



Memorandum from the Office of the Inspector General

September 29, 2010

Kimberly S. Greene, WT 7B-K

REQUEST FOR FINAL ACTION – AUDIT 2010-13022 – DISTRIBUTOR REVIEW OF
DICKSON ELECTRIC SYSTEM

Attached is the subject final report for your review and action. Your written comments, which addressed your management decision and actions planned or taken, have been included in the report. Please notify us when final action is complete.

Information contained in this report may be subject to public disclosure. Please advise us of any sensitive information in this report that you recommend be withheld.

If you have any questions, or wish to discuss our findings, please contact Andrea L. Williams, Senior Auditor, at (865) 633-7375 or Jill M. Matthews, Deputy Assistant Inspector General, Audits and Support, at (865) 633-7430. We appreciate the courtesy and cooperation received from your staff during the audit.

Robert E. Martin

Robert E. Martin
Assistant Inspector General
(Audits and Inspections)
ET 3C-K

JLM:HAC
Attachment
cc (Attachment):

Steve Byone, WT 4B-K
Peyton T. Hairston, Jr., WT 7B-K
Tom D. Kilgore, WT 7B-K
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OIG File No. 2010-13022



Office of the Inspector General

Audit Report

To the Group President,
Strategy and External
Relations

DISTRIBUTOR REVIEW OF DICKSON ELECTRIC SYSTEM

Audit Team

Andrea L. Williams

Jessica L. Monroe

Stephanie L. Simmons

Audit 2010-13022
September 29, 2010

ACRONYMS AND ABBREVIATIONS

CSA	Central Service Association
FERC	Federal Energy Regulatory Commission
FY	Fiscal Year
kW	Kilowatt
kWh	Kilowatt Hours
OIG	Office of the Inspector General
S&ER	Strategy and External Relations
SIC	Standard Industrial Classification
TVA	Tennessee Valley Authority

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- A. OBJECTIVE, SCOPE, AND METHODOLOGY
- B. LETTER DATED SEPTEMBER 28, 2010, FROM DARRELL L. GILLESPIE TO ROBERT E. MARTIN
- C. MEMORANDUM DATED SEPTEMBER 27, 2010, FROM KIMBERLY S. GREENE TO ROBERT E. MARTIN



Audit 2010-13022 – Dickson Electric System

EXECUTIVE SUMMARY

Why the OIG Did This Review

As part of the annual audit plan, the OIG (Office of the Inspector General) performed a review of the Dickson Electric System, which is a distributor for Tennessee Valley Authority (TVA) power based in Dickson, Tennessee. Annual revenues from electric sales were approximately \$79 million in fiscal year 2009. Dickson does not provide any nonelectric services. The objective of the review was to determine compliance with key provisions of the power contract between TVA and Dickson.

What the OIG Found

Our review of Dickson found improvements were needed in the areas of:

- **Customer Classification** – We identified 71 customer accounts not classified correctly that could impact (1) the proper reporting of electric sales and/or (2) nondiscrimination in providing power to customers. We were unable to estimate the monetary effect of all the classification issues because, in some instances, information was not available; however, for those instances where information was available, the monetary effect on Dickson and TVA would not be significant. Dickson reclassified the 71 customers during the audit.
- **Contract Compliance** – We identified one area where Dickson was not meeting power contract requirements with TVA. Specifically, we found Dickson did not adhere to Federal Energy Regulatory Commission accounting requirements related to correctly classifying five expense accounts. Dickson corrected this issue during the audit.
- **Distributor Internal Controls** – We identified one area where Dickson could strengthen its internal controls. Specifically, we found an improvement could be made in controls over customer contracts by (1) including certification for all manufacturing customers as part of the contract documentation and (2) ensuring customer contract demand matches the contract demand entered in the billing system. Dickson personnel took action to correct these issues during the audit.

In addition, we found Dickson had enough cash on hand at June 30, 2009, to cover actual fiscal year 2010 capital expenditures and provide a cash reserve of about 17 percent, which exceeds TVA's established guidelines for adequate cash reserves of 5 to 8 percent. While TVA has established guidelines to determine if a distributor has adequate cash reserves (cash ratio of 5 percent to 8 percent), TVA has not established guidelines to determine if a distributor's cash reserves are excessive. Based on prior distributor audit findings, TVA is in the process of defining criteria for determining when a distributor's cash reserves are excessive.



Audit 2010-13022 – Dickson Electric System

EXECUTIVE SUMMARY

Finally, we identified a new opportunity to enhance TVA's oversight of the distributors. We found TVA needs to clarify with distributors that the Standard Industrial Classification (SIC) code to determine eligibility for the manufacturing schedules should be the SIC code for the location in the distributor's service area, not the headquarters' or other location's SIC code. We also identified two opportunities that have been reported in previous distributor audits. TVA is in the process of addressing these two findings, which include (1) providing definitive guidance for distributors on what constitutes prudent expenditures and (2) establishing guidelines to determine if a distributor's cash reserves are excessive.

What the OIG Recommends

We recommend the Group President, Strategy and External Relations (S&ER), work with Dickson to ensure Dickson (1) institutes controls to prevent classification issues from recurring and (2) improves internal controls.

In addition, the Group President, S&ER, should clarify with distributors that the SIC code to determine eligibility for the manufacturing schedules should be the SIC code for the location in the distributor's service area, not the headquarters' or other location's SIC code.

Management's Comments

Dickson and TVA management agreed with our recommendations and have taken or are taking actions to address these recommendations. See Appendix B for Dickson's complete response and Appendix C for TVA's complete response.

Auditor's Response

The OIG concurs with the actions taken and planned by Dickson and TVA to correct the identified issues.

BACKGROUND

The Dickson Electric System¹ is a distributor for Tennessee Valley Authority (TVA) power based in Dickson, Tennessee, with revenues from electric sales of approximately \$79 million in fiscal year (FY) 2009. TVA relies on distributors to self-report customer usage and subsequently the amount owed to TVA (Schedule 1). Customers are generally classified as residential, commercial, manufacturing, and lighting. Within these classes are various rate classifications based on the customer type and usage. Table 1 shows the customer mix for Dickson as of June 2009.

Dickson's Customer Mix as of June 2009

Customer Classification	Number of Customers	Revenue	Kilowatt Hours Sold
Residential	27,836	\$43,940,176	448,979,144
General Power – 50 Kilowatt (kW) and Under (Commercial)	4,681	7,049,003.	60,877,129
General Power – Over 50 kW (Commercial or Manufacturing)	391	26,997,597	303,551,886
Street and Athletic	83	633,750	5,971,323
Outdoor Lighting ²	10	502,056	4,540,484
Total	33,001	\$79,122,582	823,919,966

Table 1

The distributors are required to establish control processes over customer setup, rate application, and measurement of usage to ensure accurate and complete reporting to TVA. Dickson, like many other distributors, outsources its billing and invoice processing to a third-party processor, Central Service Association (CSA). Dickson uses CSA's systems to establish and set up new customers, input customer meter information, perform the monthly billing process, and execute customer account maintenance. Additionally, CSA provides Dickson with management reporting capabilities (e.g., exception reports). All other accounting and finance responsibilities are handled by Dickson, which has a Board of Directors providing oversight and a manager and accountant managing the daily activities. Dickson does not provide any nonelectric services.

¹ The wholesale power contract is between the "City of Dickson, Tennessee," and TVA. We will use "Dickson Electric System" rather than the "City of Dickson" in this report.

² This customer count represents those customers who only have Outdoor Lighting accounts with Dickson. No customers at June 30, 2009, had Outdoor Lighting accounts and accounts for other services with Dickson. The kilowatt hours (kWh) sold includes all kWh for all accounts.

FINDINGS

Our review of Dickson found issues involving customer classification that could impact (1) the proper reporting of electric sales and/or (2) nondiscrimination in providing power to customers. In addition, we found Dickson had enough cash on hand at June 30, 2009, to cover actual FY 2010 capital expenditures and provide a cash reserve of about 17 percent. While TVA has established guidelines to determine if a distributor has adequate cash reserves (cash ratio of 5 percent to 8 percent), TVA has not established guidelines to determine if a distributor's cash reserves are excessive.

We also found improvements were needed to comply with contract provisions related to adherence to the Federal Energy Regulatory Commission (FERC) chart of accounts for classifying expense accounts. In addition, we identified an opportunity to strengthen Dickson's internal controls over customer contracts. Finally, as we explain herein, we found certain opportunities to enhance TVA's oversight of the distributors.

PROPER REPORTING OF ELECTRIC SALES AND NONDISCRIMINATION IN PROVIDING POWER TO CUSTOMERS

As discussed below, we identified a customer classification issue that could impact (1) the proper reporting of electric sales and (2) the ability to ensure nondiscrimination in providing power to members of the same rate class.³ We were unable to estimate the monetary effect of all the issues because, in some instances, information was not available; however, for those instances where information was available, the monetary effect on Dickson and TVA would not be significant. Correcting classification issues is important to ensure all customers are placed in the correct rate classification and charged the same rate as other customers with similar circumstances.

Customer Classification Issues

We found 71 customer accounts of 452 customer accounts selected for further review that were not classified properly. The 71 customer accounts were classified as Residential Rate – Schedule RS,⁴ although they should have been

³ Section 5 Resale Rates subsection (a) of the power contract between TVA and Dickson, dated October 15, 1975, states that "power purchased hereunder shall be sold and distributed to the ultimate consumer without discrimination among consumers of the same class and that no discriminatory rate, rebate, or other special concession will be made or given to any consumer, directly or indirectly."

⁴ Under the Residential Rate – Schedule RS adopted by Dickson, customers are classified based on the following requirement: "This rate shall apply only to electric service to a single-family dwelling (including its appurtenances if served through the same meter), where the major use of electricity is for domestic purposes such as lighting, household appliances, and the personal comfort and convenience of those residing herein."

classified under the General Power Rate – Schedule GSA.⁵ The GSA schedule is divided into three parts—Part 1, Part 2, and Part 3—based on electric usage and demand.⁶ The monetary impact of the classification issues below would not be significant to Dickson or TVA. Specifically, we noted:

- Thirty-eight customer accounts were separately metered structures, such as a barn, workshop, shed, etc., that should have been classified as commercial.
- Sixteen customer accounts were group homes. According to TVA personnel, a group home is not considered a single-family dwelling; therefore, the RS schedule does not apply. Group homes should be classified using the appropriate GSA schedule based on usage and demand takings.
- Twelve customer accounts were commercial businesses that should be classified as commercial.
- Five customer accounts were for commercial lighting, such as security lighting at an apartment complex, etc., that should be classified as commercial.

Dickson personnel reclassified the 71 customers from residential to commercial (GSA schedule) in July 2010.

USE OF ELECTRIC SYSTEM REVENUES

Under the TVA power contract, approved uses of revenues from electric system operations, including any surplus, are (1) operating expenses, (2) debt service, (3) tax equivalent payments, and (4) reasonable reserves for renewals,

⁵ Under the General Power Rate – Schedule GSA adopted by Dickson, customers are classified based on the following requirements:

- GSA Part 1 – If (a) the higher of (i) the customer's currently effective contract demand, if any, or (ii) its highest billing demand during the latest 12-month period is not more than 50 kW and (b) customer's monthly energy takings for any month during such period do not exceed 15,000 kWh.
- GSA Part 2 – If (a) the higher of (i) the customer's currently effective contract demand or (ii) its highest billing demand during the latest 12-month period is greater than 50 kW but not more than 1,000 kW or (b) the customer's billing demand is less than 50 kW and its energy takings for any month during such period exceed 15,000 kWh.
- GSA Part 3 – If the higher of (a) the customer's currently effective contract demand or (b) its highest billing demand during the latest 12-month period is greater than 1,000 kW.

⁶ Demand is a measure of the rate at which energy is consumed. The demand an electric company must supply varies with the time of day, day of the week, and the time of year. Peak demand seldom occurs for more than a few hours or fractions of hours each month or year, but electric companies must maintain sufficient generating and transmission capacity to supply the peak demand. Demand charges represent the high costs electric companies pay for generating and transmission capacity that sits idle most of the time. Demand charges are based on the amount of energy consumed in a specified period of time known as a demand interval. Demand intervals are usually 15 or 30 minutes. (Engineering Tech Tips, December 2000, Dave Diezinger, Project Leader, United States Department of Agriculture Forest Service, Technology & Development Program, <http://www.fs.fed.us/eng/pubs/htmlpubs/htm00712373/index.htm>.) For TVA distributors, the commercial and manufacturer Schedules of Rates and Charges direct that metered demand be calculated as "the highest average during any 30-consecutive-minute period of the month of the load metered in kW."

replacements, and contingencies. As discussed further below, we noted Dickson had enough cash on hand at June 30, 2009, to cover actual FY 2010 capital expenditures and provide a cash reserve of about 17 percent. While TVA has established guidelines to determine if a distributor has adequate cash reserves (cash ratio of 5 percent to 8 percent),⁷ TVA has not established guidelines to determine if a distributor's cash reserves are excessive.

As of June 30, 2009, Dickson reported about \$12.9 million in its cash and cash equivalent accounts, and the cash reserve was about 18 percent. According to Dickson's Finance manager, Dickson did not prepare a capital budget during our audit period. According to Dickson's manager, Dickson has developed a formal two-year capital budget for FYs 2011 and 2012. Since Dickson did not have a capital budget for FY 2010, Dickson personnel provided the actual FY 2010 capital expenditures as shown in Table 2 below.

Dickson's FY 2010 Actual Capital Expenditures

Actual Capital Expenditures	Cost
Reclosers and Controls	\$51,378
Transformers and Capacitors	\$172,688
Meters, Meter Bases, and Sockets	\$49,458
Drive-Thru Upgrade and Facility Maintenance	\$10,516
Computers, Servers, and Docks	\$36,101
Six Vehicles	\$115,766
Phone System, Software, and Radios	\$19,601
Total Actual Capital Expenditures	\$455,508

Table 2

When compared to Dickson's actual capital expenditures for FY 2010, the balance in Dickson's cash accounts at June 30, 2009, was enough to pay for these items and leave about \$12.5 million as a reserve, as shown in Table 3. Table 3 also shows Dickson's cash ratio percentage was about 18 percent before accounting for actual FY 2010 capital expenditures and about 17 percent after accounting for them.

Dickson's Cash Accounts Compared to Actual Capital Expenditures

	Cash and Cash Equivalents	Actual Capital Expenditures	Reserve After Actual Capital Expenditures
FY 2009	\$12,915,333	\$455,508	\$12,459,825
Cash Ratio	17.92%		17.29%

Table 3

⁷ TVA reviews the cash ratios of distributors as part of its regulatory rate review function. Cash ratio is calculated as follows:
$$\frac{\text{Cash} + \text{Cash Equivalents}}{\text{Total Variable Expenses (Operations and Maintenance + Purchased Power)}}$$

According to TVA records, over the past five years, Dickson was approved for three rate increases in 2005, 2006, and 2008. Table 4 shows the rate increases received by Dickson and the cash position and cash ratio at June 30 prior to the effective date of the rate change.

Dickson's Rate Increases, Cash Position, and Cash Ratio

Cash on Hand Equivalent to an 8% Cash Ratio	Cash and Cash Equivalents ⁹ and Cash Ratio	Rate Increase ⁸		
		Change in Revenue	Percent	Effective Date
\$4,015,032	\$11,255,445 CR = 22.43%	\$500,000	0.91%	10/01/2005
\$4,488,089	\$12,243,124 CR = 22.00%	\$19,724	0.04%	10/01/2006
\$4,860,816	\$9,161,124 CR = 15.08%	\$1,050,000	1.57%	04/01/2008

Table 4

Distributors usually have cash reserves as a hedge against the risks of unforeseen costs from an aging infrastructure (e.g., equipment failure), potential loss of revenue from the economic impact on commercial and industrial customers, and unpredictable weather. Discussions with Dickson's management indicated their operating philosophy is generally conservative. Several years ago, Dickson used their cash reserves for a large capital project instead of borrowing funds. This caused Dickson to deplete their cash reserves. The current philosophy of Dickson management is to use cash reserves for general operating expenses and small capital projects. For larger capital projects, Dickson management would consider financing to prevent depletion of cash reserves. Dickson management indicated a bond issue would be used to pay for an upcoming Automated Metering Infrastructure project.

CONTRACT COMPLIANCE ISSUE

We noted one area where Dickson was not meeting the requirements of the power contract with TVA. Specifically, we found Dickson did not follow the FERC chart of accounts to correctly classify five expense accounts. One expense account for political activities¹⁰ and four expense accounts for bond amortization were incorrectly classified as operating revenue accounts. We

⁸ These are the rate increases/decreases enacted by the distributor. These increases/decreases do not include any rate increases or decreases made by TVA, including fuel cost adjustments, which were passed through by the distributor to the customer.

⁹ The cash and cash equivalents and cash ratio were computed based on information from Dickson's annual report as of June 30 prior to the effective date of the rate increase.

¹⁰ According to Dickson personnel, this expense was \$5,000 per year for fees paid to a lobbyist in Washington, D.C., to keep Dickson apprised of national issues affecting the utility industry.

determined the operating revenues reported on the distributor annual report submitted to TVA were correct and did not include these five expense accounts. The accounts were reclassified when brought to the attention of Dickson personnel.

DISTRIBUTOR INTERNAL CONTROL ISSUES

We found Dickson's internal controls over customer contracts could be strengthened in three areas. We noted, as described below, customer contracts (1) did not include certification for all manufacturing customers, (2) did not contain the same contract demand entered in the billing system, and (3) were not on file for all customers.

Customer Certification Was Not On File

Certification was not included as part of the contract documentation on file for one of four customers under the Manufacturing Service Rate – Schedule MSB.¹¹ According to the wholesale power contract, a manufacturing schedule customer is required to certify to Dickson that the “major use of electricity is for activities which are classified with a 2-digit Standard Industrial Classification (SIC) Code between 20 and 39, inclusive.” The wholesale power contract also states “certifications of qualifying SIC code status which have been previously supplied under the Manufacturing Credit Agreement shall be deemed sufficient to initially meet the certification requirement of the Manufacturing Schedules.”

Dickson could not provide a Manufacturing Credit Agreement or other documentation for this customer certifying the customer meets the SIC code requirement of the manufacturing schedules. Certifying and documenting a customer meets the SIC code requirement is important to correctly place customers within rate classifications. Dickson personnel subsequently obtained the customer's SIC code certification in August 2010. This certification showed the customer met the SIC code requirements of the manufacturing schedule.

Contract Demand Entered In Billing System Did Not Match Contract

One of 21 GSA Part 3 customer's contract demand did not match the contract demand entered into the billing system for a portion of our audit period. The inconsistency resulted from a contract demand transfer error when the customer declared bankruptcy. According to Dickson's policy, when a customer initiates bankruptcy proceedings, the customer's current account is closed out, and a final bill is prepared. The customer is then required to open a new account; however, the customer is not required to execute a new contract, and the previous contract demand should be transferred to the new account. Dickson properly closed the customer's current account when the customer initiated bankruptcy proceedings.

¹¹ Under the Manufacturing Service Rate – Schedule MSB, customers are classified as MSB where (a) a customer's currently effective contract demand is greater than 5,000 kW but not more than 15,000 kW, and (b) the major use of electricity is for activities conducted at the delivery point serving that customer which are classified with a 2-digit Standard Industrial Classification Code between 20 and 39, inclusive.

However, when Dickson set up the customer's new account, the contract demand amount was not transferred from the previous account to the new account. Dickson personnel recognized the error after six months and corrected the customer's contract demand in the billing system. We noted for the three months during our audit period where the customer's contract demand was not entered into the billing system, the customer's metered demand was close enough to the contract demand amount to (1) classify the customer into the correct rate classification, (2) not require minimum bill provisions¹² to be executed, and (3) not require excess demand billing provisions¹³ to be executed.

Contract Was Not On File

One of 21 GSA Part 3 customers with a contract demand entered into the billing system did not have a contract on file with Dickson. The contract demand amount in the billing system was used to calculate both the monthly demand charge and the minimum bill amount. Dickson subsequently executed a contract with the customer in May 2010 for the contract demand entered in the billing system.

TVA OVERSIGHT OPPORTUNITIES

We found opportunities to enhance TVA's oversight of this distributor. We noted one new oversight opportunity in addition to two issues noted for this distributor which were also reported in previous Office of the Inspector General (OIG) distributor reports. Specifically, we noted TVA has not:

- Clarified with distributors that the SIC code to determine eligibility for the manufacturing schedules should be the SIC code for the location in the distributor's service area, not the headquarters' or other location's SIC code. According to the wholesale power contract between TVA and Dickson, in order to be classified under the manufacturing schedules, a customer must certify the "major use of electricity is for activities conducted at the delivery point serving that customer, which are classified with a 2-digit SIC code between 20 and 39, inclusive."

We found one customer provided an SIC code for the manufacturing certification that was applicable to the company headquarters rather than an SIC code applicable to the location in the Dickson service area. Dickson personnel were not aware that the SIC code had to be for the customer's location in Dickson's service area. Dickson personnel followed up with the customer in May 2010 to determine the SIC code applicable to the location in the Dickson service area. The customer provided an updated certification

¹² Minimum bill provisions are established by the applicable rate schedule and are executed in the billing system when a customer's metered demand does not meet a minimum level when compared to the contract demand.

¹³ Excess demand billing provisions are established by the applicable rate schedule and are executed in the billing system when a customer's metered demand exceeds the customer's contract demand.

applicable to the Dickson location. The certification showed the customer still qualified as a manufacturing customer; however, this issue highlighted the need for TVA to provide clarification to distributors regarding the SIC code a customer must provide in order to properly certify the customer is eligible under the manufacturing schedules.

- Provided definitive guidance for distributors on what constitutes prudent expenditures.
- Established guidelines to determine if a distributor's cash reserves are excessive.

In response to the previous reports, TVA agreed to take corrective actions on these issues. Full discussion of these issues and TVA's planned actions can be found in prior OIG distributor reports on our Web site, www.oig.tva.gov.

RECOMMENDATIONS

We recommend the Group President, Strategy and External Relations (S&ER), work with Dickson to improve compliance with the contract and/or strengthen internal controls. Specifically, Dickson should:

1. Implement procedures to assist in identifying accounts that need to be reclassified as commercial when service starts or changes to a non-residential type (i.e., business or separately metered structure).

Dickson's Response – Dickson agreed with the recommendation and stated review of the customer billing system and customer service application will be utilized to correctly identify customer account classifications. See Appendix B for Dickson's complete response.

TVA Management's Comments – TVA agreed that electric service should be provided in accordance with the availability provisions of the rate schedules. See Appendix C for TVA's complete response.

Auditor's Response – The OIG concurs with the planned actions.

2. Require certification from customers under manufacturing schedules that they meet the requirements of the schedule.

Dickson's Response – Dickson agreed with the recommendation and stated contract documentation will be reviewed on a continuing basis and proper documentation from the customer will be required. See Appendix B for Dickson's complete response.

TVA Management's Comments – TVA agreed that the distributor should follow the wholesale power contract that requires manufacturing schedule

customers certify that their SIC code matches the codes eligible for the manufacturing service rate. See Appendix C for TVA's complete response.

Auditor's Response – The OIG concurs with the planned actions.

The Group President, S&ER, should:

3. Clarify with distributors that the SIC code to determine eligibility for the manufacturing schedules should be the SIC code for the location in the distributor's area, not the headquarters' or other location's SIC code.

TVA Management's Comments – TVA agreed and stated their intent is to send out guidance to all distributors on new SIC code policies that will go into effect as part of the April 2011 rate change. The guidance will reiterate that the SIC code used should be for the location in the distributor's area. The target completion date is April 2011. See Appendix C for TVA's complete response.

Auditor's Response – The OIG concurs with the planned actions.

OBJECTIVE, SCOPE, AND METHODOLOGY

This audit of Dickson Electric System was initiated as a part of our annual workplan. The objective was to determine compliance with key provisions of the power contract between TVA and Dickson including:

- Proper reporting of electric sales by customer class to facilitate proper revenue recognition and billing by TVA.
- Nondiscrimination in providing power to members of the same rate class.
- Use of revenues, including any surplus, for approved purposes, such as:
 - Operating expenses
 - Debt service
 - Tax equivalent payments
 - Reasonable reserves for renewals, replacements, and contingencies

To achieve our objective, we:

- Obtained Dickson's electronic billing information from Central Service Association (CSA) for the audit period. The information was not complete because CSA does not maintain historical rate information for inactive customers. We used the information available to generate reports of exceptions related to classification and metering and conducted further review of documentation or discussed with management.
- Limited our work on internal controls to those control deficiencies identified as contributing to noted instances of noncompliance with the power contract and/or the TVA Act.
- Determined through inquiry and review of documentation whether Dickson had any nonelectric, system-related business interests supported by electric system funds.
- Reviewed disbursements to determine if electric system funds were used for any items not allowed under the TVA power contract.
- Reviewed cash and cash equivalents in relation to planned capital expenditures and other business uses of cash.
- Used nonstatistical sampling methods as needed to perform the tests above.

When evaluating results of our audit work, we used both qualitative and quantitative factors when considering the significance of an item. For the purposes of this audit, the quantitative factor considered in determining an item's significance is whether the item exceeds 3 percent of the average annual purchased power from TVA for the audit period. Also for the purposes of this audit, we considered any errors identified as systemic or intentional as significant.

The scope of the review was for the period July 2007 through June 2009. Fieldwork was conducted May 2010 through August 2010. This performance audit was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.



SERVING BUSINESS, HOME, AND INDUSTRY IN DICKSON, HICKMAN, CHEATHAM, HOUSTON, AND MONTGOMERY COUNTIES SINCE 1935

September 28, 2010

Mr. Robert E. Martin,
Assistant Inspector General
(Audits and Inspections)
TVA Office of the Inspector General
400 West Summit Hill Drive, ET 3C
Knoxville, TN 37902

Re: RESPONSE TO DRAFT AUDIT REPORT 2010-13022 – DISTRIBUTOR REVIEW OF
DICKSON ELECTRIC SYSTEM

Mr. Martin:

Based on recommendations presented by the Office of Inspector General dated September 3, 2010, we have provided the following:

Proper Reporting of Electric Sales and Non-Discrimination in Providing Power to Customers:

1. Customer Classification Issues - Of the 452 customer accounts selected for review, 71 were improperly classified as residential accounts.

Actions taken or planned, and completion dates: After a review of the specifics of each account, DES personnel re-classified the accounts from residential to commercial. (Corrections made July, 2010)

In the future, utilizing the customer billing system and review of application for service, identify the correct classification for each account.

Contract Compliance Issue:

1. Dickson Electric System did not follow the FERC Chart of Accounts to correctly classify five expense accounts.

Actions taken or planned, and completion dates: The expense accounts were re-classified. No further actions are required.

Distributor Internal Control Issues:

1. Customer Certification Was Not On File.

The customer certification was not included as part of the contract documentation for one of four customers under the Manufacturing Service Rate (Schedule MSB). DES obtained the customer's SIC Code Certification August, 2010.

2. Contract Demand Entered in Billing System Did Not Match Contract.

One of twenty-one GSA, Part 3 customers' contract demand did not match the contract demand entered into the billing system. DES personnel identified the error prior to the audit, and made the correction.

3. Contract Was Not On File.

P. O. BOX 627 • DICKSON, TENNESSEE 37056 • PHONE: (615) 448-9051

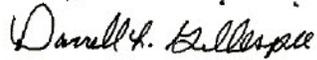
Mr. Robert Martin
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One of twenty-one GSA, Part 3 customers with a contract demand entered into the billing system did not have a contract on file with Dickson Electric System. DES personnel identified the error and executed a contract with the customer May, 2010.

Actions taken or planned, and completion dates: DES corrected errors and deficiencies identified. DES will continually review the status of customer accounts, and require proper documentation from the customer.

We appreciate the OIG personnel's time and effort in the preparation of the distribution review. If you have any questions or comments, please feel free to contact us.

Sincerely,



Darrell L. Gillespie, General Manager

/HTP

September 27, 2010

Robert E. Martin, ET 3C-K

RESPONSE TO DRAFT AUDIT REPORT 2010-13022 – DISTRIBUTOR REVIEW OF
DICKSON ELECTRIC SYSTEM

This is in response to your memorandum dated September 3, 2010.

Agreement or disagreement with all facts, conclusions, and recommendations are stated first, followed by the actions planned or taken and completion dates for each of the recommendations.

Recommendations

1. Implement procedures to assist in identifying accounts that need to be reclassified as commercial when service starts or changes to a nonresidential type.
 - o TVA management agrees that electric service should be provided in accordance with the availability provisions of the rate schedules.
 - o **Actions taken or planned, and completion dates:** The distributor has addressed the 71 customers that the Office of the Inspector General (OIG) identified.
2. Require certification from customers under manufacturing schedules that they meet the requirements of the schedule.
 - o TVA management agrees that the distributor should follow the wholesale power contract which requires the manufacturing schedule customer to certify that their SIC code matches codes eligible for the manufacturing service rate.
 - o **Actions taken or planned, and completion dates:** The distributor has obtained the certification from the one customer that did not have this certification.

The Group President, Strategy & External Relations, should:

3. Clarify with distributors that the SIC code to determine eligibility for the manufacturing schedules should be the SIC code for the location in the distributor's area, not the headquarter's code or other locations' SIC code.
 - o TVA management intends to send out guidance to all distributors on new policies on SIC codes that will go into effect as part of the rate change in April 2011. The guidance will reiterate that the SIC code used should be for the location in the distributor's area. The target completion date for this is April 2011.



Kimberly S. Greene
Group President
Strategy and External Relations
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September 27, 2010

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