox County is the principal Gateway to the Great Smoky Mountains National Park, located 40 miles to the southeast. There are over 500,000 acres that make up the nation's most visited National Park, extending over the States of Tennessee and North Carolina. More than 9.2 million people visited the National Park in 2004.

In addition to the natural beauty of the area, two of the major attractions in the Smoky Mountains are Gatlinburg and Pigeon Forge. Gatlinburg, a tourist town which has accommodations for over 60,000 people, features numerous restaurants, craft shops, and gift stores, along with a ski lodge, ski-lifts, convention center and tramway, making it a year-round resort town. Pigeon Forge, a tourist town and shoppers mecca at the foothills of the mountain, has accommodations for approximately 40,000 people. Its attractions include Dollywood - a country-style theme park, a waterslide park, a rodeo dinner theater, and numerous miniature golf courses, bumper boat rides, and theme museums.

Knoxville seeks to capitalize even more from its location through such projects as the Women's Basketball Hall of Fame, the Gateway Regional Visitor Center, Volunteer Landing, and the Knoxville Zoological Gardens.

Knoxville consistently is ranked among the best places to live in the country. According to Places Rated Almanac Millennium Edition, Knoxville was ranked the best place to live for cities under one million in population. CNN/Money.com in 2005 ranked Knoxville as one of the 10 best places to retire. The Economic Research Institute in 2006 ranked Knoxville as the number one in "Best Places for Recent College Graduates to Live". Knoxville was ranked 9<sup>th</sup> for "Best Places for Business and Careers" in Forbes magazine 2006 and 3<sup>rd</sup> on the Best Cities for Relocating Families list of Worldwide ERC and Primary Relocation, 2004. Knoxville was also noted as "Top Mid-Market with populations between 250,000 and 750,000" by the Southern Business and Development Magazine June 2003 and 14<sup>th</sup> among the "Top Logistic Cities in the Southeast". The City has also been cited nationally for its low tax rate.

The quality of life, low cost of living, convenient interstate access, along with other factors make the area an attractive location for many types of operations, particularly those in the growing field of telecommunications. Knoxville serves as home to numerous customer service centers, including Jewelry Television by ACN, Cendant Corporation, ClientLogic Corporation, G.C Services, Kimberly-Clark Corporation, Nova Information Systems, U.S. Cellular and Whirlpool Corporation. The City has worked with these firms, and others, to help foster relocation to Knoxville, or expansion of existing facilities. Companies having their corporate headquarters in Knoxville include Home and Garden Television (HGTV), Clayton Homes, CTI Molecular Imaging Corporation, DeRoyal Industries, Goody's Family Clothing, Pilot Corporation, and Sea Ray Boats.

The Metropolitan Knoxville Airport Authority (MKAA) has also contributed to area growth. McGhee Tyson Airport completed a \$70 million renovation and expansion project of its main terminal and concourses in the fall of 2000. The airport is served by two major and ten regional passenger airlines that combine for 61 daily departures connecting to fifteen hub airports with non-stop service. The direct and indirect economic impact of the airport is estimated by the MKAA to be approximately \$1 billion annually. This figure includes payroll, local spending, transportation cost savings, capital spending and other benefits.

In addition, Knoxville serves as the health, educational, and governmental center of East Tennessee. Knoxville is the home to the University of Tennessee's main campus with over 27,000 students, including its teaching hospital and veterinary school. Six other colleges operate in Knoxville, with thirty trade/vocational schools completing Knoxville's higher education system. Also operating within the area are six hospitals including the only two trauma centers for a 27-county area. The presence of the Tennessee Valley Authority, UT-Battelle, and BWXT-Bechtel serve as a magnet for technology-based corporations in the East Tennessee area. The growing trend toward allowing technology transfer to private industry is also benefiting the region. The development of the multi-billion dollar spallation neutron source project at the Oak Ridge National Laboratory is also expected to enhance economic activity and lure newer companies to the area.

### **Relevant Financial Policies/Controls**

Management of the City of Knoxville is responsible for establishing and maintaining an internal control structure. This structure is designed to protect the assets of the government from loss, theft or misuse. The system also attempts to ensure that adequate accounting data are compiled to allow for the preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (generally accepted accounting principles). The internal control structure is designed to provide reasonable, but not absolute, assurance that these objectives are met. The concept of reasonable assurance recognizes that: (1) the cost of a control should not exceed the benefits likely to be derived; and (2) the valuation of costs and benefits requires estimates and judgments by management.

### **Budgetary Controls**

The objective of the City of Knoxville's budgetary controls system is to ensure compliance with the City Code and Charter, as well as with state and federal guidelines regarding use of funds. No authority is granted to any department to expend above their annual appropriation without council approval. Appropriations for all funds, excluding capital projects, included in the annual budget process lapse at year-end and must be reappropriated annually. Additional budgetary controls include the City's encumbrance accounting system, which is designed to ensure that departments do not exceed or commit to exceed any appropriation for the fiscal year. Furthermore, the Mayor and the Finance Director can reserve or impound appropriations if there appears to be insufficient revenues to cover expenditures, or for any other valid reason.

### **Debt Administration**

Total general obligation indebtedness of the City decreased by \$13.3 million in FY2007 through budgeted debt repayments. No new debt was issued during the fiscal year.

The total amount of general obligation debt outstanding as of June 30, 2007 is \$220.3 million. Of this amount, \$147.5 million represents proprietary fund debt on the Convention Center and the Locust Street Garage. In addition to the above debt, the City has responsibility for \$1.2 million in debt relating to its portion of Animal Welfare Center, this debt being issued by Knox County.

Several indicators are useful in evaluating the City's debt position. These include the ratio of net general obligation bonded debt to assessed valuation and the amount of general obligation debt per capita. The

debt ratio for the City of Knoxville (excluding component unit debt) at the end of fiscal year 2007 is as follows:

General Obligation Debt	Amount (in thousands)		Ratio of Amount to Assessed Valuation 100%		Ratio of Amount to Estimated Actual Value		Debt per Capita	
	FY 06/07	FY 05/06	FY 06/07	FY 05/06	FY 06/07	FY 05/06	FY 06/07	FY 05/06
	Net direct bonded debt	\$ 220,280	\$ 233,555	6.49 %	6.98 %	2.04%	2.21%	\$ 1,222
Overlapping debt of Knox County	138,065	122,988	4.07 %	3.67 %	1.28%	1.16%	766	683
<b>Total</b>	<b>\$ 358,345</b>	<b>\$ 356,543</b>	<b>10.56%</b>	<b>10.65%</b>	<b>3.32%</b>	<b>3.37%</b>	<b>\$ 1,988</b>	<b>\$ 1,980</b>

The City's current and prior bond ratings are as follows:

Debt Type	Fitch/ICBA		S & P		Moody's	
	FY 06/07	FY 05/06	FY 06/07	FY 05/06	FY 06/07	FY 05/06
General Obligation Bonds	AA+	AA+	AA	AA	Aa2	Aa2
Revenue Bonds:						
Electric (KUB)	N/A	N/A	AA	AA	Aa3	Aa3
Gas (KUB)	N/A	N/A	AA	AA	Aa3	Aa3
Water (KUB)	N/A	N/A	AA+	AA+	Aa3	Aa3
Waste Water (KUB)	N/A	N/A	AA	AA	Aa3	Aa3

### Cash Management

The City of Knoxville operates a cash management program under a master banking service agreement with a major Tennessee banking institution. Idle funds are invested in accordance with the City's Investment Policy on the basis of security, liquidity and, lastly, yield. Investments are governed by state statute and City ordinances, which limit both the type and length of investments. Maturities are generally limited to two years and investments are restricted to treasury bonds and notes, agencies and instrumentalities guaranteed by the federal government, various money market instruments such as certificates of deposit, high-grade commercial paper, and bankers acceptances, and various state or local bonds. The policies also allow for participation in the State of Tennessee managed Local Government Investment Pool (LGIP).

As required by statute and ordinance, all deposits and certificates of deposit are secured by similar grade collateral pledges at 105% of market value for all amounts in excess of that guaranteed through federally sponsored insurance programs or are collateralized by participation of depository institutions in the Tennessee collateral pool.

The average yield on investments, excluding the pension fund investments, was 5.19%. Average weighted maturities were 75.3 days and ranged between 38 and 88 days during the preceding fiscal year. Duration was very short.

The City Charter mandates that portfolio management and control of the City's Pension Fund be vested in the City Pension Board. The Board is advised by Summit Strategies and engages professional investment firms in an advisory capacity.

## **Risk Management**

The City of Knoxville's risk management program is responsible for the administration of the City's self-insured liability and worker's compensation programs. The risk management division is also responsible for the administration of the City's commercial insurance and OSHA programs. An increase in net assets of \$1.5 million was reported for the Risk Management fund as of June 30, 2007, due mainly to favorable claims experience and increased rates charged to the operating funds. Total net assets in this fund equal \$6.99 million as of June 30, 2007.

## **Other Information**

### ***Independent Audit***

The State of Tennessee requires an independent audit performed by independent certified public accountants. The City's audit committee selected Pugh & Company, P.C., Certified Public Accountants, to perform the fiscal year 2007 audit.

## **MAJOR INITIATIVES**

### **For the Year ended June 30, 2007:**

Economic development has been the primary focus during the past year. Significant work has been devoted to the preparation of a South Knoxville Waterfront Master plan which will serve as a guide and incentive to future development in this area. Work has continued on the redevelopment of the downtown area with the opening of a multi-screen cinema, additional diversified retail targeting the downtown visitor, and the I-275 Business Park. Increased capital funding was devoted to on-going maintenance of the City's infrastructure as well as the expansion of parks and facilities.

### **For the Future:**

The City's focus in the foreseeable future is continued economic development, and increased operational efficiency. Major projects include funding to address chronic problem properties, reducing the homeless population, facades in commercial areas of the City and funding to promote historical restoration of properties in the City. Capital projects scheduled for the year include additional funding for infrastructure improvements and expanded maintenance, traffic calming, parks and recreation initiatives and improvements to drainage in areas prone to flooding. Funding is also provided to increase job creation efforts in the City of Knoxville and the Knoxville MSA. Recently announced private initiatives include SYSCO Corporation's plans to invest \$34.2 million at the I-275 Business Park in a distribution facility that will employ more than 300 people and Southshore Properties LLC announcing plans for a major housing project (137 units) with an estimated value of \$58.6 on the City's south waterfront.

### ***Awards***

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the City of Knoxville for its comprehensive annual financial report for the fiscal year ended June 30, 2006. This was the twenty-first consecutive year that the City has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

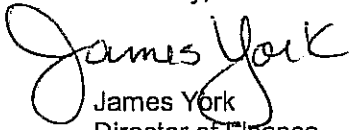
A Certificate of Achievement is valid for a period of one year only. We believe that our current comprehensive annual financial report continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

The City of Knoxville received GFOA's Distinguished Budget Presentation Award for the annual operating budget dated July 1, 2006. This marks the nineteenth consecutive year that the City has won this Award. The Distinguished Budget Presentation Award recognizes that the City's budget document is a proficient policy document, financial plan, operation guide and communications medium.

***Acknowledgments***

The preparation of this report results from the combined efforts of many people. Special recognition and appreciation goes to the City's Finance Department, Melissa Peters, the City's Internal Auditor, the City's independent auditors, Pugh & Company, P.C., and the City Council audit committee comprised of Marilyn Roddy (Chair), Bob Becker, Joe Hultquist, Barbara Pelot, and Chris Woodhull. The national recognition afforded the City of Knoxville could not have been achieved without the increasing participation and enthusiasm of the citizens of this community. Their exceptional response to the annual survey has served as the foundation for many programs and projects developed during the budgetary process which strengthen and benefit the lives of all Knoxvilleians.

Sincerely,

  
James York  
Director of Finance

# Certificate of Achievement for Excellence in Financial Reporting

Presented to

City of Knoxville  
Tennessee

For its Comprehensive Annual  
Financial Report  
for the Fiscal Year Ended  
June 30, 2006

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



*Charles S. Cox*

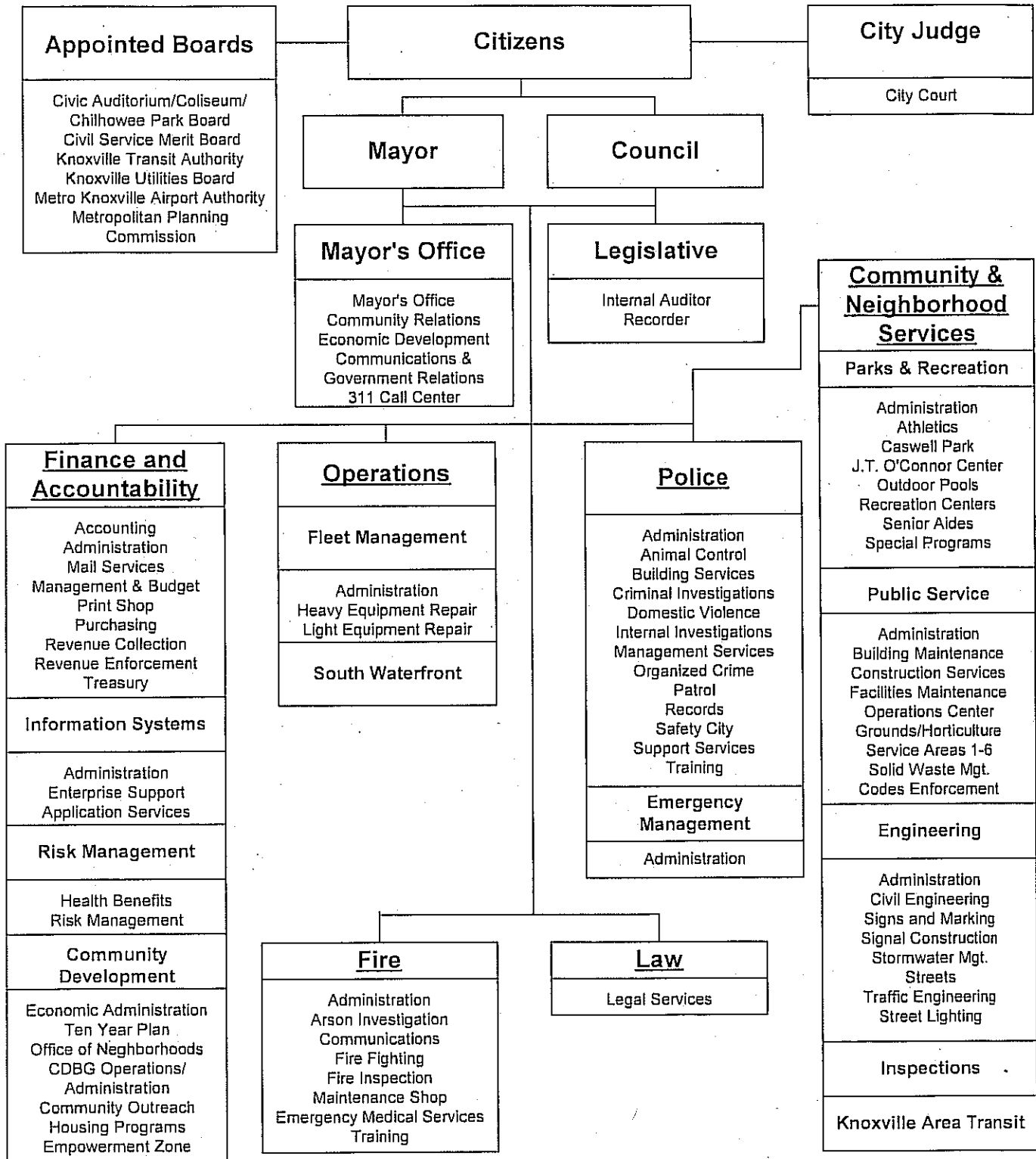
President

*Jeffrey R. Emer*

Executive Director

# City of Knoxville

## Organizational Structure



**Appointed Boards**

Civic Auditorium/Coliseum/  
Chilhowee Park Board  
Civil Service Merit Board  
Knoxville Transit Authority  
Knoxville Utilities Board  
Metro Knoxville Airport Authority  
Metropolitan Planning  
Commission

**Citizens**

**City Judge**

City Court

**Mayor**

**Council**

**Mayor's Office**

Mayor's Office  
Community Relations  
Economic Development  
Communications &  
Government Relations  
311 Call Center

**Legislative**

Internal Auditor  
Recorder

**Community & Neighborhood Services**

**Parks & Recreation**

Administration  
Athletics  
Caswell Park  
J.T. O'Connor Center  
Outdoor Pools  
Recreation Centers  
Senior Aides  
Special Programs

**Public Service**

Administration  
Building Maintenance  
Construction Services  
Facilities Maintenance  
Operations Center  
Grounds/Horticulture  
Service Areas 1-6  
Solid Waste Mgt.  
Codes Enforcement

**Engineering**

Administration  
Civil Engineering  
Signs and Marking  
Signal Construction  
Stormwater Mgt.  
Streets  
Traffic Engineering  
Street Lighting

**Inspections**

Knoxville Area Transit

**Finance and Accountability**

Accounting  
Administration  
Mail Services  
Management & Budget  
Print Shop  
Purchasing  
Revenue Collection  
Revenue Enforcement  
Treasury

**Information Systems**

Administration  
Enterprise Support  
Application Services

**Risk Management**

Health Benefits  
Risk Management

**Community Development**

Economic Administration  
Ten Year Plan  
Office of Neighborhoods  
CDBG Operations/  
Administration  
Community Outreach  
Housing Programs  
Empowerment Zone

**Operations**

**Fleet Management**

Administration  
Heavy Equipment Repair  
Light Equipment Repair

**South Waterfront**

**Police**

Administration  
Animal Control  
Building Services  
Criminal Investigations  
Domestic Violence  
Internal Investigations  
Management Services  
Organized Crime  
Patrol  
Records  
Safety City  
Support Services  
Training

**Emergency Management**

Administration

**Fire**

Administration  
Arson Investigation  
Communications  
Fire Fighting  
Fire Inspection  
Maintenance Shop  
Emergency Medical Services  
Training

**Law**

Legal Services

## OFFICIALS OF THE CITY OF KNOXVILLE, TENNESSEE

**MAYOR**  
Bill Haslam

**DEPUTY TO THE MAYOR**  
Larry Martin

### CITY COUNCIL

Joe Bailey  
Bob Becker  
Rob Frost

Mark Brown, Vice Mayor  
Steve Hall  
Joe Hultquist

Barbara B. Pelot  
Marilyn Roddy  
Chris Woodhull

**CITY JUDGE**  
John Rosson

**CITY RECORDER**  
Cindy Mitchell

### PRINCIPAL DIRECTORS AND ADMINISTRATORS

Airport – Bill Marrison, President  
Civil Service Merit Board – Vicki Hatfield, Executive Secretary  
Community Development – Madeline Rogero  
Operations – Samuel P. Anderson, Sr. Director  
Community Relations – Thomas E. Strickland, Jr. – Director  
Engineering Department – Steve King – Director  
Finance Department – James York, Director of Finance  
Fire Department – Robert Key, Chief  
Fleet Service Division – Mark Kollander, Director  
Information Systems Division – Janet Wright, Director  
Knoxville Area Transit (KAT) – Cindy McGinnis, General Manager  
Knoxville Utilities Board – Mintha Roach, President  
Law Department – Morris Kizer, Sr. Director  
Parks and Recreation Department – Joe Walsh, Director  
Police Department – Sterling P. Owen IV, Chief  
Policy Development – William Lyons, Sr. Director  
Public Assembly Facilities Department – Robert Polk, Director  
Public Service Department – David Brace, Director  
South Waterfront Development – Dave Hill, Sr. Director  
Special Events Division – Mickey Mallonee, Director

***FINANCIAL SECTION***

# PUGH & COMPANY, P.C.

CERTIFIED PUBLIC ACCOUNTANTS

WILL J. PUGH, CPA  
RONNIE G. CATE, CPA  
C. LARRY ELMORE, CPA  
W. JAMES PUGH, JR., CPA  
DANIEL C. FRANKLIN, CPA  
JAMES H. JONES, CPA  
LISA W. HILL, CPA  
SUSAN R. FOARD, CPA  
ANDREW R. HARPER, CPA  
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MEMBERS

AMERICAN INSTITUTE OF  
CERTIFIED PUBLIC ACCOUNTANTS

TENNESSEE SOCIETY OF  
CERTIFIED PUBLIC ACCOUNTANTS

## INDEPENDENT AUDITORS' REPORT

City Mayor and City Council Members of the  
City of Knoxville, Tennessee

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the Knoxville Area Transit, which is presented as a discretely presented component unit, each major fund and the aggregate remaining fund information of the City of Knoxville, Tennessee (the "City"), as of and for the year ended June 30, 2007, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the component unit financial statements of the Knoxville Utilities Board, the Metropolitan Knoxville Airport Authority, or the City Employees' Pension Fund. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for the Knoxville Utilities Board, Metropolitan Knoxville Airport Authority, and the City Employees' Pension Fund, is based on the reports of the other auditors.

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 significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the discretely presented component units, each major fund, and the aggregate remaining fund information of the City as of June 30, 2007, and the respective changes in financial position and cash flows, where applicable, thereof and the budgetary comparison of the general fund for the year 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 December 21, 2007 on our consideration of the City's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, 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 the 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.

Management's Discussion and Analysis on pages 3-19 and the schedule of funding progress of the pension plans on pages 73 to 74 are not a required part of the basic financial statements, but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City's basic financial statements. The introductory section, the combining and individual fund financial statements and schedules on pages 76 to 106, the statistical section, as well as the accompanying schedule of federal and state awards as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining and individual fund financial statements, schedules and the schedule of federal and state awards have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole. We did not audit the data included in the introductory or statistical sections of this report and, accordingly, we express no opinion on such data.

*Pugh & Company, P.C.*

Certified Public Accountants

December 21, 2007

# 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 dollars, unless otherwise specified, for the results of operations for the Fiscal Year ending June 30, 2007.

## Financial Highlights

- The assets of the City of Knoxville primary government exceeded its liabilities at the close of the most recent fiscal year by \$398,766,618 (*net assets*). Of this amount, \$169,332,908 (*unrestricted net assets*) may be used to meet the government's ongoing obligations to citizens and creditors.
- Net assets increased by \$67,034,092, an increase of 20.2% over fiscal 2006 as a result of favorable financial operations with strong revenues and effective budgetary controls, especially in the Public Safety and Physical Environment areas.
- As of the close of the fiscal year, the City's governmental funds reported combined ending fund balances of \$150,738,677, an increase of \$35,695,684 in comparison with the prior year. Approximately 89% (\$134,355,691) is available for spending at the City's discretion.
- The Fund Balance for the City's General Fund increased by \$11,817,175, an increase of 34%. This was the result of stronger than expected tax revenues accompanied by lower than expected public safety and physical environment expenditures. Only \$295,811 is reserved for specific purposes, and the remaining 99.4% (\$45,200,212) is available for spending at the City's discretion (unreserved fund balance).
- Overall, the City's total general obligation debt for the primary government decreased by \$9,710,000 (11.8%) to \$72,370,000 during the current fiscal year as a result of normal debt service payment activity.

## Overview of the Financial Statements

There are three sections to the City's financial report – *Introductory*, *Financial* and *Statistical*. The Introductory Section contains the City's Letter of Transmittal, a facsimile of the Certificate of Achievement for Excellence in Financial Reporting, an organization chart, and a list of officials. The Financial Section is comprised 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. 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 Financial Statements

The *government-wide financial statements* are designed to provide readers with a broad overview of the City of Knoxville's finances, in a manner similar to a private-sector business. 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 information on all the City of Knoxville's assets and liabilities, with the difference between the two reported as *net assets*. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the City of Knoxville is improving or deteriorating.

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.

### STATEMENT OF ACTIVITIES

The *statement of activities* presents information showing how the government's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying events giving rise to the change occur, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave).

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 shown using all revenues and expenses. Governmental activities 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 through user fees and/or operational transfers.

## Funds Financial Statements

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The City of Knoxville, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the City of Knoxville can be divided into three categories: governmental funds, proprietary funds, and fiduciary funds.

### Governmental Funds

Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of expendable resources, as well as on balances of expendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the

governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

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, Special Revenue Funds and Permanent Funds) Governmental funds are noted as follows:

<b>Major Governmental Funds</b>	<b>Non-Major Governmental Funds/Special Revenue Funds</b>
1.General	1.State Street Aid
2.Debt Service	2.Community Development Block Grants
3.Capital Projects	3.Abandoned Vehicles
	4.City Inspections
	5.City Court
	6.Miscellaneous Grants
	7.Animal Control
	8.Miscellaneous Special Revenue Funds
	9.Miscellaneous Community Development Funds
	10.Storm Water
	11.Solid Waste
	12.Coster Redevelopment
	13.Knoxville Civic Revitalization
	<b>Permanent Fund</b>
	14.Krutch Park

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.

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

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, a reconciliation is necessary. Reconciliation statements are provided following the Balance Sheet and the Statement of Revenues, Expenditures and Changes in Fund Balances.

### ***Proprietary Funds***

The City of Knoxville maintains two different types of proprietary funds: enterprise funds and internal service funds. Enterprise funds are used to report the same functions presented as business-type activities in the government-wide financial statements. The City of Knoxville uses enterprise funds to account for its Convention Center and Public Assembly Facilities consisting of the Civic Auditorium/Coliseum and Chilhowee Park, public parking garages operating under the Metro Parking Fund and the Municipal Golf Courses. Internal service funds are an accounting device used to accumulate and allocate costs internally among the City of Knoxville's various functions. The City uses internal service funds to account for its print shop operations, fleet operations, insurance functions, both risk and employee health care, replacement of non-rolling stock equipment, and maintenance operations relating to the various City build-

ings. Because these services predominantly benefit governmental rather than business-type functions, they have been included within governmental activities in the government-wide financial statements.

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

<b>Business-type Activities</b>	<b>Governmental Activities/Internal Service Funds</b>
1. Knoxville Convention Center	1. Office Services Fund
2. Other Business-type activities:	2. Fleet Maintenance Fund
Nonmajor Enterprise Funds -	3. Risk Management Fund
a. Metro Parking Fund	4. Health Insurance Fund
b. Public Assembly Facilities Fund	5. Equipment Replacement Fund
c. Municipal Golf Courses	6. City Buildings Fund

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

The Statement of Revenues, Expenditures, and Changes in Fund Net Assets isolate operating revenues and 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.

The Statement of Cash Flows is provided to allow for the assessment of the adequacy of a proprietary fund's cash flows.

### ***Fiduciary Component Unit Statements***

Fiduciary funds are used to account for resources held for the benefit of parties outside the government. Fiduciary funds are not reflected in the government-wide financial statements because the resources of those funds are not available to support the City of Knoxville programs. The accounting used for fiduciary funds is much like that used for proprietary funds. The City Choice Plus Fund accounts for funds designated by employees to offset the cost of their personal health care and the City Employees' Pension Fund accounts for assets set aside for employee retirements.

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

The Statement of Changes in Fiduciary Net Assets 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 the Financial Statements**

Completing the document are notes to the financial statements. The notes reveal additional information in order to provide a more informed understanding of the government-wide and fund financial statements.

### **Other Information**

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.

## Government-Wide Financial Analysis

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. The following analysis focuses on the total primary government, which includes both governmental and business-type activities.

### **Statement of Net Assets at June 30, 2007**

A condensed version of the Statement of Net Assets follows:

Condensed Financial Information						
Statement of Net Assets						
Primary Government						
For Fiscal Year Ending June 30						
(In \$1,000's)						
	Governmental Activities		Business-Type Activities		Total Primary Government	
	2007	2006	2007	2006	2007	2006
Current and other assets:						
Cash and investments	\$ 178,903	\$ 136,584	\$ 12,301	\$ 7,205	\$ 191,204	\$ 143,789
Other assets	50,560	43,408	2,165	4,598	52,725	48,006
Capital assets	<u>237,194</u>	<u>224,512</u>	<u>178,337</u>	<u>182,509</u>	<u>415,531</u>	<u>407,021</u>
Total assets	<u>\$ 466,657</u>	<u>\$ 404,504</u>	<u>\$ 192,803</u>	<u>\$ 194,312</u>	<u>\$ 659,460</u>	<u>\$ 598,816</u>
Other liabilities	\$ 34,648	\$ 32,808	\$ 5,784	\$ 5,937	\$ 40,432	\$ 38,745
Noncurrent liabilities	<u>77,054</u>	<u>84,421</u>	<u>143,207</u>	<u>146,808</u>	<u>220,261</u>	<u>231,229</u>
Total liabilities	<u>\$ 111,702</u>	<u>\$ 117,229</u>	<u>\$ 148,991</u>	<u>\$ 152,745</u>	<u>\$ 260,693</u>	<u>\$ 269,974</u>
Net assets:						
Invested in capital as-						
sets, net of debt	\$ 162,108	\$ 139,547	\$ 31,546	\$ 32,217	\$ 193,654	\$ 171,764
Restricted	35,780	32,847	-	-	35,780	32,847
Unrestricted	<u>157,067</u>	<u>114,881</u>	<u>12,266</u>	<u>9,350</u>	<u>169,333</u>	<u>124,231</u>
Total net assets	<u>\$ 354,955</u>	<u>\$ 287,275</u>	<u>\$ 43,812</u>	<u>\$ 41,567</u>	<u>\$ 398,767</u>	<u>\$ 328,842</u>

### **Governmental Activities**

Assets have increased by 15.3% and liabilities have decreased by 4.7% when compared to 2006 levels. The net result of these changes is an increase of 23.6% in total net assets. No particular activity is responsible for a disproportionate amount of the changes. Overall positive financial performance of all activities contributed to the positive results of this category.

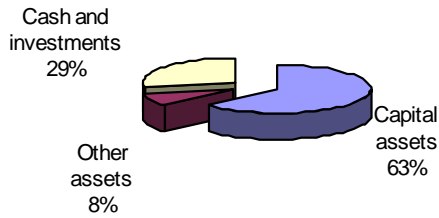
### **Business-Type Activities**

Assets have decreased by 0.8% and liabilities have decreased 2.5% from 2006 levels, resulting in an increase of 5.4% in total net assets. The cause for the increase in total net assets is the progressively increased performance by the Knoxville Convention Center and other favorable revenue increases coupled with reduced expenses in most areas.

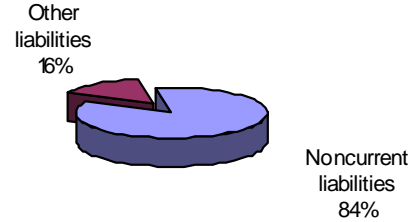
**Total Primary Government**

The City's capital assets, including land and buildings, equipment, furniture and fixtures, infrastructure and construction in progress account for 63% of \$659 million in total assets. Taxes and governmental receivables constitute 8%. Current liquidity, as shown by cash and investments, composes the remaining 29% in total assets.

**Primary Government Total Assets**



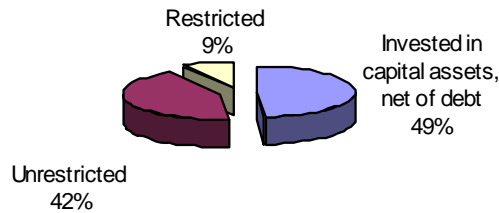
**Primary Government Total Liabilities**



Eighty-four percent of the total government liabilities are in long-term debt outstanding. Of long-term debt, approximately \$147.5 million, or 67% is related to debt issued to finance the convention center 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. The unrestricted net assets of the City's governmental activities represent 42% of total primary government net assets.

**Primary Government Total Net Assets**



## STATEMENT OF ACTIVITIES FOR THE YEAR ENDED JUNE 30, 2007

A summary version of the Statement of Activities follows.

Condensed Financial Information  
Primary Government  
Statement of Activities  
For Fiscal Year Ending June 30  
(In \$1,000's)

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2007	2006	2007	2006	2007	2006
<b>Revenues:</b>						
Program revenues:						
Charges for services	\$ 12,259	\$ 10,177	\$ 9,704	\$ 7,506	\$ 21,963	\$ 17,683
Operating grants & contributions	9,656	13,661	-	-	9,656	13,661
Capital grants & contributions	4,558	9,693	80	-	4,638	9,693
General revenues:						
Taxes	189,609	177,585	7,812	7,085	197,421	184,670
Interest	8,293	5,392	405	249	8,698	5,641
Other	3,162	5,452	189	15,027	3,351	20,479
<b>Total revenues</b>	<b>\$ 227,537</b>	<b>\$ 221,960</b>	<b>\$ 18,190</b>	<b>\$ 29,867</b>	<b>\$ 245,727</b>	<b>\$ 251,827</b>
<b>Expenses:</b>						
General government	\$ 11,671	\$ 15,015	\$ -	\$ -	\$ 11,671	\$ 15,015
Public safety	60,882	69,949	-	-	60,882	69,949
Physical Environment	40,686	70,288	-	-	40,686	70,288
Transportation	7,783	5,728	-	-	7,783	5,728
Parks and recreation	10,068	10,760	-	-	10,068	10,760
Economic development	8,314	8,070	-	-	8,314	8,070
Health & Sanitation	9,498	9,740	-	-	9,498	9,740
Interest on long-term debt	3,585	4,005	-	-	3,585	4,005
Other	-	1,683	26,206	25,385	26,206	27,068
<b>Total expenses</b>	<b>\$ 152,487</b>	<b>\$ 195,238</b>	<b>\$ 26,206</b>	<b>\$ 25,385</b>	<b>\$ 178,693</b>	<b>\$ 220,623</b>
Increase (decrease) in net assets before transfers	\$ 75,050	\$ 26,722	\$ (8,016)	\$ 4,482	\$ 67,034	\$ 31,204
Transfers	(10,261)	(9,535)	10,261	9,535	-	-
Changes in net assets	64,789	17,187	2,245	14,017	67,034	31,204
Beginning net assets	290,166	(1) 270,088	41,567	27,550	331,733	297,638
Ending net assets	<u>\$ 354,955</u>	<u>\$ 287,275</u>	<u>\$ 43,812</u>	<u>\$ 41,567</u>	<u>\$ 398,767</u>	<u>\$ 328,842</u>

(1) See Note 12 regarding Prior Period Adjustment

### **Governmental Activities**

Reflected in the Government-Wide Statement of Activities for the year ending June 30, 2007, only the City Court and State Street Aid generated revenue in excess of current expenditures. 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 \$6.023 million were earmarked for the City's Community Development efforts. Public safety operations accounted for approximately 40% of the City's

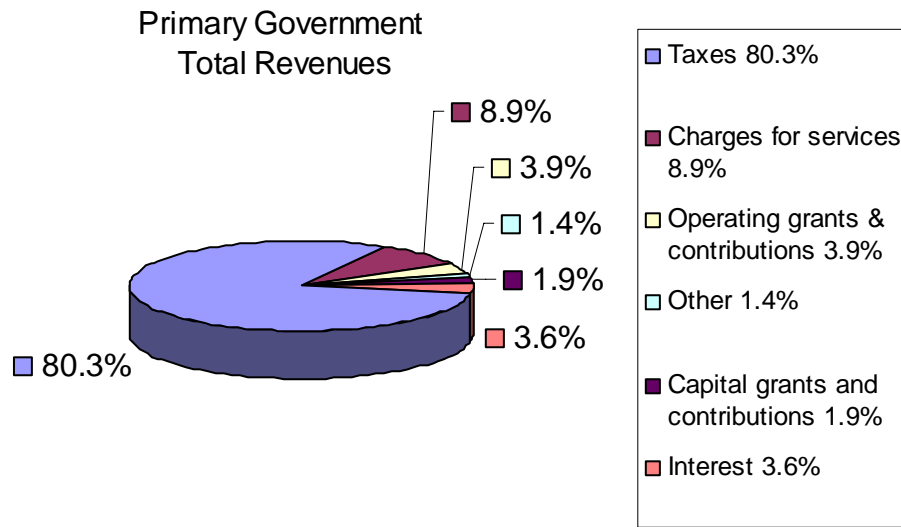
total governmental operations of \$152.5 million. All other City of Knoxville sections and operations are financed by either local or state taxes, grants, or various shared revenues.

**Business-type Activities**

The City’s business-type activities include public parking, public assembly facilities and the municipal golf courses. The City also operates the 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 government 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. Additional redevelopment efforts in the City’s downtown area are expected to increase the cost effectiveness of the City’s infrastructure investments.

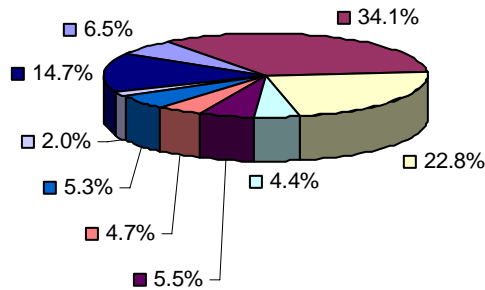
**Total Government**

Primary Government Revenues were \$245.7 million. The largest portion of these revenues (\$197.4 MM - 80.3%) was from taxes.



Total primary government expenses totaled \$178.7 million, 34% of which was directed toward public safety.

### Primary Government Total Expenses



- General government 6.5%
- Public safety 34.1%
- Physical Environment 22.8%
- Transportation 4.4%
- Parks and recreation 5.5%
- Economic development 4.7%
- Health & Sanitation 5.3%
- Interest on long-term debt 2.0%
- Other 14.7%

### Component Units

Certain organizations affiliated with the City are 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 Knoxville Area Transit. A summary of the City's component unit operations follows:

Condensed Financial Information  
Component Units  
For Fiscal Year Ending June 30,  
(In \$1,000's)

	Knoxville Utilities Board		Metropolitan Knoxville Airport Authority		Knoxville Area Transit		Total	
	2007	2006	2007	2006	2007	2006	2007	2006
Program Revenues	\$ 645,255	\$ 616,391	\$ 34,590	\$ 32,653	\$ 15,320	\$ 18,493	\$ 695,165	\$ 667,537
Program Expenses	(626,627)	(595,437)	(31,994)	(29,418)	(23,389)	(24,937)	(682,010)	(649,792)
Total General Revenues	8,641	8,380	1,735	898	6,586	5,062	16,962	14,340
Change in Net Assets	\$ 27,269	\$ 29,334	\$ 4,331	\$ 4,133	\$ (1,483)	\$ (1,382)	\$ 30,117	\$ 32,085
Net Assets at Year End	\$ 685,083	\$ 657,814	\$ 100,878	\$ 96,547	\$ 12,753	\$ 14,236	\$ 798,714	\$ 768,597

## Financial Analysis of the Government's Funds

### Balance Sheet at June 30, 2007

The total Government Funds balance as of June 30, 2007 is \$151 million of which the general fund's balance is approximately \$46.6 million, debt service fund is \$35 million, capital projects comprise \$44.7 million and the remaining \$24.5 million is distributed between the various special revenue and permanent funds. In the aggregate, the governmental funds fund balances grew by \$35.7 million over prior year. The general fund grew by \$11.8 to \$46.6 million as a result of favorable financial operations. The debt service fund increased by \$2.2 million to \$35 million, capital projects increased by \$16.7 million to \$44.7 as a result of advance funding for approved capital projects and the remaining \$5 million was spread over various special revenue and the permanent fund. Significant causes of the various increases are explained in the following section.

### Statement of Revenues, Expenditures & Changes in Fund Balances for the Year Ended June 30, 2007

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, 2007, 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					
(In \$1,000's)					
Revenues	2007	2006	Percent of Total 2007	Increase (Decrease) from Prior Year	Percent of Increase (Decrease)
Taxes, assessments, interest & penalties	\$ 168,434	\$ 160,146	74.95%	\$ 8,288	5.18%
Licenses, permits and inspection charges	2,565	2,341	1.14%	224	9.57%
Intergovernmental revenue	34,185	36,908	15.21%	(2,723)	(7.38%)
Charges for services	6,030	5,405	2.68%	625	11.56%
Fines and forfeitures	4,231	3,127	1.88%	1,104	35.31%
Other	9,303	12,727	4.14%	(3,424)	(26.90%)
Total	<u>\$ 224,748</u>	<u>\$ 220,654</u>	<u>100.00%</u>	<u>\$ 4,094</u>	<u>1.86%</u>

A comparison of revenues between FY06 and FY07 shows the total general government revenues increased by approximately \$4.09 million or 1.86%. The largest dollar change occurs in General Fund's "Taxes" category and was caused by extraordinarily high collections of delinquent prior year taxes.

New construction and renovation, particularly in the downtown area have contributed to the modest increase in building related fees.

Although intergovernmental revenues declined overall, general fund intergovernmental revenues increased from \$18.4 million to \$23.5 million due to strong sales and income tax collections which were offset by declining grant revenues (\$18.5 Million to \$10.6 Million) in the capital projects funds. Unlike previous years, the State did not reduce any shared revenue in FY07, which enabled the City to capture the real growth in these revenues.

General fund charges for service increased modestly with the increase being spread relatively evenly between the funds with no one particular revenue contributing an extraordinary amount.

The "Other" revenue category shows a decrease for various reasons. In FY06, there was a one-time revenue for \$2.8 Million in the Capital Projects fund which accounts for 82% of the decrease in this category. The balance of the reductions were spread relatively evenly between the remaining governmental funds.

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, 2007, and the percentage of increases and decreases in relation to prior year amounts.

Condensed Financial Information  
Total Governmental Funds - Expenditures  
For Fiscal Years Ending 06/30/07 and 06/30/06  
(In \$1,000's)

Expenditures	FY 06/07	FY 05/06	Percent of Total FY 06/07	Increase (Decrease) from Prior Year	Percentage Change from Prior Year
Administration	\$ 2,066	\$ 2,762	1.17%	\$ (696)	(25.20%)
Finance and Accountability	6,190	5,976	3.50%	214	3.58%
Operations and Engineering	18,103	17,014	10.23%	1,089	6.40%
Community and Neighborhood Services	38,392	38,174	21.70%	218	0.57%
Law	2,389	2,426	1.35%	(37)	(1.53%)
Police	42,454	40,448	23.99%	2,006	4.96%
Fire	28,013	27,999	15.83%	14	0.05%
Legislative	896	923	0.51%	(27)	(2.93%)
Civil Service	920	887	0.52%	33	3.72%
Metropolitan Planning Commission	713	726	0.40%	(13)	(1.79%)
Knoxville Zoological Park	908	738	0.51%	170	23.04%
Community agency grants	1,900	864	1.07%	1,036	119.91%
Waterfront operations	359	1,238	0.20%	(879)	(71.00%)
Community Action Committee	445	323	0.25%	122	37.77%
Reserve	-	445	0.00%	(445)	(100.00%)
Mass Transit	7,338	5,728	4.15%	1,610	28.11%
Capital and grant projects	12,504	27,666	7.07%	(15,162)	(54.80%)
Debt service:					
Principal retirement	9,773	10,646	5.52%	(873)	(8.20%)
Interest on bonds and notes	3,586	4,004	2.03%	(418)	(10.44%)
<b>Total Expenditures</b>	<b>\$ 176,949</b>	<b>\$ 188,987</b>	<b>100.00%</b>	<b>\$ (12,038)</b>	<b>(6.37%)</b>

Overall general government expenditures for FY07 decreased by approximately \$12 million or 6.4%. This decrease is almost entirely due to reduced project and grant spending of \$15.2 million in the Capital Projects Fund caused by completion of various large construction projects. Overall spending for on-going operations was up for the year, due primarily to the police department being able get back to full strength following successful recruitment efforts and increased energy costs.

## Proprietary Funds Statements

### *Statement of Net Assets at June 30, 2007*

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 Fund Net Assets for the Year Ended June 30, 2007**

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 \$9.8 million after transfers.

**Statement of Cash Flows for the Year Ended June 30, 2007**

The three main business type activities of the City are the Convention Center, the municipal parking garages, and the Public Assembly Facilities operations. As expected, overall operations experienced a net operating loss. Both parking garages operate at a profit, if interest on debt is excluded. The revenues from the combined properties are sufficient to cover total costs including debt service, with gains from the certain garages offsetting the loss on the others. Public Assembly Facilities also operated at a profit. 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. New this year are the Municipal Golf Courses. In December, the City took back from a lessor the operation of Whittle Springs Golf Course. Previously the City had not received any revenues from its operation therefore there was no prior financial presentation of its operations. In the upcoming fiscal year, the City will be assuming control of a second golf course, also leased to a private corporation for minimal revenues.

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

Condensed Financial Information Proprietary Funds For Fiscal Year Ending June 30 (In \$1,000's)						
Proprietary Funds	Revenues		Expenses		Net Interfund Transfers	
	2007	2006	2007	2006	2007	2006
I. Business-type Activities						
A. Knoxville Convention Center	\$ 12,839	\$ 12,280	\$ 20,734	\$ 20,846	\$ 8,330	\$ 7,811
B. Other (Non-major enterprise funds)						
1. Metro Parking	1,488	11,600	1,264	819	-	-
2. Public Assembly Facilities	3,572	5,986	3,902	3,718	1,839	1,724
3. Municipal Golf Courses	291	-	305	-	92	-
II. Governmental Activities						
A. Internal Service Funds						
1. Office Services	185	167	181	156	-	-
2. Fleet Maintenance	12,285	11,017	10,130	10,664	172	5,392
3. Risk Management	8,315	7,209	7,482	9,048	679	5,104
4. Employee Health Insurance	12,347	13,400	12,166	12,868	924	1,113
5. Equipment Replacement	2,909	2,222	1,850	2,217	67	72
6. City Buildings	2,977	1,421	1,502	1,254	-	-
<b>TOTAL</b>	<b>\$ 57,208</b>	<b>\$ 65,302</b>	<b>\$ 59,516</b>	<b>\$ 61,590</b>	<b>\$ 12,103</b>	<b>\$ 21,216</b>

Condensed Financial Information  
Proprietary Funds  
For Fiscal Year Ending June 30  
(In \$1,000's)

	Change in Net		Net Assets at	
	Assets		Year End	
	2007	2006	2007	2006
I. Business-type Activities				
A. Knoxville Convention Center	\$ 435	\$ (755)	\$ 11,235	\$ 10,800
B. Other (Non-major enterprise funds)				
1. Metro Parking	224	10,781	18,065	17,841
2. Public Assembly Facilities	1,509	3,992	14,435	12,926
3. Municipal Golf Courses	78	-	78	-
II. Governmental Activities				
A. Internal Service Funds				
1. Office Services	4	11	56	52
2. Fleet Maintenance	2,327	5,745	25,293	22,966
3. Risk Management	1,512	3,265	6,988	5,476
4. Health Insurance	1,105	1,645	7,829	6,724
5. Equipment Replacement	1,126	77	13,934	12,808
6. City Buildings	1,475	167	5,027	3,552
TOTAL	<u>\$ 9,795</u>	<u>\$ 24,928</u>	<u>\$ 102,940</u>	<u>\$ 93,145</u>

## Fiduciary Funds Statements

The City Pension Trust Fund is reported with the City Choice Plus Fund in the fiduciary funds statements. 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 06/07	FY 05/06
	Contribution	Contribution
	Rates	Rates
General Government Employees:		
Defined Contribution (G1)	7.55%	5.20%
Defined Benefit (G2)	6.05%	3.70%
Police and Fire Employees	13.79%	11.49%

The City's Pension Fund remains fully funded at year-end. The fund, like similar funds, has been affected by the declining interest rate environment and relatively unstable 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. The City Choice Plus Fund accounts for employee contributions to an IRS Section 125 health benefit plan.

## General Fund Budgetary Highlights

During the year there was a \$7.087 million increase in appropriations between the original and final budget. The following chart provides a snapshot of the changes in the budget.

General Fund  
Budget Appropriation Changes  
For Fiscal Year Ending June 30, 2007

Department	Encumbrances	Other	Total Changes
Administration	\$ 13,767	\$ (1,440)	\$ 12,327
Finance and Accountability	118,499	(13,000)	105,499
Operations and Engineering	42,362	9,559	51,921
Community and Neighborhood Services	358,885	(151,229)	207,656
Law	24,999	-	24,999
Police	356,439	(124,294)	232,145
Fire	69,228	(2)	69,226
Legislative	128,094	-	128,094
Knoxville Zoo	-	45,000	45,000
Community Agency Grants	-	30,000	30,000
Reserve	-	297,590	297,590
Transfers	-	5,882,815	5,882,815
Total General Fund Expenditures	<u>\$ 1,112,273</u>	<u>\$ 5,974,999</u>	<u>\$ 7,087,272</u>

The largest change occurred in the transfers to other funds. \$900,000 was transferred for initial funding of infrastructure improvements to the City's south waterfront. This is the beginning of a major redevelopment effort in that area which ultimately will be developed for townhouses and condominiums and light retail. Additional funding of \$1.25 million was made available for new and rehabilitation of existing sidewalks. Two (\$2) million was allocated for drainage improvements and street paving received an additional \$1 million.

## Capital Asset and Debt Administration

As of June 30, 2007 the primary government of the City had invested \$415.5 million in capital assets as reflected by the following table. The total amount represents an overall increase primarily due to the completion of various projects and revitalization efforts throughout the City and in the downtown area. The City has ongoing paving programs as well as other maintenance programs designed to preserve and increase the life of existing assets in the other categories, primarily equipment, which includes vehicles.

Capital Assets at Year-End  
(Net of Depreciation)  
(In \$1,000's)

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2007	2006	2007	2006	2007	2006
Land and site improvements	\$ 38,996	\$ 37,287	\$ 6,743	\$ 6,743	\$ 45,739	\$ 44,030
Buildings and improvements	41,213	39,060	221,481	219,922	262,694	258,982
Equipment, furniture & fixtures	57,689	57,440	3,608	3,713	61,297	61,153
Infrastructure	239,696	224,167	-	-	239,696	224,167
Construction in progress	16,927	11,661	103	-	17,030	11,661
Less accumulated depreciation	<u>(157,327)</u>	<u>(145,103)</u>	<u>(53,597)</u>	<u>(47,869)</u>	<u>(210,924)</u>	<u>(192,972)</u>
Total	<u>\$ 237,194</u>	<u>\$ 224,512</u>	<u>\$ 178,338</u>	<u>\$ 182,509</u>	<u>\$ 415,532</u>	<u>\$ 407,021</u>

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.

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2007	2006	2007	2006	2007	2006
	Beginning balance	\$ 369,615	\$ 375,597	\$ 230,378	\$ 215,361	\$ 599,993
Additions	49,003	83,760	1,927	15,068	50,930	98,828
Deletions	(24,097)	(89,742)	(370)	(51)	(24,467)	(89,793)
Balance before depreciation	394,521	369,615	231,935	230,378	626,456	599,993
Accumulated depreciation	(157,327)	(145,103)	(53,597)	(47,869)	(210,924)	(192,972)
Balance after depreciation	<u>\$ 237,194</u>	<u>\$ 224,512</u>	<u>\$ 178,338</u>	<u>\$ 182,509</u>	<u>\$ 415,532</u>	<u>\$ 407,021</u>

As of the year-end, the City's Total Primary Government had \$220.3 million in general obligation debt outstanding. In addition to this amount the City is obligated to pay \$1.2 million to Knox County, representing the City's portion in the joint construction of the City/County animal shelter.

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2007	2006	2007	2006	2007	2006
Current						
Bonds, notes and capital leases due within one year	<u>\$ 8,536</u>	<u>\$ 9,773</u>	<u>\$ 3,670</u>	<u>\$ 3,565</u>	<u>\$ 12,206</u>	<u>\$ 13,338</u>
Noncurrent						
Bonds, notes and capital leases due in more than one year	<u>65,056</u>	<u>73,592</u>	<u>144,240</u>	<u>147,910</u>	<u>209,296</u>	<u>221,502</u>
Subtotal	<u>73,592</u>	<u>83,365</u>	<u>147,910</u>	<u>151,475</u>	<u>221,502</u>	<u>234,840</u>
Unamortized premiums, discounts and gains on refunding	<u>1,494</u>	<u>1,600</u>	<u>(1,118)</u>	<u>(1,183)</u>	<u>376</u>	<u>417</u>
TOTAL	<u>\$ 75,086</u>	<u>\$ 84,965</u>	<u>\$ 146,792</u>	<u>\$ 150,292</u>	<u>\$ 221,878</u>	<u>\$ 235,257</u>

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.

## Economic Factors

Like most local governments, the largest source of revenue for the City of Knoxville is taxes. This category constitutes \$137.3 million or 83% of the total operating 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, personal, and public utility. The growth rate for assessed value on real estate has historically been relatively moderate, a trend that is expected to continue. In FY07 the taxable value of real property increased by 2% and the overall tax roll increased by 1.7%. 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 06/07 the assessed value of real property was \$3.36 billion. Historically, the City has collected an average of 95% of property taxes in the year they are due. The trend in recent years has been higher than the long-term average due to better economic conditions and enhanced collection efforts. Personal property growth has been higher than real property in the recent past and we expect that to continue in the future. We expect no real growth in the valuation of Public Utility property.

Local option sales tax revenues comprise approximately \$36.7 million or 22.2% of total General Fund revenues. Knoxville has experienced continued growth in sales tax receipts in FY 06/07. We attribute this growth to overall economic growth, which was mirrored statewide. Recent commercial/retail development in the Turkey Creek area of the City has also contributed to growth. As sales tax collections are situs based revenues, the Turkey Creek development has shifted some sales from other areas to the City.

The second largest revenue category of the General Fund is intergovernmental revenue, and accounts for \$23.5 million or 14.2% of total revenue. This category of revenue had declined as a percentage of the total in recent years, but grew in FY07. In the past the ending of certain grants, as well as state cuts in shared revenue had contributed to a decline in this funding category. The State economy has, however, fared better than expected and has led to a rescinding of previous cuts during the past two years. These changes have been evidenced in higher state shared sales tax revenue and proceeds from the Hall income tax. The income tax known as the Hall Income Tax generated \$7.3 million this year, a \$4 million increase from the prior year of \$3.2 million. We have not been able to determine the exact nature of the cause of growth in this revenue and do not anticipate that it will continue at this high level.

Other revenue sources include fines and forfeitures and miscellaneous revenue items. Revenues coming from the City Municipal Court system have grown in the past two years and are expected to continue to do so. This is due to the imposition of some new charges as well as efficiency improvements in Court processes. The category of miscellaneous revenue includes interest earnings. The increase in short-term interest rates, combined with higher balances available for investment, has resulted in continued increases 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. The City has experienced double digit premium increases in recent years. In FY07 the City was able to slow these increases and keep the premiums the same due to a change in plans, and the implementation of programs that focus on wellness and disease prevention.

Other areas experiencing particularly high expenditure growth include pension costs and utility increases. The City uses a multi-year smoothing technique to determine pension contributions. Lower than expected returns in the portfolio in last few years has resulted in increased contributions. The City is also conducting energy audits and taking other steps to reduce the cost of utilities and fuel.

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.

On the plus side, the performance of the new Convention Center has improved in the past two years, which will lower the expected operating loss 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.

As part of its efforts to deal with potential problems, the City does long-term budget forecasting. This allows us to recognize problems and respond to them before they get out of hand. The City is also actively engaged in performance measurement and productivity improvement efforts. We believe that these efforts will allow us to slow down or avoid future expenditure increases.

## **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.

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CITY OF KNOXVILLE, TENNESSEE

Statement of Net Assets  
June 30, 2007

	Primary Government			Component Units			
	Governmental Activities	Business Type Activities	Total Primary Government	Knoxville Utilities Board	Metropolitan Knoxville Airport Authority	Knoxville Area Transit	Total Reporting Unit
<b>Assets</b>							
Cash & cash equivalents	\$ 11,708,437	\$ 4,867,766	\$ 16,576,203	\$ 47,579,017	\$ 5,215,064	\$ 649,338	\$ 70,019,622
Investments	167,194,307	7,433,366	174,627,673	56,932,285	26,722,251	735,227	259,017,436
Receivables (net of allowance for uncollectibles):							
Accounts	26,648,802	1,649,520	28,298,322	62,808,228	1,702,618	3,507,259	96,316,427
Taxes on real & personal property	3,884,231	-	3,884,231	-	-	-	3,884,231
Notes	10,211,001	798,435	11,009,436	173,925	-	-	11,183,361
TVA conservation program	-	-	-	3,779,919	-	-	3,779,919
Net assets held by convention center managers	-	150,000	150,000	-	-	-	150,000
Other	-	-	-	177,152	-	-	177,152
Equity interest in joint venture	4,302,647	-	4,302,647	-	-	-	4,302,647
Internal balances	438,777	(438,777)	-	-	-	-	-
Due from component units	3,790,238	-	3,790,238	-	-	-	3,790,238
Inventories	1,257,632	5,543	1,263,175	5,502,887	-	714,945	7,481,007
Prepaid items	26,735	-	26,735	17,887,038	135,053	192,528	18,241,354
Deferred charges	-	-	-	7,147,695	1,661,836	-	8,809,531
Restricted assets:							
Temporarily restricted:							
Bond funds	-	-	-	12,855,118	261,539	-	13,116,657
Unused bond proceeds	-	-	-	835	-	-	835
Receivables	-	-	-	-	600,000	-	600,000
Other	-	-	-	250,343	27,884	-	278,227
Other assets	-	-	-	5,371,101	3,264,433	-	8,635,534
Capital assets:							
Land & site improvements	38,995,947	6,743,270	45,739,217	-	144,605,399	-	190,344,616
Building & building improvements	41,213,484	221,480,749	262,694,233	-	126,794,815	5,025,175	394,514,223
Utility plant in service	-	-	-	1,387,872,114	-	-	1,387,872,114
Equipment, furniture & fixtures	57,689,182	3,607,668	61,296,850	-	9,766,717	25,416,090	96,479,657
Infrastructure	239,695,859	-	239,695,859	-	-	-	239,695,859
Construction in progress	16,926,462	102,766	17,029,228	86,544,402	13,383,255	753,427	117,710,312
Less accumulated depreciation	(157,326,968)	(53,596,674)	(210,923,642)	(474,992,297)	(129,306,526)	(19,358,180)	(834,580,645)
<b>Total assets</b>	<b>466,656,773</b>	<b>192,803,632</b>	<b>659,460,405</b>	<b>1,219,889,762</b>	<b>204,834,338</b>	<b>17,635,809</b>	<b>2,101,820,314</b>
<b>Liabilities</b>							
Accounts payable	7,877,040	811,251	8,688,291	50,377,757	961,040	893,244	60,920,332
Matured principal & interest on bonds	-	-	-	6,589,060	-	-	6,589,060
Accrued liabilities	2,222,556	776,391	2,998,947	8,150,344	787,784	65,432	12,002,507
Due to primary government	-	-	-	-	-	3,790,238	3,790,238
Due to other governmental agencies	891,405	-	891,405	-	-	-	891,405
Unearned revenue	8,191,465	251,508	8,442,973	-	-	134,247	8,577,220
Customer deposits, plus accrued interest	260,064	245,021	505,085	9,247,986	-	-	9,753,071
Liabilities payable with restricted assets:							
Long-term debt due within one year	14,693,745	3,700,198	18,393,943	16,443,201	2,925,000	-	37,762,144
Accrued interest	512,544	-	512,544	-	463,542	-	976,086
Noncurrent liabilities:							
Long-term debt due in more than one year	67,053,607	143,206,992	210,260,599	432,368,927	98,818,567	-	741,448,093
Other noncurrent liabilities	10,000,000	-	10,000,000	11,629,594	-	-	21,629,594
<b>Total liabilities</b>	<b>111,702,426</b>	<b>148,991,361</b>	<b>260,693,787</b>	<b>534,806,869</b>	<b>103,955,933</b>	<b>4,883,161</b>	<b>904,339,750</b>
<b>Net assets</b>							
Invested in capital assets, net of related debt	162,107,836	31,545,999	193,653,835	561,455,582	67,378,750	11,836,512	834,324,679
Restricted for:							
Debt service	35,084,149	-	35,084,149	6,266,056	-	-	41,350,205
Permanent funds	695,726	-	695,726	-	-	-	695,726
Other	-	-	-	250,344	889,423	-	1,139,767
Unrestricted	157,066,636	12,266,272	169,332,908	117,110,911	32,610,232	916,136	319,970,187
<b>Total net assets</b>	<b>\$ 354,954,347</b>	<b>\$ 43,812,271</b>	<b>\$ 398,766,618</b>	<b>\$ 685,082,893</b>	<b>\$ 100,878,405</b>	<b>\$ 12,752,648</b>	<b>\$ 1,197,480,564</b>

CITY OF KNOXVILLE, TENNESSEE

Statement of Activities  
For the year ended June 30, 2007

Functions/Programs	Expenses	Program Revenues		
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions
<b>Primary government:</b>				
Governmental activities:				
General Government	\$ 11,671,480	\$ 697,156	\$ 824,561	\$ -
Public Safety	60,882,473	9,016,128	1,486,502	1,137,370
Physical Environment	40,685,683	923,903	75,261	877,151
Transportation	7,782,590	830,457	-	-
Economic Development	8,313,500	78,000	7,269,490	2,466,422
Parks & Recreation	10,067,796	665,662	-	-
Health & Sanitation	9,498,414	48,159	-	77,323
Interest on long-term debt	3,585,453	-	-	-
<b>Total governmental activities</b>	<b>152,487,389</b>	<b>12,259,465</b>	<b>9,655,814</b>	<b>4,558,266</b>
Business-type activities:				
Metro parking	1,264,233	1,308,277	-	-
Public assembly facilities	3,902,170	2,210,341	-	-
Knoxville Convention Center	20,734,159	5,974,667	-	-
Municipal Golf Courses	305,422	211,040	-	79,851
<b>Total business-type activities</b>	<b>26,205,984</b>	<b>9,704,325</b>	<b>-</b>	<b>79,851</b>
<b>Total primary government</b>	<b>\$ 178,693,373</b>	<b>\$ 21,963,790</b>	<b>\$ 9,655,814</b>	<b>\$ 4,638,117</b>
<b>Component units:</b>				
Knoxville Utilities Board	\$ 626,627,427	\$ 641,512,503	\$ -	\$ 3,743,132
Metropolitan Knoxville Airport Authority	31,993,960	26,083,079	-	8,507,430
Knoxville Area Transit	23,389,972	3,616,106	4,501,856	7,201,868
<b>Total component units</b>	<b>\$ 682,011,359</b>	<b>\$ 671,211,688</b>	<b>\$ 4,501,856</b>	<b>\$ 19,452,430</b>

General revenues:  
 Property taxes  
 Intergovernmental revenue, unrestricted  
 Other taxes  
 Excise tax  
 Alcoholic beverage tax  
 Business tax  
 Cable television franchise tax  
 Other unrestricted revenue  
 Unrestricted investment earnings  
 Gain (loss) on disposal of capital assets  
 Increase in equity interest in joint venture

Transfers  
 Total general revenues and transfers

Change in net assets

Net assets - beginning (as restated)  
 Net assets - ending

Net (Expense) Revenue and Changes in Net Assets						
Primary Government			Component Units			
Governmental Activities	Business-type Activities	Total	Knoxville Utilities Board	Metropolitan Knoxville Airport Authority	Knoxville Area Transit	Total Reporting Unit
\$ (10,149,763)	\$ -	\$ (10,149,763)	\$ -	\$ -	\$ -	\$ (10,149,763)
(49,242,473)	-	(49,242,473)	-	-	-	(49,242,473)
(38,809,368)	-	(38,809,368)	-	-	-	(38,809,368)
(6,952,133)	-	(6,952,133)	-	-	-	(6,952,133)
1,500,412	-	1,500,412	-	-	-	1,500,412
(9,402,134)	-	(9,402,134)	-	-	-	(9,402,134)
(9,372,932)	-	(9,372,932)	-	-	-	(9,372,932)
(3,585,453)	-	(3,585,453)	-	-	-	(3,585,453)
<u>(126,013,844)</u>	<u>-</u>	<u>(126,013,844)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(126,013,844)</u>
-	44,044	44,044	-	-	-	44,044
-	(1,691,829)	(1,691,829)	-	-	-	(1,691,829)
-	(14,759,492)	(14,759,492)	-	-	-	(14,759,492)
-	(14,531)	(14,531)	-	-	-	(14,531)
-	<u>(16,421,808)</u>	<u>(16,421,808)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(16,421,808)</u>
<u>(126,013,844)</u>	<u>(16,421,808)</u>	<u>(142,435,652)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(142,435,652)</u>
-	-	-	18,628,208	-	-	18,628,208
-	-	-	-	2,596,549	-	2,596,549
-	-	-	-	-	(8,070,142)	(8,070,142)
-	-	-	<u>18,628,208</u>	<u>2,596,549</u>	<u>(8,070,142)</u>	<u>13,154,615</u>
107,900,730	-	107,900,730	-	-	-	107,900,730
64,449,525	1,295,704	65,745,229	-	-	6,508,040	72,253,269
-	6,516,911	6,516,911	-	-	-	6,516,911
581,494	-	581,494	-	-	-	581,494
10,020,539	-	10,020,539	-	-	-	10,020,539
5,130,529	-	5,130,529	-	-	-	5,130,529
1,526,086	-	1,526,086	-	-	-	1,526,086
1,685,179	188,828	1,874,007	-	57,428	63,658	1,995,093
8,293,054	404,545	8,697,599	8,640,883	1,627,186	47,308	19,012,976
64,660	-	64,660	-	49,887	(32,169)	82,378
1,411,960	-	1,411,960	-	-	-	1,411,960
<u>(10,261,474)</u>	<u>10,261,474</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
<u>190,802,282</u>	<u>18,667,462</u>	<u>209,469,744</u>	<u>8,640,883</u>	<u>1,734,501</u>	<u>6,586,837</u>	<u>226,431,965</u>
64,788,438	2,245,654	67,034,092	27,269,091	4,331,050	(1,483,305)	97,150,928
290,165,909	41,566,617	331,732,526	657,813,802	96,547,355	14,235,953	1,100,329,636
<u>\$ 354,954,347</u>	<u>\$ 43,812,271</u>	<u>\$ 398,766,618</u>	<u>\$ 685,082,893</u>	<u>\$ 100,878,405</u>	<u>\$ 12,752,648</u>	<u>\$ 1,197,480,564</u>

CITY OF KNOXVILLE, TENNESSEE

Balance Sheet  
Governmental Funds  
June 30, 2007

	General	Debt Service	Capital Projects	Other Governmental Funds	Total Governmental Funds
<b>Assets</b>					
Cash & cash equivalents	\$ 388,832	\$ 4,640,084	\$ 193,754	\$ 5,529,406	\$ 10,752,076
Investments	22,091,098	28,062,744	44,546,463	20,325,379	115,025,684
Accounts receivable	20,884,071	-	1,698,368	3,978,530	26,560,969
Taxes on real & personal property receivable	2,715,743	1,168,488	-	-	3,884,231
Notes receivable	-	2,143,200	-	8,067,801	10,211,001
Due from other funds	2,921,074	-	221,000	-	3,142,074
Due from component units	3,790,238	-	-	-	3,790,238
Inventories	269,076	-	-	2,358	271,434
Prepaid items	26,735	-	-	-	26,735
Total assets	<u>\$ 53,086,867</u>	<u>\$ 36,014,516</u>	<u>\$ 46,659,585</u>	<u>\$ 37,903,474</u>	<u>\$ 173,664,442</u>
<b>Liabilities and fund balances</b>					
Liabilities:					
Accounts payable	\$ 1,743,423	\$ -	\$ 1,971,800	\$ 2,273,837	\$ 5,989,060
Accrued liabilities	1,752,391	129,693	-	264,927	2,147,011
Customer deposits	-	36,400	-	223,664	260,064
Due to other funds	-	-	-	2,522,732	2,522,732
Due to other governmental agencies	865,479	-	-	25,926	891,405
Deferred revenue	2,159,754	764,274	-	8,191,465	11,115,493
Total liabilities	<u>6,521,047</u>	<u>930,367</u>	<u>1,971,800</u>	<u>13,502,551</u>	<u>22,925,765</u>
Fund balances:					
Reserved for:					
Encumbrances	1,069,797	-	-	3,970,462	5,040,259
Inventories	269,076	-	-	2,358	271,434
Prepaid items	26,735	-	-	-	26,735
Notes receivable	-	2,143,200	-	8,067,801	10,211,001
Permanent funds	-	-	-	695,726	695,726
Designated for:					
Permanent funds	-	-	-	137,831	137,831
Unreserved, reported in:					
General fund	45,200,212	-	-	-	45,200,212
Special revenue	-	-	-	11,526,745	11,526,745
Debt service	-	32,940,949	-	-	32,940,949
Capital projects	-	-	44,687,785	-	44,687,785
Total fund balances	<u>46,565,820</u>	<u>35,084,149</u>	<u>44,687,785</u>	<u>24,400,923</u>	<u>150,738,677</u>
Total liabilities and fund balances	<u>\$ 53,086,867</u>	<u>\$ 36,014,516</u>	<u>\$ 46,659,585</u>	<u>\$ 37,903,474</u>	<u>\$ 173,664,442</u>

The notes to the financial statements are an integral part of this statement

# CITY OF KNOXVILLE, TENNESSEE

## Reconciliation of the Balance Sheet of Governmental Funds to the Statement of Net Assets June 30, 2007

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Amounts reported for governmental activities in the statement of net assets are different because:

Ending fund balance - governmental funds		\$ 150,738,677
Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the balance sheets of the governmental funds.		224,271,483
Revenues that have been deferred in the balance sheet of the governmental funds because they were not available to pay current liabilities of the period are recognized as revenue in the statement of activities and therefore are not included in the statement of net assets.		2,924,028
Internal service funds are used by management to charge the costs of office service, fleet management, risk management, health insurance and equipment replacement to individual funds. The assets and liabilities of the internal service funds are included in governmental activities in the statement of net assets.		59,127,278
Accrued interest payable is not due and payable in the current period and therefore is not reported as a liability in the balance sheets of the governmental funds.		(512,544)
Long-term liabilities, including bonds payable and accrued interest, are not due and payable in the current period and therefore are not reported in the funds.		
General Obligation Debt	\$ (72,370,000)	
Debt Participation Agreement	(1,221,546)	
Discounts and Premiums (net)	(1,494,584)	
Compensated Absences	(6,508,445)	(81,594,575)
Net assets of governmental activities		<u>\$ 354,954,347</u>

The notes to the financial statements are an integral part of this statement.

CITY OF KNOXVILLE, TENNESSEE

Statement of Revenues, Expenditures and Changes in Fund Balances  
 Governmental Funds  
 For the Year Ended June 30, 2007

	General	Debt Service	Capital Projects	Other Governmental Funds	Total Governmental Funds
<b>Revenues</b>					
Taxes, assessments, interest & penalties	\$ 137,254,316	\$ 25,516,044	\$ -	\$ 5,663,592	\$ 168,433,952
Licenses, permits & inspection charges	318,235	-	-	2,246,611	2,564,846
Fines & forfeitures	1,128,826	-	-	3,102,414	4,231,240
Charges for services	1,295,149	-	-	4,734,964	6,030,113
Other	1,900,681	1,657,140	2,686,813	3,058,730	9,303,364
Intergovernmental revenue	23,544,824	-	2,466,422	8,173,270	34,184,516
Total revenues	<u>165,442,031</u>	<u>27,173,184</u>	<u>5,153,235</u>	<u>26,979,581</u>	<u>224,748,031</u>
<b>Expenditures</b>					
Current:					
Administration	2,055,211	-	-	-	2,055,211
Finance & accountability	6,189,732	-	-	-	6,189,732
Operations & engineering	5,377,418	-	-	12,725,669	18,103,087
Community & neighborhood services	25,185,588	-	-	12,666,575	37,852,163
Law	1,573,216	-	-	815,997	2,389,213
Police	40,089,082	-	-	2,364,029	42,453,111
Fire	27,998,057	-	-	14,693	28,012,750
Legislative	815,855	-	-	80,000	895,855
Civil service	920,493	-	-	-	920,493
City elections	10,933	-	-	-	10,933
Knoxville Partnership	540,000	-	-	-	540,000
Metropolitan Planning Commission	713,430	-	-	-	713,430
Knoxville Zoological Park	908,420	-	-	-	908,420
Agency grants	1,900,400	-	-	-	1,900,400
Waterfront	358,543	-	-	-	358,543
Community Action Committee	444,550	-	-	-	444,550
Mass transit	7,158,040	-	-	180,000	7,338,040
Capital & grant projects	-	-	12,503,829	-	12,503,829
Debt service:					
Principal retirement	-	9,773,301	-	-	9,773,301
Interest payments on bonds & notes	-	3,585,453	-	-	3,585,453
Total expenditures	<u>122,238,968</u>	<u>13,358,754</u>	<u>12,503,829</u>	<u>28,846,963</u>	<u>176,948,514</u>
Excess (deficiency) of revenues over (under) expenditures	<u>43,203,063</u>	<u>13,814,430</u>	<u>(7,350,594)</u>	<u>(1,867,382)</u>	<u>47,799,517</u>
<b>Other financing sources (uses)</b>					
Transfers in	3,933,750	-	31,474,409	12,314,289	47,722,448
Transfers out	(35,319,638)	(11,577,000)	(7,443,721)	(5,485,922)	(59,826,281)
Total other financing sources (uses)	<u>(31,385,888)</u>	<u>(11,577,000)</u>	<u>24,030,688</u>	<u>6,828,367</u>	<u>(12,103,833)</u>
Net change in fund balances	11,817,175	2,237,430	16,680,094	4,960,985	35,695,684
Fund balance - beginning	<u>34,748,645</u>	<u>32,846,719</u>	<u>28,007,691</u>	<u>19,439,938</u>	<u>115,042,993</u>
Fund balance - ending	<u>\$ 46,565,820</u>	<u>\$ 35,084,149</u>	<u>\$ 44,687,785</u>	<u>\$ 24,400,923</u>	<u>\$ 150,738,677</u>

CITY OF KNOXVILLE, TENNESSEE

Reconciliation of the Statement of Revenues, Expenditures, and  
Changes in Fund Balances of Governmental Funds to the  
Statement of Activities  
For the Year Ended June 30, 2007

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Amounts reported for governmental activities in the statement of activities are different because:

Net change in fund balances - total governmental funds	\$ 35,695,684
Governmental funds report capital outlays as expenditures. However, in the statement of activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which net capital outlay and gain/loss on disposal (\$23,897,802) exceed the depreciation expenses (\$10,387,465).	13,510,337
Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds.	(1,533,819)
Long-term liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds.	9,493,112
Accrued interest associated with long-term liabilities that are not due and payable in the current period and therefore are not reported in the funds.	73,966
The internal service fund is used by management to charge the costs of office services.	4,379
The internal service fund is used by management to charge the costs of fleet maintenance.	2,326,885
The internal service fund is used by management to charge the costs of risk management.	1,512,506
The internal service fund is used by management to charge the costs of employee health insurance.	1,104,809
The internal service fund is used by management to charge the costs of equipment replacement.	1,125,890
The internal service fund is used by management to charge the costs of City buildings.	<u>1,474,689</u>
Change in net assets of governmental activities	<u>\$ 64,788,438</u>

The notes to the financial statements are an integral part of this statement.

CITY OF KNOXVILLE, TENNESSEE

Statement of Revenues, Expenditures and Changes in Fund Balances  
Budget and Actual - General Fund  
For the Year Ended June 30, 2007

	Original Budget	Final Budget	Actual	Variance With Final Budget
<b>REVENUES</b>				
Taxes, assessments, interest & penalties	\$ 130,655,180	\$ 136,294,677	\$ 137,254,316	\$ 959,639
Licenses, permits & inspection charges	297,870	297,870	318,235	20,365
Fines & forfeitures	316,800	316,800	1,128,826	812,026
Charges for services	960,850	960,850	1,295,149	334,299
Other	827,390	827,390	1,900,681	1,073,291
Intergovernmental revenue	18,936,560	18,936,560	23,544,824	4,608,264
Total revenues	<u>151,994,650</u>	<u>157,634,147</u>	<u>165,442,031</u>	<u>7,807,884</u>
<b>EXPENDITURES</b>				
Current:				
Administration	2,169,830	2,182,157	2,055,211	126,946
Finance & accountability	6,558,950	6,664,449	6,189,732	474,717
Operations & engineering	5,325,990	5,377,911	5,377,418	493
Community & neighborhood services	25,226,940	25,434,596	25,185,588	249,008
Law	1,582,860	1,607,859	1,573,216	34,643
Police	41,109,800	41,341,945	40,089,082	1,252,863
Fire	28,032,920	28,102,146	27,998,057	104,089
Legislative	861,660	989,754	815,855	173,899
Civil service	945,800	945,800	920,493	25,307
City elections	40,000	40,000	10,933	29,067
Knoxville Partnership	540,000	540,000	540,000	-
Metropolitan Planning Commission	713,430	713,430	713,430	-
Knoxville Zoological Park	863,420	908,420	908,420	-
Agency grants	1,870,400	1,900,400	1,900,400	-
Waterfront	372,920	372,920	358,543	14,377
Community Action Committee	444,550	444,550	444,550	-
Reserve	1,952,410	2,250,000	-	2,250,000
Mass transit	7,158,040	7,158,040	7,158,040	-
Total expenditures	<u>125,769,920</u>	<u>126,974,377</u>	<u>122,238,968</u>	<u>4,735,409</u>
<b>Excess (deficiency) of revenues over (under) expenditures</b>	<u>26,224,730</u>	<u>30,659,770</u>	<u>43,203,063</u>	<u>12,543,293</u>
<b>OTHER FINANCING SOURCES (USES)</b>				
Transfers in	3,250,250	4,698,025	3,933,750	(764,275)
Transfers out	(29,474,980)	(35,357,795)	(35,319,638)	38,157
Total other financing sources (uses)	<u>(26,224,730)</u>	<u>(30,659,770)</u>	<u>(31,385,888)</u>	<u>(726,118)</u>
<b>Net change in fund balances</b>	<u>\$ -</u>	<u>\$ -</u>	11,817,175	<u>\$ 11,817,175</u>
FUND BALANCE - BEGINNING			<u>34,748,645</u>	
FUND BALANCE - ENDING			<u>\$ 46,565,820</u>	

CITY OF KNOXVILLE, TENNESSEE

Statement of Net Assets  
Proprietary Funds  
June 30, 2007

	Enterprise Funds			Internal Service Funds
	Knoxville Convention Center	Other Nonmajor Activities	Total	
<b>Assets</b>				
Current assets				
Cash & temporary investments	\$ 3,873,380	\$ 994,386	\$ 4,867,766	\$ 956,361
Investments	-	7,433,366	7,433,366	52,168,623
Accounts receivable	1,648,186	1,334	1,649,520	87,833
Notes receivable	-	798,435	798,435	-
Net assets held by convention center managers	150,000	-	150,000	-
Equity interest in joint venture	-	-	-	4,302,647
Inventories	-	5,543	5,543	986,198
Total current assets	<u>5,671,566</u>	<u>9,233,064</u>	<u>14,904,630</u>	<u>58,501,662</u>
Noncurrent assets				
Land & site improvements	2,952,020	3,791,250	6,743,270	-
Building & building improvements	180,206,778	41,273,971	221,480,749	257,391
Equipment	2,865,948	741,720	3,607,668	55,078,719
Construction in progress	-	102,766	102,766	139,229
Less: accumulated depreciation	<u>(32,502,925)</u>	<u>(21,093,749)</u>	<u>(53,596,674)</u>	<u>(42,552,856)</u>
Total noncurrent assets	<u>153,521,821</u>	<u>24,815,958</u>	<u>178,337,779</u>	<u>12,922,483</u>
Total assets	<u>159,193,387</u>	<u>34,049,022</u>	<u>193,242,409</u>	<u>71,424,145</u>
<b>Liabilities</b>				
Current liabilities				
Accounts payable	686,858	124,393	811,251	1,887,980
Accrued liabilities	708,067	68,324	776,391	75,545
Customer deposits	-	245,021	245,021	-
Due to other funds	-	438,777	438,777	180,565
Deferred revenue	160,004	91,504	251,508	-
Compensated absences	-	-	-	152,777
Long-term debt due within one year	3,220,196	480,002	3,700,198	-
Total current liabilities	<u>4,775,125</u>	<u>1,448,021</u>	<u>6,223,146</u>	<u>2,296,867</u>
Noncurrent liabilities				
Long-term debt due in more than one year	143,183,582	23,410	143,206,992	-
Estimated litigation liability	-	-	-	10,000,000
Total noncurrent liabilities	<u>143,183,582</u>	<u>23,410</u>	<u>143,206,992</u>	<u>10,000,000</u>
Total liabilities	<u>147,958,707</u>	<u>1,471,431</u>	<u>149,430,138</u>	<u>12,296,867</u>
<b>Net assets</b>				
Invested in capital assets, net of related debt	7,118,043	24,427,956	31,545,999	12,922,483
Restricted for equity interest in joint venture	-	-	-	4,302,647
Unrestricted	4,116,637	8,149,635	12,266,272	41,902,148
Total net assets	<u>\$ 11,234,680</u>	<u>\$ 32,577,591</u>	<u>\$ 43,812,271</u>	<u>\$ 59,127,278</u>

CITY OF KNOXVILLE, TENNESSEE  
Statement of Revenues, Expenses, and Changes in Fund Net Assets  
Proprietary Funds  
For the Year Ended June 30, 2007

	Enterprise Funds			Internal Service Funds
	Knoxville Convention Center	Other Nonmajor Activities	Total	
<b>Operating revenues</b>				
Charges for services	\$ 5,974,667	\$ 3,729,658	\$ 9,704,325	\$ 34,239,458
Total operating revenues	<u>5,974,667</u>	<u>3,729,658</u>	<u>9,704,325</u>	<u>34,239,458</u>
<b>Operating expenses</b>				
Personal services	-	1,911,690	1,911,690	2,402,253
Materials & supplies	-	97,317	97,317	3,682,857
Maintenance	-	896,827	896,827	500,836
Depreciation & amortization	4,554,499	1,205,169	5,759,668	5,274,419
Other services and charges	10,259,369	1,341,214	11,600,583	21,411,953
Total operating expenses	<u>14,813,868</u>	<u>5,452,217</u>	<u>20,266,085</u>	<u>33,272,318</u>
<b>Operating income (loss)</b>	<u>(8,839,201)</u>	<u>(1,722,559)</u>	<u>(10,561,760)</u>	<u>967,140</u>
<b>Nonoperating revenue (expense)</b>				
Interest income	-	404,545	404,545	1,687,117
Intergovernmental revenue	6,734,236	1,158,230	7,892,466	823,457
Other revenues	129,955	58,873	188,828	855,729
Gain (loss) on disposal of capital assets	-	-	-	(38,604)
Interest expense	(5,920,291)	(19,608)	(5,939,899)	-
Increase in equity interest in joint venture	-	-	-	1,411,960
Total nonoperating revenue (expense)	<u>943,900</u>	<u>1,602,040</u>	<u>2,545,940</u>	<u>4,739,659</u>
<b>Income (loss) before transfers</b>	<u>(7,895,301)</u>	<u>(120,519)</u>	<u>(8,015,820)</u>	<u>5,706,799</u>
<b>Transfers:</b>				
Transfers in	8,330,260	1,934,814	10,265,074	1,842,359
Transfers out	-	(3,600)	(3,600)	-
<b>Change in net assets</b>	<u>434,959</u>	<u>1,810,695</u>	<u>2,245,654</u>	<u>7,549,158</u>
<b>Total net assets - beginning (as restated)</b>	<u>10,799,721</u>	<u>30,766,896</u>	<u>41,566,617</u>	<u>51,578,120</u>
<b>Total net assets - ending</b>	<u>\$ 11,234,680</u>	<u>\$ 32,577,591</u>	<u>\$ 43,812,271</u>	<u>\$ 59,127,278</u>

CITY OF KNOXVILLE, TENNESSEE

Statement of Cash Flows  
 Proprietary Funds  
 For the Year Ended June 30, 2007

	Enterprise Funds			Internal Service Funds
	Knoxville Convention Center	Other Nonmajor Activities	Total	
<b>Operating activities</b>				
Cash received from customers and users	\$ 7,674,611	\$ 4,209,812	\$ 11,884,423	\$ -
Receipts from interfund services provided	-	-	-	34,164,765
Cash paid to suppliers	(10,405,190)	(2,297,987)	(12,703,177)	(7,784,610)
Cash paid to employees	-	(1,910,153)	(1,910,153)	(2,623,670)
Cash paid for interfund services used	(93,520)	(13,738)	(107,258)	(558,955)
Payments of claims and insurance	-	-	-	(15,279,768)
<b>Net cash provided by (used in) operating activities</b>	<u>(2,824,099)</u>	<u>(12,066)</u>	<u>(2,836,165)</u>	<u>7,917,762</u>
<b>Noncapital financing activities</b>				
Transfers from other funds	8,330,260	2,148,591	10,478,851	2,022,924
Transfers to other funds	-	(3,600)	(3,600)	-
Transfers from component units	-	-	-	4,020,000
Tax and intergovernmental revenues	6,864,191	1,217,103	8,081,294	1,679,186
<b>Net cash provided by (used in) noncapital financing activities</b>	<u>15,194,451</u>	<u>3,362,094</u>	<u>18,556,545</u>	<u>7,722,110</u>
<b>Capital and related financing activities</b>				
Principal paid on general obligation bond maturities	(3,085,847)	(414,166)	(3,500,013)	-
Interest paid	(5,920,291)	(19,608)	(5,939,899)	-
Acquisition and construction of capital assets	(111,274)	(1,477,201)	(1,588,475)	(4,484,569)
<b>Net cash provided by (used in) capital and related financing activities</b>	<u>(9,117,412)</u>	<u>(1,910,975)</u>	<u>(11,028,387)</u>	<u>(4,484,569)</u>
<b>Investing activities</b>				
Sales/(purchases) of investments	-	(893,949)	(893,949)	(13,999,712)
Investment earnings	-	404,545	404,545	1,687,117
<b>Net cash provided by (used in) investing activities</b>	<u>-</u>	<u>(489,404)</u>	<u>(489,404)</u>	<u>(12,312,595)</u>
<b>Net increase (decrease) in cash and cash equivalents</b>	<u>3,252,940</u>	<u>949,649</u>	<u>4,202,589</u>	<u>(1,157,292)</u>
<b>Cash and cash equivalents</b>				
Beginning of year	620,440	44,737	665,177	2,113,653
End of year	<u>\$ 3,873,380</u>	<u>\$ 994,386</u>	<u>\$ 4,867,766</u>	<u>\$ 956,361</u>

Continued:

The notes to the financial statements are an integral part of this statement.

CITY OF KNOXVILLE, TENNESSEE

Statement of Cash Flows  
 Proprietary Funds  
 For the Year Ended June 30, 2007

	Enterprise Funds			Internal Service Funds
	Knoxville Convention Center	Other Nonmajor Activities	Total	
<b>Reconciliation of operating income (loss)</b>				
to net cash provided by				
(used in) operating activities				
Operating income (loss)	\$ (8,839,201)	\$ (1,722,559)	\$ (10,561,760)	\$ 967,140
Adjustments to reconcile operating income (loss)				
to net cash provided by (used in) operating				
activities:				
Depreciation	4,554,499	1,205,169	5,759,668	5,274,419
Change in assets and liabilities				
(Increase) decrease in receivables	1,539,940	498,590	2,038,530	(74,693)
(Increase) decrease in inventory	-	(5,543)	(5,543)	(199,037)
(Increase) decrease in prepayments	187,000	-	187,000	1,108
Increase (decrease) in accounts payable	209,389	42,994	252,383	553,637
Increase (decrease) in accrued expenses	(635,730)	(12,281)	(648,011)	(104,812)
Increase (decrease) in deferred revenue	160,004	-	160,004	-
Increase (decrease) in estimated liability for litigation and claims	-	-	-	1,500,000
Increase (decrease) in customer deposits	-	(18,436)	(18,436)	-
Total adjustments	6,015,102	1,710,493	7,725,595	6,950,622
<b>Net cash provided by (used in) operating activities</b>	<b>\$ (2,824,099)</b>	<b>\$ (12,066)</b>	<b>\$ (2,836,165)</b>	<b>\$ 7,917,762</b>
<b>Noncash investing, capital, and financing activities:</b>				
Increase in equity interest in joint venture	\$ -	\$ -	\$ -	\$ 1,411,960

The notes to the financial statements are an integral part of this statement.

CITY OF KNOXVILLE, TENNESSEE

Statement of Fiduciary Net Assets  
Fiduciary Funds  
June 30, 2007

	City Choice Plus Fund	City Employees' Pension Fund
<b>Assets</b>		
Cash	\$ 152,979	\$ 570
Investments (held by trustee):		
Cash equivalents	-	11,087,151
United States government securities	-	50,484,818
State & municipal government securities	28,637	2,229,349
International securities	-	49,081,360
Corporate bonds & debentures	-	38,173,625
Real estate	-	64,026,276
Equity securities	-	332,387,032
Pending sales proceeds	-	816,587
Other receivables	-	7,797
Accrued interest & dividends	-	2,243,659
Equipment, furniture & fixtures	-	84,884
Accumulated depreciation	-	(76,923)
Total assets	<u>181,616</u>	<u>550,546,185</u>
<b>Liabilities</b>		
Accounts payable	57,114	445,656
Investment purchase pending	-	2,116,551
Health care claims liability	124,502	-
Total liabilities	<u>181,616</u>	<u>2,562,207</u>
<b>Net assets</b>		
Held in trust for:		
Pension benefits	-	547,983,978
Total net assets	<u>\$ -</u>	<u>\$ 547,983,978</u>

The notes to the financial statements are an integral part of this statement.

CITY OF KNOXVILLE, TENNESSEE

Statement of Changes in Fiduciary Net Assets  
Fiduciary Funds  
For the Year Ended June 30, 2007

	City Choice Plus Fund	City Employees' Pension Fund
<b>Additions</b>		
Employee contributions	\$ 357,806	\$ 3,185,738
Employer contributions	209,710	5,632,265
Investment income	379	78,955,710
Total additions	567,895	87,773,713
<b>Deductions</b>		
Benefits paid	567,895	33,586,417
Refunds	-	648,706
Administration	-	406,494
Total deductions	567,895	34,641,617
<b>Change in net assets</b>	-	53,132,096
<b>Total net assets - beginning</b>	-	494,851,882
<b>Total net assets - ending</b>	\$ -	\$ 547,983,978

The notes to the financial statements are an integral part of this statement.

CITY OF KNOXVILLE, TENNESSEE  
Notes to Financial Statements  
June 30, 2007

**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 a nine-member City Council. As required by accounting principles generally accepted in the United States of America, 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. 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. Additional information may be obtained from Cindy McGinnis, General Manager, 1135 Magnolia Avenue, Knoxville, Tennessee 37917.

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

***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 (PBA)  
Knoxville, Knox County, KUB Geographic Information Systems  
Knoxville-Knox County Animal Center*

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

CITY OF KNOXVILLE, TENNESSEE  
Notes to Financial Statements (Continued)  
June 30, 2007

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

***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 by user fees and charges. Each legally separate component unit, for which the primary government is financially accountable, is reported 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 the 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.

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, expenditures relating to long-term liabilities such as compensated absences and claims and judgments are recorded when payment is due.

CITY OF KNOXVILLE, TENNESSEE  
Notes to Financial Statements (Continued)  
June 30, 2007

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

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 types:

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.

Pension Trust Fund - The pension trust fund accounts for the activities of the City Employees' Pension Plan which accumulates resources of the pension benefit payments to qualified employees.

Other Employee Benefits Fund - The City Choice Plus fund accounts for the flexible spending accounts of the participating employees of the City.

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.

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.

CITY OF KNOXVILLE, TENNESSEE  
Notes to Financial Statements (Continued)  
June 30, 2007

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

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.

**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.

CITY OF KNOXVILLE, TENNESSEE  
Notes to Financial Statements (Continued)  
June 30, 2007

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

**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 the 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 \$5,920,291. Because there was no construction during 2007, no interest was capitalized. Total interest expense incurred by the Metropolitan Knoxville Airport Authority was \$4,985,389 and no interest was capitalized as part of construction.

Depreciation on property, plant and equipment 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. When other property is retired, the related asset and accumulated depreciation are removed from the accounts, and the gain or loss is included in results of operations.

**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 a result of employee resignation or retirement and which 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. Amortization is computed using the straight-line method over the plans' estimated useful life of five years.

CITY OF KNOXVILLE, TENNESSEE  
Notes to Financial Statements (Continued)  
June 30, 2007

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

**Passenger facility charges** - The collection of Passenger Facility Charges ("PFCs") has been approved to be used for qualifying capital improvement projects. PFCs, along with related interest earnings, are recorded as deferred revenue until used or authorized for use under FAA approved application to use. Once authorized to use, the PFC receipts are recognized and recorded as non-operating revenue in the year collected by the air carriers. In 2007, all PFCs were authorized for use and no deferred revenue was recorded.

**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 affect 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.

**NOTE 2 - RECONCILIATION OF GOVERNMENT-WIDE AND FUND FINANCIAL STATEMENTS**

Certain differences exist between the governmental fund financial statements and the government-wide financial statements. These differences relate to differences between the modified accrual basis of accounting used in the fund financial statements and the accrual basis of accounting used in the government-wide financial statements and to the consolidation of the internal service funds into the governmental activities in the government-wide financial statements.

Reconciliations between the governmental fund balance sheet and the government-wide statement of net assets and between the governmental fund statement of revenues, expenditures, and changes in fund balances and the government-wide statement of activities are shown on pages 25 and 27, respectively.

**NOTE 3 - STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY**

The City is required by its charter to adopt annual budgets for those operating funds that are under the direct control of City Council. This includes all governmental funds except the Miscellaneous Grants Fund, Animal Control Fund, Miscellaneous Community Development Funds, Coster Redevelopment Fund, Krutch Park Fund, Knoxville Civic Revitalization Fund and City Choice Fund. City Council adopts project-length budgets for the capital projects fund. In addition City Council adopts annual operating budgets for all enterprise and internal service funds. The City prepares its budget on a basis of accounting consistent with accounting principles generally accepted in the United States of America (GAAP).

The Mayor is required by the City Charter to propose a balanced budget to the City Council on or before May 1 for the fiscal year commencing the following July 1. The proposed budget includes anticipated expenditures by department and sources of financing the expenditures.

CITY OF KNOXVILLE, TENNESSEE  
Notes to Financial Statements (Continued)  
June 30, 2007

**NOTE 3 - STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY (Continued)**

Public hearings are conducted to allow taxpayers an opportunity to comment on the proposed budgets before they become law.

The Mayor is authorized to transfer budgeted amounts within departments within any fund. All other transfers or supplemental appropriations must be enacted by City Council. Other management is not authorized to make such changes. Appropriations lapse at each fiscal year end. Encumbered appropriations are reappropriated in the ensuing year's budget.

The following supplemental budgetary appropriations were enacted by City Council during the fiscal year 2007.

General Fund	\$	7,087,272
Special revenue funds		10,251,996
Capital projects funds		11,719,724

Encumbrance accounting is employed in governmental funds. Encumbrances represent commitments related to unperformed contracts for goods or services. Encumbrance accounting, under which purchase orders, contracts and other commitments for expenditure of resources are recorded to reserve that portion of the applicable appropriation, is utilized in the governmental funds. Encumbrances outstanding at year-end are reported as reservations of fund balances and do not constitute expenditures or liabilities because the commitments will be honored during the subsequent year.

A comparison of revenues and expenses – final budget and actual for proprietary funds for which City Council has legally adopted budgets is as follows:

	Revenues, Transfers In and Capital Contributions			Expenses and Transfers Out		
	Budget	Actual	Variance Favorable (Unfavorable)	Budget	Actual	Variance Favorable (Unfavorable)
	Budget	Actual	(Unfavorable)	Budget	Actual	(Unfavorable)
<i>Enterprise Funds</i>						
Knoxville Convention Center	\$ 22,448,358	\$ 21,169,118	\$ (1,279,240)	\$ 22,448,358	\$ 20,734,159	\$ 1,714,199
Metro Parking	1,226,787	1,488,231	261,444	1,226,787	1,264,233	(37,446)
Public Assembly Facilities	3,857,668	5,414,834	1,557,166	3,857,668	3,905,770	(48,102)
City Golf Courses	300,000	383,055	83,055	300,000	305,422	(5,422)
Knoxville Area Transit (Component unit)	17,992,209	21,906,137	3,913,928	17,992,209	23,389,442	(5,397,233)
<i>Internal Service Funds</i>						
Office Services	211,648	185,661	(25,987)	211,648	181,282	30,366
Fleet Maintenance	10,760,877	12,456,119	1,695,242	10,760,877	10,129,234	631,643
Risk Management	8,528,459	8,994,792	466,333	8,528,459	7,482,286	1,046,173
Employee Health Insurance	12,392,401	13,269,916	877,515	12,392,401	12,165,107	227,294
Equipment Replacement	1,828,300	2,974,081	1,145,781	1,828,300	1,848,191	(19,891)
City Buildings	1,630,234	2,977,072	1,346,838	1,630,234	1,502,383	127,851

CITY OF KNOXVILLE, TENNESSEE  
Notes to Financial Statements (Continued)  
June 30, 2007

**NOTE 4 - DEPOSITS AND INVESTMENTS**

The City maintains a cash and investment pool that is available for use by all funds except the Pension Trust Fund and the Knoxville Utilities Board and Metropolitan Knoxville Airport Authority component unit enterprise funds. Each fund type's portion of this pool is displayed on the combined balance sheet as "Cash". Deficits in pooled cash are reported as interfund liabilities. See Note 8 for a schedule of interfund receivables and payables. In addition, investments are separately held by several of the City's funds.

**Deposits** - Deposits are included in the City's financial statements as "Cash and cash equivalents", "Cash and temporary investments", "Restricted cash and investments", "Cash float on pooled cash", and "Unused bond proceeds." Certain certificates of deposit are included in "Investments." Cash equivalents are defined as short-term, highly liquid investments.

**Investments** - Statutes authorize the City to invest in direct obligations of the United States Treasury, its agencies and instrumentalities; money market funds; and, the state treasurer's investment pool, prime commercial paper, bankers' acceptance notes and certificates of deposit. The state treasurer's investment pool is a SEC 2a-7-like fund and the amount stated is based on the pool price per share. The pool is reported at its amortized book value.

The Pension Trust Fund's investment policies allow its agents to invest in government securities, certificates of deposit, bankers' acceptances, repurchase agreements, bonds and notes (with "A" or better ratings) and common stocks and common stock equivalents. The Pension Trust Fund is required to maintain a minimum of 25% of its carrying value in fixed income accounts. State statutes and Pension Trust Fund investment policies allow the Pension Trust Fund to lend its securities to a list of approved broker-dealers and other entities with a simultaneous agreement to return collateral for the same securities in the future. The total amount of securities on loan is restricted to no more than 30% of the assets of the fund. The lending is managed by the Pension Trust Fund's custodial bank. The Pension Trust Fund lends securities of the type on loan at year-end for collateral in the form of cash or other securities of 102%.

**Investment policies**

*Investment Rate Risk:* As a means of limiting its exposure to fair value losses arising from rising interest rates the City's investment policies limit investments to terms of no more than two years. As of June 30, 2007, the average weighted maturity of the City's portfolio was 39 days.

*Credit Risk:* Statutes authorize the City to invest in obligations of the United States Treasury, its agencies and instrumentalities; money market funds; and, the state treasurer's investment pool. The state treasurer's investment pool is a non-rated, SEC 2a-7-like fund and the amount stated is based on the pool price per share. The pool is reported at its amortized book value.

The City's Investment Policy allows only investments in the highest-grade securities. Investments in commercial paper require that the issuer be rated A1, P1, or F1 by at least two rating agencies. The City's investments meet this requirement.

*Custodial Credit Risk:* For an investment, custodial credit risk is the risk that, in the event of failure of the custodian, the City will not be able to recover the value of investments or collateral securities that are in the possession of an outside party. The City's investments are typically uninsured and unregistered investments for which the securities are held by the custodian's trust department or agent in the City's name. Certificates of deposit are secured by collateral held by the State's Collateral Pool. These would again include uninsured and unregistered investments for which the securities are held by the custodian's trust department or agent in the State's name.

**CITY OF KNOXVILLE, TENNESSEE**  
**Notes to Financial Statements (Continued)**  
**June 30, 2007**

**NOTE 4 - DEPOSITS AND INVESTMENTS (Continued)**

*Concentration of Credit Risk:* The City's Investment Policy imposes several limits on the amount and type of investments in order to avoid having a large percentage of the portfolio in a single issuer. First, the policy states that, with the exception of U.S. treasuries, agency securities, and the state investment pool, no more than thirty-five percent of the portfolio shall be invested in a single security type. The policy further limits, with respect to banker's acceptances and commercial paper, that no more than ten percent of the portfolio, or \$10 million whichever is less, shall be from a single issuer. As of June 30, 2007, the City held 4% of its investments in various commercial paper instruments including Lockhart Funding and Toyota Motor Credit Commercial Paper which represents 1% each of the total portfolio. Also, the City held securities of the Federal Home Loan Bank of \$25.2 million or approximately 14% of the total portfolio. All U.S. Government Agency investments have an Aaa credit rating.

As of June 30, 2007, the City had the following investments and maturities.

<b>Investments:</b>	<u>Fair Value</u>	<u>Less Than 6 Months</u>	<u>6 - 12 Months</u>	<u>1 - 2 Years</u>
U.S. Government Agencies:				
Federal Home Loan Bank (FHLB)	\$ 25,163,419	\$ 499,690	\$ 8,814,497	\$ 15,849,232
Federal Home Loan Mortgage Corp (FHLMC)	12,530,608	523,940	2,841,915	9,164,753
Federal Farm Credit Bureau (FFCB)	7,071,172	599,937	2,706,738	3,764,497
Federal National Mortgage Assoc. (FNMA)	5,409,250	-	1,992,510	3,416,740
Federal Agency Mortgage Credit Assoc. (FAMCA)	998,890		998,890	
Commercial Paper	7,250,000	7,250,000	-	-
Other Governmental Bonds	1,496,018	-	-	1,496,018
Corporate Equities	204,830	-	-	-
Tennessee Local Government Investment Pool	115,267,350	115,267,350	-	-
	<u>\$ 175,391,537</u>	<u>\$ 124,140,917</u>	<u>\$ 17,354,550</u>	<u>\$ 33,691,240</u>

Investments are included in the City's financial statements as "Cash and temporary investments", "Investments", "Restricted cash and investments", "Unused bond proceeds", and "Restricted assets".

**CITY OF KNOXVILLE, TENNESSEE**  
**Notes to Financial Statements (Continued)**  
**June 30, 2007**

**NOTE 4 - DEPOSITS AND INVESTMENTS (continued)**

Deposits and investments of component units are classified in the statement of net assets and the statement of fiduciary net assets as follows:

	<u>Knoxville Utilities Board</u>	<u>Metropolitan Knoxville Airport Authority</u>	<u>Knoxville Area Transit</u>	<u>City of Knoxville Pension System</u>
<b>Deposits:</b>				
Bank balances	\$ 78,107,916	\$ 5,968,100	\$ 649,338	\$ 570
Carrying amounts:				
Deposits (outstanding checks) in financial institutions	\$ (13,864,095)	\$ 5,476,603	\$ 649,338	\$ 570
Certificates of deposit	20,555,461	-	-	-
Super NOW Account	51,127,500	-	-	-
Total deposits - carrying value	<u>\$ 57,818,866</u>	<u>\$ 5,476,603</u>	<u>\$ 649,338</u>	<u>\$ 570</u>

	<u>Knoxville Utilities Board</u>	<u>Metropolitan Knoxville Airport Authority</u>	<u>Knoxville Area Transit</u>	<u>City of Knoxville Pension System</u>	<u>Total Amount</u>	<u>Fair Value</u>
<b>Investments:</b>						
Cash equivalents	\$ -	\$ -	\$ -	\$ 11,087,151	\$ 11,087,151	\$ 11,087,151
United States government securities	49,040,382	26,722,251	-	8,761,431	84,524,064	84,524,064
Equity securities	-	-	-	381,040,631	381,040,631	381,040,631
Corporate bonds	-	-	-	28,163,665	28,163,665	28,163,665
State and municipal government securities	-	-	-	2,229,349	2,229,349	2,229,349
International securities	-	-	-	49,081,360	49,081,360	49,081,360
Total classified investments	<u>49,040,382</u>	<u>26,722,251</u>	<u>-</u>	<u>480,363,587</u>	<u>556,126,220</u>	<u>556,126,220</u>
<i>Investments not categorized:</i>						
Investments held by broker-dealers under securities loans:						
Broker-dealers holding cash collateral:						
United States government securities	-	-	-	40,328,208	40,328,208	40,328,208
Equity securities	-	-	-	15,372,677	15,372,677	15,372,677
Corporate bonds	-	-	-	10,009,960	10,009,960	10,009,960
Third parties holding cash collateral:						
United States government securities	-	-	-	1,395,179	1,395,179	1,395,179
Investments in state treasurer's						
Investment pool	10,315,611	-	735,227	-	11,050,838	11,050,838
Total investments	<u>\$ 59,355,993</u>	<u>\$ 26,722,251</u>	<u>\$ 735,227</u>	<u>\$ 547,469,611</u>	<u>\$ 634,283,082</u>	<u>\$ 634,283,082</u>
Total deposits and investments	<u>\$ 117,174,859</u>	<u>\$ 32,198,854</u>	<u>\$ 1,384,565</u>	<u>\$ 547,470,181</u>		

**CITY OF KNOXVILLE, TENNESSEE**  
**Notes to Financial Statements (Continued)**  
**June 30, 2007**

**NOTE 4 - DEPOSITS AND INVESTMENTS (continued)**

	Knoxville Utilities Board	Metropolitan Knoxville Airport Authority	Knoxville Area Transit	City of Knoxville Pension System
Cash and cash equivalents	\$ 47,579,017	\$ 5,215,064	\$ 649,338	\$ 11,087,721
Investments	56,490,381	26,722,251	735,227	536,382,460
Other Assets	441,903	-	-	-
Bond funds	12,855,953	261,539	-	-
Other temporarily restricted assets	250,343	-	-	-
	<u>117,617,597</u>	<u>32,198,854</u>	<u>1,384,565</u>	<u>547,470,181</u>
Less accrued interest	442,738	-	-	-
Total deposits and investments	<u>\$ 117,174,859</u>	<u>\$ 32,198,854</u>	<u>\$ 1,384,565</u>	<u>\$ 547,470,181</u>

The City of Knoxville Pension System also has a credit risk exposure for cash held in its securities lending short-term collateral investment pools (not included in the City of Knoxville Pension System financial statements) for \$65,710,845 held by broker dealers and \$1,395,179 held by third parties. The contract with the Pension System's custodian requires it to indemnify the Pension System if the borrowers fail to return the borrowed securities (and if the collateral is inadequate to replace the securities lent) or fail to pay the system for income distributions by the securities' issuers while the securities are on loan. Because collateral exceeds the fair value of securities lent, there is no credit risk exposure to the borrowers at June 30, 2007.

**NOTE 5 - RECEIVABLES**

Receivables at June 30, 2007, including the applicable allowance for uncollectible accounts, consisted of the following:

	Intergovern- mental	Interest and Dividends	Grants	Customers	Other	Allowance for Doubtful Accounts	Total
General fund	\$ 20,768,887	\$ -	\$ 112,605	\$ -	\$ 2,579	\$ -	\$ 20,884,071
Capital projects fund	-	-	1,712,506	-	-	(14,138)	1,698,368
Other governmental activities	-	-	3,978,530	-	-	-	3,978,530
Knoxville Convention Center	-	-	-	-	1,648,186	-	1,648,186
Other business-type activities	-	-	-	1,334	-	-	1,334
Internal service funds	-	-	-	87,833	-	-	87,833
Total primary government	<u>20,768,887</u>	<u>-</u>	<u>5,803,641</u>	<u>89,167</u>	<u>1,650,765</u>	<u>(14,138)</u>	<u>28,298,322</u>
Component units:							
Knoxville Utilities Board	-	-	-	63,728,612	-	(920,384)	62,808,228
Metropolitan Knoxville Airport Authority	-	433,159	822,231	447,228	-	-	1,702,618
Knoxville Area Transit	-	-	3,507,259	-	-	-	3,507,259
Total reporting unit	<u>20,768,887</u>	<u>433,159</u>	<u>10,133,131</u>	<u>64,265,007</u>	<u>1,650,765</u>	<u>(934,522)</u>	<u>96,316,427</u>
Knoxville Employees' Pension Plan	-	2,243,659	-	-	824,383	-	3,068,042
Total reporting entity	<u>\$ 20,768,887</u>	<u>\$ 2,676,818</u>	<u>\$ 10,133,131</u>	<u>\$ 64,265,007</u>	<u>\$ 2,475,148</u>	<u>\$ (934,522)</u>	<u>\$ 99,384,469</u>

CITY OF KNOXVILLE, TENNESSEE  
Notes to Financial Statements (Continued)  
June 30, 2007

**NOTE 6 - LEASES RECEIVABLE**

*Public Assembly Facilities Fund*

The Public Assembly Facilities Fund leases a portion of the exhibition center to an adjoining hotel. Components of the Public Assembly Facilities investment in the capitalized lease at June 30, 2007, are as follows:

Total minimum lease payments receivable	\$	1,525,275
Less unearned income		<u>726,840</u>
Net investment in lease receivable	\$	<u><u>798,435</u></u>

Lease payments under the agreement are \$100,000 a year.

*Metropolitan Knoxville Airport Authority*

The Metropolitan Airport Authority, as lessor, leases certain capital assets under operating leases expiring in various years through 2028. As of June 30, 2007, minimum future base rentals to be received on noncancellable leases are as follows:

Years ended June 30:		
2008	\$	8,112,176
2009		4,834,102
2010		2,237,976
2011		2,129,828
2012		1,458,120
Thereafter		<u>21,509,651</u>
	\$	<u><u>40,281,853</u></u>

Under the terms of one of the Metropolitan Knoxville Airport Authority leases, payments in future years increase significantly. The Authority recognizes income from this lease on a straight-line basis, considering total payments over the lease term. Accordingly, advance rents of approximately \$1,006,000 are included in other assets in the accompanying statement of net assets as of June 30, 2007. Airport Authority contingent rentals, which consist primarily of rental car concessions and other similar revenues, amounted to \$1,593,479 for the year ended June 30, 2007.

**CITY OF KNOXVILLE, TENNESSEE**  
**Notes to Financial Statements (Continued)**  
**June 30, 2007**

**NOTE 7 - CAPITAL ASSETS**

Capital asset activity for the primary government for the year ended June 30, 2007 was as follows:

	Beginning Balance	Additions and Transfers In	Deletions and Transfers Out	Ending Balance
<b>Primary Government</b>				
<b>Governmental activities:</b>				
<i>Nondepreciable:</i>				
Land & site improvements	\$ 37,286,836	\$ 2,583,414	\$ (874,303)	\$ 38,995,947
Construction in progress	11,660,784	12,186,426	(6,920,748)	16,926,462
Total nondepreciable capital assets	48,947,620	14,769,840	(7,795,051)	55,922,409
<i>Depreciable:</i>				
Buildings and building improvements	39,060,757	2,152,727	-	41,213,484
Equipment, furniture and fixtures	57,439,879	5,064,917	(4,815,614)	57,689,182
Infrastructure	224,166,780	27,015,477	(11,486,398)	239,695,859
Total depreciable capital assets	320,667,416	34,233,121	(16,302,012)	338,598,525
<i>Accumulated depreciation:</i>				
Buildings and building improvements	(19,513,434)	(1,308,472)	(1,467)	(20,823,373)
Equipment, furniture and fixtures	(48,236,048)	(5,444,920)	9,285,200	(44,395,768)
Infrastructure	(77,353,471)	(8,908,492)	(5,845,864)	(92,107,827)
Total accumulated depreciation	(145,102,953)	(15,661,884)	3,437,869	(157,326,968)
Total depreciable capital assets, net	175,564,463	18,571,237	(12,864,143)	181,271,557
Governmental activities capital assets, net	\$ 224,512,083	\$ 33,341,077	\$ (20,659,194)	\$ 237,193,966
<b>Business-type activities:</b>				
<i>Nondepreciable:</i>				
Land & site improvements	\$ 6,743,270	\$ -	\$ -	\$ 6,743,270
Artwork	764,875	-	-	764,875
Construction in progress	-	102,766	-	102,766
Total nondepreciable capital assets	7,508,145	102,766	-	7,610,911
<i>Depreciable:</i>				
Buildings and building improvements	219,922,141	1,573,084	(14,476)	221,480,749
Equipment, furniture and fixtures	2,947,358	250,835	(355,400)	2,842,793
Total depreciable capital assets	222,869,499	1,823,919	(369,876)	224,323,542
<i>Accumulated depreciation:</i>				
Buildings and building improvements	(46,671,540)	(5,496,365)	27,690	(52,140,215)
Equipment, furniture and fixtures	(1,197,132)	(263,304)	3,977	(1,456,459)
Total accumulated depreciation	(47,868,672)	(5,759,669)	31,667	(53,596,674)
Total depreciable capital assets, net	175,000,827	(3,935,750)	(338,209)	170,726,868
Business-type activities capital assets, net	\$ 182,508,972	\$ (3,832,984)	\$ (338,209)	\$ 178,337,779

CITY OF KNOXVILLE, TENNESSEE  
Notes to Financial Statements (Continued)  
June 30, 2007

NOTE 7 - CAPITAL ASSETS (Continued)

Depreciation expense was charged to functions/programs of the primary government as follows:

<u>Governmental activities</u>	
General Government	\$ 1,344,334
Public Safety	3,303,733
Physical Environment	8,596,574
Economic Development	258,645
Parks & Recreation	2,048,820
Health & Sanitation	109,778
	<u>\$ 15,661,884</u>
 <u>Business-type activities</u>	
Knoxville Convention Center	\$ 4,554,499
Metro Parking	666,172
Public Assembly Facilities	536,780
Municipal Golf Courses	2,218
	<u>\$ 5,759,669</u>

**CITY OF KNOXVILLE, TENNESSEE**  
**Notes to Financial Statements (Continued)**  
**June 30, 2007**

**NOTE 7 - CAPITAL ASSETS (Continued)**

Capital asset activity for component units for the year ended June 30, 2007 was as follows:

Component Units	Beginning Balance	Additions and Transfers In	Deletions and Transfers Out	Ending Balance
<b>Knoxville Utilities Board:</b>				
<i>Nondepreciable: Construction in Progress</i>	\$ 124,781,229	\$ 7,842,442	\$ (46,079,269)	\$ 86,544,402
<i>Depreciable:</i>				
Pumping and treatment plant	158,931,896	11,032,669	(112,570)	169,851,995
Distribution & collection plant	957,637,232	160,181,986	(15,456,446)	1,102,362,772
General plant	109,686,131	6,724,717	(753,501)	115,657,347
Total depreciable assets	1,226,255,259	177,939,372	(16,322,517)	1,387,872,114
Accumulated depreciation	(445,966,435)	(46,850,481)	17,824,619	(474,992,297)
Total depreciable capital assets, net	780,288,824	131,088,891	1,502,102	912,879,817
<b>Total Knoxville Utilities Board</b>	<b>\$ 905,070,053</b>	<b>\$ 138,931,333</b>	<b>\$ (44,577,167)</b>	<b>\$ 999,424,219</b>
<b>Metropolitan Knoxville Airport Authority:</b>				
<i>Nondepreciable:</i>				
Land	\$ 22,192,319	\$ 29,736	\$ -	\$ 22,222,055
Construction in progress	7,194,876	9,099,891	(2,911,512)	13,383,255
Total nondepreciable capital assets	29,387,195	9,129,627	(2,911,512)	35,605,310
<i>Depreciable:</i>				
Land improvements	122,181,762	201,582	-	122,383,344
Buildings and building improvements	124,328,100	2,466,715	-	126,794,815
Equipment, furniture and fixtures	9,629,232	243,737	(106,252)	9,766,717
Total depreciable assets	256,139,094	2,912,034	(106,252)	258,944,876
<i>Accumulated depreciation:</i>				
Land improvements	(71,658,117)	(5,484,005)	-	(77,142,122)
Buildings and building improvements	(39,411,631)	(5,042,482)	-	(44,454,113)
Equipment, furniture and fixtures	(7,380,661)	(621,896)	292,266	(7,710,291)
Total accumulated depreciation	(118,450,409)	(11,148,383)	292,266	(129,306,526)
Total depreciable capital assets, net	137,688,685	(8,236,349)	186,014	129,638,350
<b>Total Metropolitan Knoxville Airport Authority</b>	<b>\$ 167,075,880</b>	<b>\$ 893,278</b>	<b>\$ (2,725,498)</b>	<b>\$ 165,243,660</b>
<b>Knoxville Area Transit:</b>				
<i>Nondepreciable: Construction in progress</i>	\$ -	\$ 753,427	\$ -	\$ 753,427
<i>Depreciable:</i>				
Buildings and building improvements	5,025,175	-	-	5,025,175
Equipment, furniture and fixtures	25,373,587	293,369	(250,866)	25,416,090
Total depreciable assets	30,398,762	293,369	(250,866)	30,441,265
<i>Accumulated depreciation:</i>				
Buildings and building improvements	(2,185,666)	(125,282)	-	(2,310,948)
Equipment, furniture and fixtures	(15,014,751)	(2,248,769)	216,288	(17,047,232)
Total accumulated depreciation	(17,200,417)	(2,374,051)	216,288	(19,358,180)
Total depreciable capital assets, net	13,198,345	(2,080,682)	(34,578)	11,083,085
<b>Total Knoxville Area Transit</b>	<b>\$ 13,198,345</b>	<b>\$ (1,327,255)</b>	<b>\$ (34,578)</b>	<b>\$ 11,836,512</b>
<b>Knoxville Employees' Pension Plan</b>				
<i>Depreciable: Equipment, furniture and fixtures</i>	\$ 70,472	\$ 14,412	\$ -	\$ 84,884
<i>Accumulated Depreciation</i>	(57,875)	(19,048)	-	(76,923)
<b>Total Knoxville Employees' Pension Plan</b>	<b>\$ 12,597</b>	<b>\$ (4,636)</b>	<b>\$ -</b>	<b>\$ 7,961</b>

CITY OF KNOXVILLE, TENNESSEE  
Notes to Financial Statements (Continued)  
June 30, 2007

**NOTE 8 - INTERFUND RECEIVABLES AND PAYABLES**

Interfund receivables consist primarily of pooled cash balances. A detailed listing of interfund receivables and payables at June 30, 2007 is as follows:

	<u>Due From Other Funds</u>	<u>Due to Other Funds</u>	<u>Internal Balances</u>	<u>Due From Component Units</u>	<u>Due to Primary Government</u>
<b>Governmental activities</b>					
<i>General Fund</i>	\$ 2,921,074	\$ -	\$ 2,921,074	\$ 3,790,238	\$ -
<i>Special Revenue Fund:</i>					
Abandoned Vehicle	-	1,112	(1,112)	-	-
Animal Control	-	1,962	(1,962)	-	-
Community Development Block Grants	-	843,374	(843,374)	-	-
City Inspections	-	14,613	(14,613)	-	-
City Court	-	836,630	(836,630)	-	-
Miscellaneous Special Revenue Funds	-	221,000	(221,000)	-	-
Storm Water	-	6,126	(6,126)	-	-
Solid Waste	-	4,479	(4,479)	-	-
Miscellaneous Community Development Funds	-	593,436	(593,436)	-	-
<i>Capital Projects Fund</i>	221,000	-	221,000	-	-
Total governmental activities	<u>3,142,074</u>	<u>2,522,732</u>	<u>619,342</u>	<u>3,790,238</u>	<u>-</u>
<b>Business-type activities</b>					
Public Assembly Facilities	-	393,777	(393,777)	-	-
City Golf Courses	-	45,000	(45,000)	-	-
<i>Internal Service Funds:</i>					
Employee Health Insurance	-	169,877	(169,877)	-	-
Risk Management	-	10,688	(10,688)	-	-
Total business-type activities	<u>-</u>	<u>619,342</u>	<u>(619,342)</u>	<u>-</u>	<u>-</u>
<b>Component Units:</b>					
Knoxville Area Transit	-	-	-	-	3,790,238
	<u>\$ 3,142,074</u>	<u>\$ 3,142,074</u>	<u>\$ -</u>	<u>\$ 3,790,238</u>	<u>\$ 3,790,238</u>

**CITY OF KNOXVILLE, TENNESSEE**  
**Notes to Financial Statements (Continued)**  
**June 30, 2007**

**NOTE 9 - LONG-TERM DEBT**

Bonds at June 30, 2007, are comprised of the following issues:

	General Obligation Bonds		
	Governmental Activities	Business-type Activities	Total
<b>Primary Government</b>			
General Obligation Refunding Bonds, Series 1999A maturing through 2008 at an interest rate of 4.1%	\$ -	\$ 385,000	\$ 385,000
General Obligation Public Improvement Bonds, Series 2000A maturing through 2020 at varying rates of interest ranging from 5.0% to 5.6%	795,000	-	795,000
General Improvement Bonds, Series 2004A maturing through 2024 at varying rates of interest ranging from 2.0% to 4.1%	30,165,000	-	30,165,000
General Obligation Refunding Bonds, Series 2004B maturing through 2017 at varying rates of interest ranging from 3.0% to 5.0%	27,860,000	-	27,860,000
General Obligation Bonds Series IIIF through the Public Building Authority of Sevier County, Tennessee maturing through 2020 with a floating interest rate	-	36,020,000	36,020,000
General Obligation Public Improvement Bond Series A-4-A maturing through 2032 with a floating interest rate	-	59,970,000	59,970,000
General Obligation Public Improvement Bond Series 2002A maturing through 2024 at varying rates of interest ranging from 4.0% to 5.0%	-	51,535,000	51,535,000
General Obligation Public Improvement Bond Series 2005A maturing through 2020 at varying rates of interest ranging from 3.0% to 5.0%	13,550,000	-	13,550,000
<b>Total Primary Government</b>	<b>\$ <u>72,370,000</u></b>	<b>\$ <u>147,910,000</u></b>	<b>\$ <u>220,280,000</u></b>

CITY OF KNOXVILLE, TENNESSEE  
Notes to Financial Statements (Continued)  
June 30, 2007

NOTE 9 - LONG-TERM DEBT (Continued)

Component Units:	Revenue Bonds
<i>Knoxville Utilities Board:</i>	
Electric Revenue Bonds Series T to X, maturing through 2032 at varying rates of interest ranging from 2.0% to 5.12%	\$ 114,725,000
Water Revenue Bonds Series O to S maturing through 2030 at varying rates of interest ranging from 2.0% to 5.2%	42,170,000
Gas Revenue Bonds Series I to M, maturing through 2031 at varying rates of interest ranging from 2.0% to 5.2%	83,580,000
Waste Water Revenue Bonds Series 1998, 2001, 2001A 2004A, 2005 A&B, maturing through 2040 at varying rates of interest ranging from 3.0% to 5.1%	190,535,000
	\$ 431,010,000
<i>Metropolitan Knoxville Airport Authority:</i>	
Local Government Public Improvement Bonds, 2000 Series II-D-1 maturing through 2026. The remaining principal bears interest at 5.79%	\$ 15,985,000
Local Government Public Improvement Bonds, 2001 Series III-A maturing through 2028. \$47,515,000 bears interest at 4.74%. The remaining principal bears interest at a variable rate (3.85% at June 30, 2007).	86,320,000
	\$ 102,305,000

Each of the Divisions of the Knoxville Utilities Board 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, 2007, these requirements had been satisfied.

CITY OF KNOXVILLE, TENNESSEE  
Notes to Financial Statements (Continued)  
June 30, 2007

NOTE 9 - LONG-TERM DEBT (Continued)

Debt service requirements to maturity for bonds and notes are as follows:

	General Obligation Bonds			
	Governmental Activities		Business-type Activities	
	Principal	Interest	Principal	Interest
2008	\$ 8,470,000	\$ 3,075,270	\$ 3,670,000	\$ 6,819,950
2009	7,340,000	2,694,220	3,430,000	6,662,310
2010	5,325,000	2,383,310	3,580,000	6,514,190
2011	4,560,000	2,135,560	3,735,000	6,359,560
2012	4,660,000	1,924,180	3,900,000	6,196,530
2013 - 2017	23,185,000	6,736,140	22,305,000	28,205,570
2018 - 2022	14,160,000	2,606,200	28,020,000	22,548,130
2023 - 2027	4,670,000	288,180	35,575,000	14,973,360
2025 - 2032	-	-	43,695,000	6,052,520
	<u>72,370,000</u>	<u>\$ 21,843,060</u>	147,910,000	<u>\$ 104,332,120</u>
Unamortized premium and deferred gain on refunding	1,494,584		3,911	
Unamortized discounts	-		(1,122,131)	
Total	<u>\$ 73,864,584</u>		<u>\$ 146,791,780</u>	

	Revenue Bonds	
	Principal	Interest
2008	\$ 14,395,000	\$ 23,952,159
2009	15,015,000	23,331,045
2010	15,645,000	22,670,066
2011	16,335,000	21,968,398
2012	16,715,000	21,249,761
2013 - 2017	84,385,000	94,526,716
2018 - 2022	95,710,000	74,390,769
2023 - 2027	124,290,000	50,593,738
2028 - 2032	64,150,000	27,691,300
2033 - 2037	50,125,000	15,072,500
2038 - 2040	36,550,000	2,971,000
	<u>533,315,000</u>	<u>\$ 378,417,452</u>
Unamortized discount and deferred loss on refunding	(561,433)	
Total	<u>\$ 532,753,567</u>	

CITY OF KNOXVILLE, TENNESSEE  
Notes to Financial Statements (Continued)  
June 30, 2007

**NOTE 9 - LONG-TERM DEBT (Continued)**

*Interest Swap Agreements*

Primary government

During 2002, the City transferred the \$45,000,000 liability for the General Obligation Bonds Series IIIF bonds, along with the related cost of the convention center construction, from the governmental activity of the capital projects fund to the Knoxville Convention Center fund. As a hedge against rising interest rates, the City entered into an interest swap agreement with Wachovia Bank. The City pays Wachovia (through a trust with Morgan Keegan) interest at a fixed rate of 3.955%. Wachovia pays the trust interest at a variable rate based on LIBOR. The trust pays the bondholders interest at a variable rate based on Bond Market Association Municipal Index (BMA). The City has a risk that if the LIBOR rate is less than the BMA rate, it will have to pay additional amounts to the trust to cover bondholder interest. During 2007, the City paid \$87,887 in additional interest due to an unfavorable difference in the LIBOR and BMA rates.

Component units

The Metropolitan Knoxville Airport Authority Series II-D-1 and III-A Bonds bear interest at variable rates. Portions of the Series II-D-1 and III-A Bonds totaling \$15,985,000 and \$47,515,000, respectively, are subject to interest rate swap agreements to effectively fix the interest rate. Based on the swap agreements, the Authority owes interest at an effective fixed rate of 5.79% and 4.74% on the Series II-D-1 and III-A Bonds, respectively. In return, the counterparty owes the Authority interest based on a variable rate that is calculated based on a published index rate. The \$15,985,000 and \$47,515,000 in bond principal are not exchanged; only the net difference in interest payments is actually exchanged with the counterparty and recorded by the Authority as interest expense. The Authority, through the trustee, continues to pay interest to the bondholders at the variable rate provided by the bonds. However, during the term of the swap agreement, the Authority effectively pays a fixed rate on the debt plus or minus the difference between the variable rate due the bondholders and the variable rate received from the counterparty. The Authority would be exposed to variable rates if the counterparty to the swaps defaults, if the variable rate received from the counterparty is less than that due to bondholders or if the swap is terminated. A termination of the swap agreements could also result in the Authority's making or receiving termination payments. The fair value of the swap agreements is a deferred loss of \$3,867,664 as of June 30, 2007. These amounts, which were estimated by obtaining quotes from the bank, have not been recorded in the accompanying financial statements. The debt service requirements for the Series II-D-1 and III-A Bonds, as presented on the Schedule of maturity for bonds and notes above, are based solely on the fixed rate. Other than the net interest expenditures resulting from the swap agreement, no other amounts are recorded in the financial statements.

The debt service requirements for both primary government and Airport Authority bonds subject to interest swap arrangements are based on the fixed rate. Other than the net interest expenditures resulting from the swap agreement, no other amounts are recorded in the financial statements. The Authority incurred additional interest costs of approximately \$1,019,000 in 2007 related to the swap agreements.

*Advance and Current Refundings*

Primary government

The City issued the 2005A General Obligation Refunding Bonds totaling \$13,725,000 for the purpose of refunding a portion of the City's Series 2000A Series General Obligation Bonds. U. S. Government State and Local Government Series securities were purchased and placed in an irrevocable trust for the purpose of generating resources for all future debt service payments of \$13,395,000 of the City's Series 2000A General Obligation Bonds. As a result, the refunded bonds are considered to be defeased and the liability has been removed from the governmental activities column of the statement of net assets. The outstanding principal balances on defeased bond issues were \$13,395,000 at June 30, 2007.

CITY OF KNOXVILLE, TENNESSEE  
Notes to Financial Statements (Continued)  
June 30, 2007

**NOTE 9 - LONG-TERM DEBT (Continued)**

The City transferred funds to an irrevocable trust in 2003 to pay the remaining maturities of principal and interest of its Series 1999B General Obligation Bonds. As a result, the refunded bonds are considered to be defeased and the liability has been removed from the governmental activities column of the statement of net assets. The outstanding principal balances on defeased bond issues were \$305,000 at June 30, 2007.

**Component units**

*Knoxville Utilities Board*

KUB's Electric Division issued the Series T 2001 bonds to retire certain existing debt. 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 1993 Series Q revenue bonds and 1995 Series R revenue bonds. In fiscal year 2001, KUB's Electric Division issued Series U 2001 bonds to fund Electric capital improvements. During fiscal year 2004, KUB issued Series V 2004 bonds in part to retire certain existing debt. 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. 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 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. The outstanding principal balances on defeased bond issues were \$84.5 million at June 30, 2007.

KUB's Gas Division issued the issued Series I 2001 bonds in part to retire certain existing debt. Concurrent with issuance of these bonds, KUB transferred funds to an irrevocable trust to pay a portion of the 1993 Series F Revenue bonds and 1997 Series G Revenue bonds, as such amounts mature. During fiscal year 2001, KUB's Gas division issued Series J 2001 bonds to fund capital improvements. During fiscal year 2004, KUB issued Series K 2004 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 H 1998 revenue 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 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. The outstanding principal balances on defeased bond issues were \$64.8 million at June 30, 2007.

KUB's Water Division issued the Series O 2001 bonds to retire certain existing debt. Concurrent with issuance of these bonds, KUB transferred funds to an irrevocable trust to pay a portion of the 1992 Series L Revenue bonds and 1993 Series M Revenue bonds, as such amounts mature. During fiscal year 2001, KUB's Water division issued Series P 2001 bonds to fund capital improvements. During fiscal year 2004, KUB issued Series Q 2004 bonds in part to retire certain existing debt. 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 revenue bonds as such amounts mature. During fiscal year 2006, KUB's Water Division issued Series R 2005 for the purpose of funding improvements and extensions to the water system. KUB's Water Division also issued Series S 2005 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 P 2001 bonds, as such amounts mature. The outstanding principal balances on defeased bond issues were \$23.7 million at June 30, 2007.

CITY OF KNOXVILLE, TENNESSEE  
Notes to Financial Statements (Continued)  
June 30, 2007

**NOTE 9 - LONG-TERM DEBT (Continued)**

KUB's Wastewater Division issued Series 1998 bonds in part to retire certain existing debt and to fund Wastewater capital improvements. During fiscal year 2002, KUB's Wastewater Division issued the Series 2001 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 1993 Series Q revenue bonds as such amounts mature. KUB's Wastewater Division also issued Series 2001A to fund capital improvements to the wastewater system. During fiscal year 2004, the Wastewater Division issued Series 2004A bonds to fund Wastewater capital improvements. During fiscal year 2006, KUB's Wastewater Division issued Series 2005A for the purpose of funding improvements and extensions to the wastewater system 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 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 1998 bonds and Series 2001A bonds, as such amounts mature. Remaining principal balances outstanding at June 30, 2007, on these defeased bond issues were \$31 million.

*Metropolitan Knoxville Airport Authority*

Proceeds from the Metropolitan Knoxville Airport Authority Series III-A bonds totaling \$75,930,000 were used to refund the remaining principal balances of the Series E-1, E-2, II-G-2, III-B-I, III-G-2 and IV-A-I general obligation bonds. The Authority recognized a loss of \$999,159 in 2001 on the refunding which has been deferred and is being amortized over the remaining life of the refunded bonds. The remaining unamortized balance of the loss at June 30, 2007 was \$561,433.

***Other Agreements***

**Primary government**

In 2002 the City entered into an agreement with Knox County to pay a portion of the debt service on bonds that were issued, in part, to fund construction of a new animal shelter. Under the agreement, the City must ratably reimburse Knox County \$1,520,754 of the County's \$80,000,000 bond issuance plus interest at the same rate of the County's bonds. Interest on the bonds ranges from 4.0% to 5.5% and is payable semiannually. Principal is payable annually through May 2021.

Debt service requirements to maturity for the agreement are as follows:

	Principal	Interest
2008	\$ 65,590	\$ 62,910
2009	68,060	59,310
2010	70,630	55,730
2011	73,480	52,030
2012	76,520	47,990
2013-2017	436,760	175,740
2018-2021	430,506	55,140
	\$ 1,221,546	\$ 508,850

The City and Knox County have an interlocal agreement to support debt service of the General Obligation Public Improvement Bonds, Series 2002A. Under the agreement the County has agreed to pay the City 75% of the Hotel-Motel tax revenues received from the portion of the privilege tax imposed by the County that is in excess of 3% of the value being taxed up to a maximum amount of \$1,500,000 per year.

CITY OF KNOXVILLE, TENNESSEE  
Notes to Financial Statements (Continued)  
June 30, 2007

**NOTE 9 - LONG-TERM DEBT (Continued)**

**Component units**

*Metropolitan Knoxville Airport Authority*

During 2000, the Authority's Board of Commissioners adopted a Master Resolution allowing the Authority to issue Airport Revenue Obligations. Under this resolution, the Authority is required to establish certain funds, accounts and subaccounts to deposit funds to be held in trust by the Authority in order to meet the requirements of the resolution. These funds include:

Revenue Fund, including accounts for General Revenue and PFC Revenue into which the Authority is to deposit all such revenues.

Sinking Fund, including a payments account and a debt service reserve account, into which the Authority will deposit funds from the Revenue Fund as needed to pay revenue obligations as they come due.

Revenue and Extension Fund, into which the Authority may deposit any moneys or securities held in the Revenue Fund (excluding PFC funds) in excess of 45 days' estimated expenses.

Project Fund, into which proceeds from issuance of revenue obligations will be deposited to fund project costs.

***Changes in long-term liabilities***

The following schedule is a summary of the changes in long-term debt (including current amounts) for the year ended June 30, 2007:

	Balance June 30, 2006	Additions and Transfers	Reductions and Transfers	Balance June 30, 2007	Due Within One Year
<b>Primary Government</b>					
Governmental Activities:					
General obligation bonds	\$ 82,080,000	\$ -	\$ 9,710,000	\$ 72,370,000	\$ 8,470,000
Debt participation agreement	1,284,847	-	63,301	1,221,546	65,590
	<u>83,364,847</u>	<u>-</u>	<u>9,773,301</u>	<u>73,591,546</u>	<u>8,535,590</u>
Add deferred amounts for issuance premiums and gain on refunding	1,599,962	-	105,378	1,494,584	105,378
	<u>84,964,809</u>	<u>-</u>	<u>9,878,679</u>	<u>75,086,130</u>	<u>8,640,968</u>
Compensated absences payable	6,335,360	6,047,976	5,722,114	6,661,222	6,052,777
Total governmental activities long-term liabilities	<u>\$ 91,300,169</u>	<u>\$ 6,047,976</u>	<u>\$ 15,600,793</u>	<u>\$ 81,747,352</u>	<u>\$ 14,693,745</u>
Business-type Activities:					
General obligation bonds	\$ 151,475,000	\$ -	\$ 3,565,000	\$ 147,910,000	\$ 3,670,000
Add deferred amounts for issuance premiums	7,171	-	3,260	3,911	3,260
Less deferred amounts for issuance discounts	(1,190,378)	-	(68,247)	(1,122,131)	(65,062)
	<u>150,291,793</u>	<u>-</u>	<u>3,500,013</u>	<u>146,791,780</u>	<u>3,608,198</u>
Compensated absences payable	103,747	91,897	80,234	115,410	92,000
Total business-type activities long-term liabilities	<u>\$ 150,395,540</u>	<u>\$ 91,897</u>	<u>\$ 3,580,247</u>	<u>\$ 146,907,190</u>	<u>\$ 3,700,198</u>

**CITY OF KNOXVILLE, TENNESSEE**  
**Notes to Financial Statements (Continued)**  
**June 30, 2007**

**NOTE 9 - LONG-TERM DEBT (Continued)**

Component Units	Balance June 30, 2006	Additions	Reductions	Balance June 30, 2007	Due Within One Year
<b>Knoxville Utilities Board:</b>					
Revenue bonds	\$ 441,205,000	\$ -	\$ 10,195,000	\$ 431,010,000	\$ 11,470,000
Anticipation notes	-	12,790,000	-	12,790,000	-
Capital lease obligations	-	57,128	-	57,128	18,201
TVA conservation program	3,863,957	1,369,789	1,503,354	3,730,392	1,500,000
Accrued compensated absences	9,234,404	15,783,809	15,949,074	9,069,139	2,600,000
Customer advances for construction	570,665	850,146	427,268	993,543	220,000
Supplemental environmental project	1,700,000	-	450,000	1,250,000	250,000
Other	1,583,402	578,706	620,588	1,541,520	385,000
<b>Total Knoxville Utilities Board</b>	<b>455,507,428</b>	<b>31,429,578</b>	<b>29,145,284</b>	<b>460,441,722</b>	<b>16,443,201</b>
<b>Metropolitan Knoxville Airport Authority:</b>					
Revenue/general obligation bonds	105,090,000	-	2,785,000	102,305,000	2,925,000
Less deferred amounts for loss on refunding	(625,366)	-	(63,933)	(561,433)	-
<b>Total Metropolitan Knoxville Airport Authority</b>	<b>104,464,634</b>	<b>-</b>	<b>2,721,067</b>	<b>101,743,567</b>	<b>2,925,000</b>
<b>Total component units</b>	<b>\$ 559,972,062</b>	<b>\$ 31,429,578</b>	<b>\$ 31,866,351</b>	<b>\$ 562,185,289</b>	<b>\$ 19,368,201</b>

Internal service funds predominately serve the governmental funds. Accordingly, long-term liabilities for them are included as part of the above totals for governmental activities. At year end \$152,777 of internal service funds compensated absences are included in the above amounts. Also, for the governmental activities, claims and judgments and compensated absences are generally liquidated by the general fund.

***Conduit Debt***

The Authority issued \$8,500,000 Metropolitan Knoxville Airport Authority Special Purpose Revenue Bonds on June 18, 2002. The bonds bear interest at 8% and are due in an aggregate principal amount of \$8,500,000 on April 1, 2032. Interest is payable semiannually on each April 1 and October 1.

The bonds were issued pursuant to a lease agreement between the Authority and Northwest Airlines, Inc. ("Northwest") dated July 12, 2001, and subsequently amended. The proceeds of the bonds were used for the construction by Northwest of an aircraft maintenance hangar and related facilities to be leased by Northwest from the Authority under the lease agreement. Under the terms of the lease agreement, Northwest is obligated to pay base rental to a trustee assigned by the Authority in the amount necessary to meet debt service requirements on the bonds as they are due.

The Authority has no liability for repayment of these bonds and, accordingly, the bonds are not reported in the Authority's financial statements. Revenues and receipts derived from the lease agreement and a guaranty by Northwest's parent company, Northwest Airlines Corporation, are the only security for the bondholders. The entire amount of the bonds was outstanding at June 30, 2007.

The Authority also issued \$9,500,000 Metropolitan Knoxville Airport Authority Special Obligation Revenue Bonds on October 1, 1980. The 9.5% bonds are to be repaid in varying amounts through 2010. The principal balance outstanding at June 30, 2007, was \$1,188,639.

CITY OF KNOXVILLE, TENNESSEE  
Notes to Financial Statements (Continued)  
June 30, 2007

**NOTE 9 - LONG-TERM DEBT (Continued)**

*Conduit Debt (Continued)*

Under the terms of a promissory note between the Authority and the Knoxville Airport Hotel Company (the "Developer"), the proceeds were used by the Developer to construct a hotel adjacent to the airport terminal. Note principal and interest payments consist of the amount necessary to make the principal and interest payments on the bonds. Under a forbearance agreement dated May 24, 1990, the Developer agreed to pay the other bondholders the sum of the principal currently due on all of the bonds, plus 30 days accrued interest on the bonds held by the bondholders, plus accrued interest on the bonds held by the Developer. On each note payment date thereafter, the Developer will pay all payments due on the note, other than interest on and attributable to the bonds held by the Developer. Interest on and attributable to bonds held by the Developer, together with all previously deferred interest payments, has been irrevocably waived and forgiven.

The Authority has no liability for repayment of these bonds and, accordingly, the bonds are not reported in the Authority's financial statements. The note payments and property are the only security for the bondholders.

**NOTE 10 - LEASES**

**Primary government**

The City was committed to semiannual payments to the Public Building Authority for rental of the City-County Building. The lease expired during 2001 and the City is renting the space on a month-to month basis until a new lease is established. Total rental payments for the year ending June 30, 2007 were \$1,212,930.

**Component units**

The Knoxville Utilities Board has non-cancelable operating lease commitments for office equipment that expire in various years through June 30, 2010. Future minimum lease payments under leases having initial or remaining noncancellable terms in excess of one year as follows:

	Operating Leases
2008	\$ 32,794
2009	4,320
2010	4,299
	\$ 41,413

**NOTE 11 - FUND BALANCES PERMANENTLY RESTRICTED AND DESIGNATED FOR FUTURE USE**

Permanent funds are used to report resources that are legally restricted to the extent that only earnings, not principal, may be used for purposes that support the Primary Government's program. The Krutch Park Trust fund is used to account for the principal trust amounts received and related interest income. The interest portion of the trust can be used for maintenance and groundskeeping of the downtown City park. Therefore, the portion of the permanent fund representing the earnings from the permanent portion of the fund is designated for this purpose. The designated balance as of June 30, 2007 is \$137,831.

**CITY OF KNOXVILLE, TENNESSEE**  
**Notes to Financial Statements (Continued)**  
**June 30, 2007**

**NOTE 12 - PRIOR PERIOD ADJUSTMENT**

As described in Note 1, the City is a participant in a joint venture with Knox County in the operation of the Public Building Authority of the County of Knox and the City of Knoxville, Tennessee (PBA). As mentioned in Note 14, PBA holds title to certain properties used for City and County operations. In addition, PBA holds financial resources that have been obtained from the City and the County pursuant to PBA's operations related to property management and other similar functions performed on behalf of the joint venture participants.

In prior years, the City had not recorded an equity interest in the assets of the joint venture. As a result of a re-examination of the arrangement among the parties, it has been determined that the City should record its equity interest in the net assets of the joint venture. Accordingly, the fund balance of the City Buildings internal service fund as of the beginning of the fiscal year has been restated, as follows:

	City Buildings	Governmental Activities
Fund Balance, as previously reported	\$ 661,501	\$ 287,275,222
Adjustment for equity interest in net financial assets	2,890,687	2,890,687
Fund Balance, as restated	\$ 3,552,188	\$ 290,165,909

**NOTE 13 - RISK MANAGEMENT**

**Primary government**

The City is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Risk Management Fund, an internal service fund, was established to consolidate all of the City's insurance under a comprehensive risk management program.

Revenues come from either the City's General Fund or from inter-fund charges. Revenues are forecasted to match expenses, which include estimated incurred losses from claims, premiums for excess insurance coverage, various taxes and assessments, and administrative operating expenses.

The City insures itself against potential losses by purchasing various types of insurance coverage including fiduciary liability, professional liability, crime coverage, long-term disability, boiler and machinery, and group life coverage. The City insures itself for potential losses as the result of auto liability, general liability, and workers compensation through participation in a risk management pool. The pool requires each participant in the pool to share the liability for claims if the pool becomes insolvent. At present, the City has no indication that it will incur a liability as a result of its participation in the pool. Settled claims have not exceeded the above coverage in any of the past three fiscal years.

***Health Insurance Fund***

The City maintains as an internal service fund, the Health Insurance Fund, to provide medical coverage for City employees and their families with the employees paying a portion of the costs. The City has experienced no significant reduction in insurance coverage from the prior year. Settlements have not exceeded insurance coverage for each of the past three fiscal years.

***Risk Management Fund***

The City maintains, as an internal service fund, the Risk Management Fund, to account for legal claims and judgments incurred by the City. The City is currently the defendant in numerous lawsuits. Of these claims, the City has recorded a liability in the Risk Management Fund of \$10,000,000 for those lawsuits and claims that the City's attorney has advised will result in probable liabilities.

CITY OF KNOXVILLE, TENNESSEE  
Notes to Financial Statements (Continued)  
June 30, 2007

**NOTE 13 - RISK MANAGEMENT (Continued)**

An analysis of claims activity for the years ended June 30, 2007 and 2006 is as follows:

	<u>2007</u>	<u>2006</u>
Claims liability, beginning of year	\$ 8,500,000	\$ 5,592,171
Provision for incurred claims	6,624,821	4,483,214
Payments made on claims	<u>(5,124,821)</u>	<u>(1,575,385)</u>
Claims liability, end of year	<u>\$ 10,000,000</u>	<u>\$ 8,500,000</u>

Additionally, the City's attorney believes that there is a possible liability to the City of approximately \$1,350,000 related to the remaining lawsuits and claims not determined to be probable liabilities. Since the outcome is not probable, a liability has not been recorded for these lawsuits and claims.

Estimated payments on insurance claims pending and claims incurred but not reported at June 30, 2007, were accrued in the financial statements of the fund based on pending claims filed and past experience, calculated in accordance with Governmental Accounting Standards Board Statement No. 10. The current portion of the claims liability is estimated to be \$7.1 million.

**Component units**

*Knoxville Utilities Board*

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

The Knoxville Utilities Board 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.

At June 30, 2007, the amount of these liabilities was \$2,173,264. This liability is the Utilities Board's best estimate based on available information. An analysis of claims activity for the years ended June 30, 2007 and 2006 is as follows:

	<u>2007</u>	<u>2006</u>
Claims liability, beginning of year	\$ 2,275,752	\$ 2,224,622
Provision for incurred claims	12,752,998	13,293,162
Payments made on claims	<u>(12,855,486)</u>	<u>(13,242,032)</u>
Claims liability, end of year	<u>\$ 2,173,264</u>	<u>\$ 2,275,752</u>

*Metropolitan Knoxville Airport Authority*

The Authority is subject to risks that include personal injury, property damage, employee bodily injury, employee theft, employee medical, public officials and employee conduct and workers' compensation. The Authority has purchased insurance policies that transfer these risks, subject to policy limits. Settlements have not exceeded insurance coverage in any of the past three fiscal years.

CITY OF KNOXVILLE, TENNESSEE  
Notes to Financial Statements (Continued)  
June 30, 2007

**NOTE 14 - JOINT VENTURES**

*Public Building Authority*

In 1975, the Authority was formed as a not-for-profit corporation incorporated pursuant to provisions of the Public Building Authority Act of the State of Tennessee and an operating agreement between the City and Knox County. The Authority constructed and presently maintains and operates the City/County Building, which houses the governments of the City and County. The City and County pay rent to the Authority sufficient to meet operating costs with the City responsible for 36.49% of the payments. An eleven-member board comprised of six County appointees and five City appointees operates the Authority. As described in the operating agreement, the City and County acting jointly may terminate the lease when all debt service and other obligations of the Authority have been met. In the event of termination, the City and County shall direct the Authority to whom and in what manner title to the assets is to be transferred. The City retains an equity interest in the joint venture. Complete separate financial statements for the Public Building Authority may be obtained at Room M22, 400 Main Street, Knoxville, TN 37902.

*Knoxville, Knox County, KUB Geographic Information Systems*

The City is a participant in a joint venture with Knox County and its discretely presented component unit, Knoxville Utilities Board, in the operation of the Geographic Information Systems. The Geographic Information Systems was established to create and maintain a digitized mapping system of Knox County. Each of the participants appoints one of the three board members who oversee the operations. In accordance with the terms of the joint venture agreement, payments are shared between the City, Knox County and the Knoxville Utilities Board. The City does not retain an equity interest in the joint venture. Complete separate financial statements for the Geographic Information Systems may be obtained at 606 Main Street, Suite 150, Main Place, Knoxville, TN 37902.

*Knoxville-Knox County Animal Center*

The City is a participant in a joint venture with Knox County in the operation of the Animal Center, which was established to administer the service delivery system for the care of animals. The Animal Center Board consists of eleven members appointed by the Mayor of the City, the Knox County Mayor, the Knox County Commission, and the Knoxville Academy of Veterinary Medicine. The Center's operations are primarily funded by the City and Knox County. Complete separate financial statements for the Animal Center may be obtained at 3201 Division Street, Knoxville, TN 37919.

**NOTE 15 - MANAGEMENT AGREEMENTS**

The City has entered into the following management agreements:

**Knoxville Zoo** - The City entered into a new agreement on July 1, 2001, with Knoxville Zoological Gardens, Inc. whereby Knoxville Zoological Gardens, Inc. shall lease the Zoo to provide for its operation and management. Under terms of the agreement the City shall grant to Knoxville Zoological Park \$855,000 by August 1 each year through 2006.

**Whittle Springs Golf Course** - The City has entered into a contract with Billy Casper Golf, LLC to manage and operate its Whittle Springs Municipal Golf Course from October 25, 2006, to December 31, 2007. Under the terms of the agreement Billy Casper Golf, LLC will receive a base fee of \$5,000 per month and an incentive fee equal to 20% of the annual gross revenues over \$500,000.

CITY OF KNOXVILLE, TENNESSEE  
Notes to Financial Statements (Continued)  
June 30, 2007

**NOTE 15 - MANAGEMENT AGREEMENTS (Continued)**

**Knoxville Municipal Golf Course** - The City entered into an agreement on March 25, 1983, with C. E. Roberts, Inc. to develop and operate the Knoxville Municipal Golf Course from December 23, 1982, to December 23, 2007. Under terms of the lease, Roberts shall remit one dollar per year to the City as well as place 20% of its annual net income in a sinking fund reserved specifically for capital improvements to the golf course.

**Parking Garages** - The City entered into an agreement with the Public Building Authority of the County of Knox and the City of Knoxville, Tennessee (PBA) on August 11, 2005 to manage and operate the State Street, Main Avenue, and Market Square Parking Garages and the Jackson Avenue Parking Lot. The terms of the agreement shall continue until terminated by either party. The terms call for the City and PBA to agree upon an annual budget for the management of the above, said budget to cover direct and indirect costs of PBA relating to the management of the facilities. The amount of this budget in FY 06/07 is \$593,510.

**IJAMS Nature Park** - The City entered into an agreement on August 2, 1993, with the IJAMS Nature Park whereby IJAMS will provide management and operation of a nature park. The agreement has been extended through July 31, 2007. The agreement calls for a management fee of \$109,250.

**Knoxville Convention Center** - The City has negotiated a revised agreement effective July 1, 2006, with SMG to manage the operations of the Convention Center for a period of five years, with an option for an additional five years. The agreement calls for a fixed base fee of \$250,000 in FY 2006/07, and increasing by the CPI each year thereafter. SMG is also to receive an incentive fee each year depending upon the increase in various revenue categories as defined by the contract, but which in no instance exceed the fixed base fee. SMG shall also receive an additional incentive fee based upon various qualitative factors, but which shall not exceed \$50,000 in FY 06/07, said maximum to be annually adjusted by the CPI.

**NOTE 16 - COMMITMENTS AND CONTINGENCIES**

*Primary Government*

**Federal Financial Assistance** - The City participates in a number of federal financial assistance programs. These programs have been audited through June 30, 2007 in accordance with provisions of the Single Audit Act of 1984.

**Urban Growth Plan** - The City and Knox County entered into an agreement that defines City and County growth areas within the County. The agreement prohibits alteration to the Urban Growth Plan through December 31, 2004 and was automatically extended for an additional three years through December 31, 2007. The agreement prohibits the City from annexing certain property for the four-year period unless certain conditions exist. The County agreed to invest \$5,000,000 from its current five-year capital plan for the City to make capital projects within its Empowerment Zone. The County will also designate an additional \$2,000,000 from its capital plan beginning in August, 2005. Should the City take actions resulting in the residential annexation during the period of the agreement, all funds provided to the City by Knox County must be returned to the County within 15 days.

*Knoxville Utilities Board*

**Purchased Gas Adjustments** - Knoxville Utilities Board's gas division purchased gas adjustment mechanism 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 Knoxville Utilities Board's Board of Commissioners. The purchased gas adjustment is intended to ensure 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 purchased gas adjustment is also intended to ensure that no excess or deficient cost recovery from the Division's customers occurs.

CITY OF KNOXVILLE, TENNESSEE  
Notes to Financial Statements (Continued)  
June 30, 2007

**NOTE 16 - COMMITMENTS AND CONTINGENCIES (Continued)**

Under the purchased gas adjustment mechanism, the Division tracks the actual over/under recovered amount in the unrecovered purchased gas costs accounts. These accounts are rolled into the purchased gas rate adjustment on June 30 of each year thereby assuring that any over/under recovered amounts are passed on to the Division's customers. The amount of underrecovered costs was (\$517,567) at June 30, 2007.

**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.

In October 2006, TVA decreased its wholesale power rates for its electric power distributors, including KUB. The PPA was utilized to flow the wholesale cost reduction through KUB's retail rate structures. Residential customers saw a decrease of approximately 3.8 percent; small commercial and industrial customers experienced decreases ranging from 3.5 to 4.4 percent and large commercial and industrial customers saw decreases of 3.9 to 4.3 percent.

TVA implemented a fuel cost adjustment in October 2006 that is applied on a quarterly basis to wholesale power rates. KUB flowed changes to wholesale power rates, from TVA's fuel cost adjustment mechanism, directly through to its retail electric rates via the purchased power adjustment in January and April 2007, respectively.

**Natural Gas Supply Contract Commitments** - For the year ended June 30, 2007, the Gas Division of the Knoxville Utilities Board locked the price on 62% of its total gas purchases via gas supply contracts. As of June 30, 2007, the Gas Division had hedged the price on approximately 37% of its anticipated gas purchases for fiscal year 2008.

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

	2008	2009	2010	2011	2012
Demand:					
Transportation	\$ 15,514,178	\$ 14,841,698	\$ 14,841,698	\$ 12,998,843	\$ 12,998,843
Storage	3,396,910	3,396,910	3,396,910	3,396,910	3,396,910
Demand total	<u>\$ 18,911,088</u>	<u>\$ 18,238,608</u>	<u>\$ 18,238,608</u>	<u>\$ 16,395,753</u>	<u>\$ 16,395,753</u>
Commodity:					
Baseload	<u>\$ 4,315,610</u>	<u>\$ 15,159,990</u>	<u>\$ 4,488,485</u>	<u>\$ -</u>	<u>\$ -</u>

**Other Commitments and Contingencies**

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, achieving the goal of remediation of identified sanitary sewer overflows ("SSOs") on KUB's wastewater system must be completed by June 30, 2016. In addition, KUB is also required to perform an evaluation of the wet-weather performance and capacity of KUB's wastewater treatment plants. The Consent Decree also requires KUB to fund a Supplemental Environmental Project ("SEP") in the amount of \$2 million over an eight-year period, which commenced February 2005. The parties to the Consent Decree include KUB, the Department of Justice, the Environmental Protection Agency, the Tennessee Clean Water Network, and the City of Knoxville.

KUB's funding plan for the Consent Decree includes approximately \$400 million in long-term bond issues plus a series of rate increases phased in over the term of the Consent Decree. The Wastewater Division issued \$140 million in long-term bonds in August 2005 to fund capital improvements for the collection system. To help fund expenditures, the KUB Board of Commissioners also approved two 50 percent rate increases which went into effect April 2005 and January 2007.

**CITY OF KNOXVILLE, TENNESSEE**  
**Notes to Financial Statements (Continued)**  
**June 30, 2007**

**NOTE 17 – OTHER POST-EMPLOYMENT BENEFITS**

Former City employees are allowed to maintain health care coverage comparable to what they had at retirement. Premium payments are the responsibility of the retiree. Once they become eligible for Medicare the benefit terminates. Approximately 225 retirees were eligible to receive such benefits at June 30, 2007. Payments for health insurance including the retiree's portion are expensed through the Health Insurance internal service fund and were approximately \$10 million. Actuarial estimates for future liabilities calculate costs to be greater than or equal to expected liability under GASB 45; therefore, no liability for these benefits is reflected in the financial statements.

In addition to providing pension benefits, KUB provides certain health care and life insurance benefits for retired employees, their spouses and dependent children. The cost of retired health care and life insurance benefits is recognized as expense as claims are paid. Substantially all KUB employees hired on or before July 1, 1999, are eligible for these benefits, if they meet the Rule of 80 upon termination of employment, with a minimum of 20 years of service. Approximately 1,400 retirees and dependents were eligible to receive such benefits at June 30, 2007. KUB's portion of total benefits and related administrative expenses for 2007 was approximately \$5,090,310.

**NOTE 18 - BUSINESS AND CREDIT CONCENTRATIONS**

The Metropolitan Knoxville Airport Authority is dependent to a large extent on three major airlines and their subsidiaries in that a significant portion of aviation area revenue is generated by these airlines. These airlines accounted for \$1,513,131 in aviation area revenue during 2007. In addition, a significant portion of terminal area revenue is directly and indirectly generated from this airline's passengers, which accounted for approximately 47% of total passengers during 2007. As of June 30, 2007 37% of trade accounts receivable are due from these major airlines.

**NOTE 19 - TRANSFERS**

The general fund transfers funds, in accordance with its budget, to supplement revenues of the storm water, solid waste, Knoxville Convention Center, and public assembly facilities funds. Transfers are also made by the general fund to partially fund insurance and employee health insurance costs. The general fund and debt service fund transfer funds to the Knoxville Convention Center to partially fund debt service costs. Transfers from the general fund and state street aid fund are used to partially fund capital outlay costs in the capital projects fund.

Fines and court costs collected by city court are transferred to the general fund and certain special revenue funds based on approved schedules of costs.

The capital projects fund transferred funds to the debt service to fund retirement of the outstanding balance of the City's line of credit.

**CITY OF KNOXVILLE, TENNESSEE**  
**Notes to Financial Statements (Continued)**  
**June 30, 2007**

**NOTE 19 - TRANSFERS (Continued)**

A detailed reconciliation of operating transfers at June 30, 2007 is as follows:

Transfers To:	Transfers From:									Total
	Governmental Activities								Business Type Activities	
	General Fund	Debt Service	Capital Projects	State Street Aid	City Court	Misc. Grants	Misc. Community Developmt	Solid Waste	Public Assembly Facilities	
<b>Primary Government:</b>										
<i>Governmental Activities:</i>										
General Fund	\$ -	\$ -	\$ -	\$ -	\$ 3,933,750	\$ -	\$ -	\$ -	\$ -	\$ 3,933,750
Capital Projects Fund	15,614,460	7,171,160	7,403,789	1,275,000	-	-	10,000	-	-	31,474,409
Miscellaneous Grants	58,872	-	-	-	-	-	-	-	-	58,872
Miscellaneous Special Revenue	1,171,500	-	-	-	-	27,768	-	-	-	1,199,268
Misc. Community Development	90,000	-	-	-	-	-	122,749	-	-	212,749
Storm Water	1,826,110	-	-	-	-	-	-	-	-	1,826,110
Solid Waste	9,017,290	-	-	-	-	-	-	-	-	9,017,290
<i>Business-type Activities:</i>										
Convention Center	3,924,420	4,405,840	-	-	-	-	-	-	-	8,330,260
Public Assembly Facilities	1,842,650	-	-	-	-	-	-	-	-	1,842,650
City Golf Courses	92,164	-	-	-	-	-	-	-	-	92,164
<i>Internal Service Funds:</i>										
Fleet Maintenance	24,627	-	39,932	-	-	106,955	-	-	-	171,514
Risk Management	679,540	-	-	-	-	-	-	-	-	679,540
Employee Health										
Health Insurance	924,168	-	-	-	-	-	-	-	-	924,168
Equipment Replacement	53,837	-	-	-	-	-	-	9,700	3,600	67,137
	<u>\$ 35,319,638</u>	<u>\$ 11,577,000</u>	<u>\$ 7,443,721</u>	<u>\$ 1,275,000</u>	<u>\$ 3,933,750</u>	<u>\$ 134,723</u>	<u>\$ 132,749</u>	<u>\$ 9,700</u>	<u>\$ 3,600</u>	<u>\$ 59,829,881</u>

CITY OF KNOXVILLE, TENNESSEE  
Notes to Financial Statements (Continued)  
June 30, 2007

NOTE 20 - RETIREMENT AND DISABILITY PLANS

Defined Benefit Pension Plans

*City Employees' Pension Plan*

The City also maintains a single-employer defined benefit pension plan (City Employees' Pension Plan), administered by the City of Knoxville Pension Board, which is comprised of three divisions of current membership and a membership of certain former City School employees. All participants are fully vested in the plan after 5 years of service. The plan includes employees of the City of Knoxville.

**Division A** - All employees of the City who were hired on or after January 16, 1963, and prior to July 1, 1997 became members of Division A. Participants of Division A are covered by Social Security. Division A is now a closed plan. Participation in Division A requires employee contributions of 3% of the first \$4,800 of annual earnings and 5% of annual earnings in excess of \$4,800. Division A provides for early retirement benefits with 25 years of service and normal retirement benefits at age 62 or later.

**Division B** - All employees of the City of Knoxville who were employed on January 16, 1963, and who participated in the City Employees' Pension Fund as created by the City of Knoxville Pension Act of 1935, were deemed to be members of Division B of the System unless they elected to transfer to Division A. (This excludes firefighters and police officers who were participants of the Firemen and Policemen Pension Fund created by the Firemen and Police Pension Act of 1929.) Participants of Division B are not covered by Social Security. Division B is now a closed plan and no participants can be added. Participation in Division B requires employee contributions of 4% of annual earnings. Division B provides for retirement benefits after 25 years of service and the attainment of age 50.

**Division C** - All firefighters and police officers employed after January 2, 1971, and those transferring from the Firemen and Policemen Pension Act of 1929 (now Division F) or Division B by election are participants of the Division C Plan. Participants of Division C are covered by Social Security. Participation in Division C requires employee contributions of 6% of annual earnings subject to a maximum of 30 years. Division C provides for retirement benefits after 25 years of service and attainment of age 50. Retirement is compulsory after reaching age 60.

**Division F** - All firefighters and police officers employed prior to January 16, 1963 (former members of the Firemen and Policemen Pension Act of 1929 plan, a "pay-as-you-go" funded plan which terminated as of June 30, 2000) are participants of the Division F Plan. Participants of Division F are not covered by Social Security. Participation in Division F requires employee contributions of 5% of monthly earnings. Division F provides for retirement benefits after 25 years of service and attainment of age 50.

**Division G** - As a condition of employment, each employee hired on or after January 1, 1997 becomes a member of Division G after six months of service. In addition, members who elected to transfer from Division A prior to May 15, 1997, and former non-participants who elected participation prior to May 15, 1997 became members of Division G. Members of Division G are covered by Social Security. Participation in Division G requires employee contributions of 6% of annual earnings. Division G provides for normal retirement benefits at age 62 or later.

CITY OF KNOXVILLE, TENNESSEE  
Notes to Financial Statements (Continued)  
June 30, 2007

**NOTE 20 - RETIREMENT AND DISABILITY PLANS (Continued)**

**Defined Benefit Pension Plans (Continued)**

***City Employees' Pension Plan (Continued)***

**Board of Education Division** - The City of Knoxville School System was abolished effective July 1, 1987 and absorbed into the operations of the Knox County School System. A court ruling has held and the Tennessee Court of Appeals has affirmed that the City is liable for the accrued pension liability, through June 30, 1987, for those former City School employees who remain in the City Employees' Pension Plan. Because of the abolition of the City School System, the Board of Education Division of the City Employees' Pension Plan has, in substance, been terminated. The City is responsible for any unfunded pension liability for the benefits that former City School employees would be entitled to if their earned benefits were frozen at July 1, 1987. No liability existed at June 30, 2007.

Benefit provisions are established in the City's Charter and can be amended by voter referendum. The City of Knoxville Pension Board issues a publicly available financial report that includes financial statements and required supplementary information for the City Employees' Pension Plan. That report may be obtained by writing to the City of Knoxville Pension Board, 917B East Fifth Avenue, Knoxville, Tennessee 37917. The Plan is also included in the reporting entity as a discretely presented fiduciary component unit.

***Annual Pension Costs***

For the year ended June 30, 2007, the annual pension cost for the City and participating component units was \$5,382,627 and was equal to the required and actual contributions. The required contribution was determined as part of the July 1, 2007 actuarial valuation using the aggregate method with supplemental liability for Plan F. Under this method, the unfunded actuarial liability is only identified and amortized for Plan F. Significant actuarial assumptions used in the valuation include (a) rate of return on investment of present and future assets of 8.0% per year compounded annually, (b) annual projected salary increases based on plan experience for employees of 3% with no explicit assumptions made regarding the portion attributable to the effect of inflation on salaries), and (c) projected post retirement increases of 3.5% 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. The unfunded actuarial liability for Plan F is being amortized over 30 years on a closed basis beginning in July 1, 2001.

Trend information for the City's contributions to the City Employees' Pension Plan for the last three years is as follows:

Year Ended June, 30	<u>General Government Divisions A, B and G</u>		<u>Board of Education</u>		<u>Firefighters and Police Divisions C and F</u>		<u>Total City Employees' Pension Plan</u>	
	Annual Pension Cost (APC)	Percentage of APC Contributed	Annual Pension Cost (APC)	Percentage of APC Contributed	Annual Pension Cost (APC)	Percentage of APC Contributed	Annual Pension Cost (APC)	Percentage of APC Contributed
2007	\$1,618,040	100%	\$ -	n/a	\$3,764,587	100%	\$5,382,627	100%
2006	1,133,337	100%	-	n/a	3,077,456	100%	4,210,793	100%
2005	610,584	100%	-	n/a	2,302,822	100%	2,913,406	100%

CITY OF KNOXVILLE, TENNESSEE  
Notes to Financial Statements (Continued)  
June 30, 2007

NOTE 20 - RETIREMENT AND DISABILITY PLANS (Continued)

Defined Benefit Pension Plans (Continued)

*Knoxville Utilities Board Pension 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. The Plan is currently overfunded.

At December 31, 2006, the Plan had 716 retirees and beneficiaries currently receiving benefits and 56 terminated employees entitled to benefits but not yet receiving them. Of the approximately 954 current employees in the Plan, 748 were fully vested at December 31, 2006. 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.

The Plan consists of 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.

All new eligible employees become 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.

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

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% of annual earnings. Plan B provides for retirement benefits after 25 years of service and the attainment of age 50.

CITY OF KNOXVILLE, TENNESSEE  
Notes to Financial Statements (Continued)  
June 30, 2007

NOTE 20 - RETIREMENT AND DISABILITY PLANS (Continued)

Defined Benefit Pension Plans (Continued)

*Knoxville Utilities Board Pension Plan (Continued)*

*Funding Policy and Annual Pension Costs*

For the plan year ended December 31, 2006 the actuarial-accrued liability for the Plan was less than the actuarial value of assets; however, a contribution of \$936,268 is required to be made because the amortization of the negative unfunded actuarial liability is less than the normal cost. The contribution is required to be made during the plan sponsor's fiscal year ending June 30, 2008. The annual required contribution was determined as part of the January 1, 2006 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.

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%, (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 3.21% to 6.26%, and (d) cost of living adjustment of 4% in 2001 and 3% annually for years 2002 through 2006. Use of the RP2000 Mortality Table for 2006 and 2005 in the actuarial valuation represents a change in actuarial assumption from prior years, when the 1983 Group Annuity Mortality Table was used. 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.

Trend information for KUB's contributions to the Plan for the last three years is as follows:

<u>Year Ended</u>	<u>Annual Pension Cost (APC)</u>	<u>Percentage of APC Contributed</u>
December 31, 2006	\$ 936,268	100%
December 31, 2005	710,987	100%
December 31, 2004	-	N/A

CITY OF KNOXVILLE, TENNESSEE  
Notes to Financial Statements (Continued)  
June 30, 2007

**NOTE 20 - RETIREMENT AND DISABILITY PLANS (Continued)**

**Defined Contribution Plans**

*Knoxville Utilities Board*

KUB has a defined contribution 401(k) employee retirement savings plan covering KUB employees who are eligible and elect to participate.

401(k) matching contributions for employees eligible to participate in the KUB Pension Plan were funded by the Pension Plan for the year ended June 30, 2007, using a portion of excess pension assets accumulated during past years. These funds are held by the trustee custodian until necessary for distribution. IRS rules permit the funding of 401(k) matching contributions from excess pension assets for employees covered under the Pension Plan.

KUB funded 401(k) matching contributions of \$0 for the year ended June 30, 2007, for employees not covered under the Pension Plan.

*Metropolitan Knoxville Airport Authority*

The Metropolitan Knoxville Airport Authority provides retirement benefits for all of its full-time employees through a defined contribution plan (Metropolitan Knoxville Airport Authority Plan) which was established and amended under the authority of the Board of Commissioners and is administered by International City Management Association Retirement Corporation. In a defined contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings. Employees are eligible to participate from the date of employment.

The Authority's contributions for each employee (and investment income allocated to the employees' account) are vested after one year of employment. Under the terms of the plan, employer contributions are determined annually by the Board of Commissioners. There are no minimum required employer contributions under the terms of the plan. Employee contributions are optional. Employer contributions totaled \$619,378 in 2007. Employee contributions totaled \$0 in 2007.

*Knoxville Area Transit*

Knoxville Area Transit ("KAT") provides retirement benefits for all of its full-time employees through a defined contribution plan (Knoxville Transit Retirement Plan) which was established and amended under the authority of the Board of Directors and is administered by ERISA Services, Inc. In a defined contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings. Employees are eligible to participate upon attaining a minimum age of twenty-one years and completing one year of eligible service.

KAT's contributions for each employee (and investment income allocated to the employees' account) are vested after five years of employment. Under the terms of the plan, employer contributions are determined annually by the Board of Directors. There are no minimum required employer contributions under the terms of the plan. Employee contributions are optional. Employer contributions totaled \$306,256 in 2007. Employee contributions totaled \$335,366 in 2007.

CITY OF KNOXVILLE, TENNESSEE  
Notes to Financial Statements (Continued)  
June 30, 2007

**NOTE 21 - RELATED PARTY TRANSACTIONS**

Related party transactions are summarized as follows:

Amounts billed by the Knoxville Utilities Board to the City of Knoxville for electric, gas, water and sewer service	\$ 10,239,055
Payments by the Knoxville Utilities Board to the City of Knoxville in lieu of property tax	\$ 11,867,500
Payments by the Knoxville Utilities Board to the City of Knoxville for services provided	\$ 861,441
Subsidies paid by the City to Knoxville Area Transit	\$ 7,158,040