



**Memorandum from the Office of the Inspector General**

February 8, 2011

Kimberly S. Greene, WT 7B-K

**REQUEST FOR FINAL ACTION – AUDIT 2010-13024 – DISTRIBUTOR AUDIT OF  
NEWPORT UTILITIES**

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 me or Melissa M. Neusel, Acting Director, Distributor Audits, at (865) 633-7357. 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

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Attachment  
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OIG File No. 2010-13024



Office of the Inspector General

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## *Audit Report*

To the Group President,  
Strategy and External  
Relations

# **DISTRIBUTOR AUDIT OF NEWPORT UTILITIES**

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Audit Team  
Jennifer R. Torregiano  
Jessica L. Monroe

Audit 2010-13024  
February 8, 2011

## **ACRONYMS AND ABBREVIATIONS**

FCA	Fuel Cost Adjustment
FERC	Federal Energy Regulatory Commission
FY	Fiscal Year
kW	Kilowatt
kWh	Kilowatt Hours
MW	Megawatt
NISC	National Information Solutions Cooperative
OIG	Office of the Inspector General
TVA	Tennessee Valley Authority

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## Audit 2010-13024 – Newport Utilities

### EXECUTIVE SUMMARY

#### Why the OIG Did This Audit

As part of the annual audit plan, the OIG (Office of the Inspector General) performed an audit of Newport Utilities, a distributor for Tennessee Valley Authority (TVA) power based in Newport, Tennessee. Annual revenues from electric sales were approximately \$50 million in fiscal year 2009. Newport also operates nonelectric businesses, which are water and sewer utilities. The objective of the audit was to determine compliance with key provisions of the power contract between TVA and Newport.

#### What the OIG Found

Our audit of Newport found improvements were needed in the areas of:

- **Customer Classification** – We identified 56 customer accounts, of 392 customer accounts selected for further review, 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 Newport and TVA would not be significant. According to Newport personnel, 52 of the 56 customer accounts were reclassified during the audit.
- **Contract Compliance** – We identified two areas where Newport was not meeting power contract requirements with TVA. Specifically, we found Newport (1) had three customers without an effective and/or signed contract for all 24 months of the audit period and (2) did not follow the Federal Energy Regulatory Commission (FERC) chart of accounts to correctly classify certain accounts. According to Newport personnel, the accounts were corrected to comply with FERC during the audit. In addition, after the exit conference, Newport provided signed contracts covering the audit period for two of the three customers.
- **Distributor Internal Controls** – We identified one area where Newport could strengthen internal controls. Specifically, we found an improvement could be made by implementing a corrected program code to ensure customers with estimated meter readings receive a refund for previously granted fuel cost adjustment amounts when the account is adjusted for actual usage.

In addition, we found Newport had enough cash on hand to provide a cash reserve equivalent to a cash ratio of about 8 percent, which is within TVA's established guidelines for an adequate cash ratio of 5 to 8 percent.



## Audit 2010-13024 – Newport Utilities

### EXECUTIVE SUMMARY

Finally, we identified one opportunity to enhance TVA's oversight of the distributors reported in previous distributor audits. TVA is in the process of addressing this finding by developing definitive guidance for distributors on what constitutes prudent expenditures.

#### What the OIG Recommends

We recommend the Group President, Strategy and External Relations, work with Newport to (1) implement procedures to prevent classification issues from recurring, (2) comply with various contract provisions related to documentation of customer contracts, and (3) strengthen internal controls.

#### Management's Comments

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

#### Auditor's Response

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

## **BACKGROUND**

Newport Utilities<sup>1</sup> is a distributor for Tennessee Valley Authority (TVA) power based in Newport, Tennessee, with revenues from electric sales of approximately \$50 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 Newport as of June 2009.

**Newport's Customer Mix as of June 2009**

<b>Customer Classification</b>	<b>Number of Customers</b>	<b>Revenue</b>	<b>Kilowatt Hours (kWh) Sold</b>
Residential	17,384	\$24,572,248	250,332,836
General Power – 50 kW and Under (Commercial)	3,859	5,148,173	44,892,896
General Power – Over 50 kW (Commercial or Manufacturing)	227	19,327,153	242,852,158
Street and Athletic	45	317,831	2,465,532
Outdoor Lighting <sup>2</sup>	147	638,692	5,355,224
<b>Total</b>	<b>21,662</b>	<b>\$50,004,097</b>	<b>545,898,646</b>

**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. Newport utilizes a software package from a third-party processor, National Information Solutions Cooperative (NISC). Prior to March 2008, Newport used an in-house system for billing and invoice processing. Newport currently uses NISC systems to establish and set up new customers, input customer meter information, perform the monthly billing process, and execute customer account maintenance. Additionally, the prior in-house system included and the current NISC system includes management reporting capabilities (e.g., exception reports). All other accounting and finance responsibilities are handled by Newport, which has a Board of Directors providing oversight and a manager and accountant managing the daily activities. Newport also operates nonelectric businesses, which are water and sewer utilities.

<sup>1</sup> The wholesale power contract is between the "Town of Newport, Tennessee," and TVA. We will use "Newport Utilities" rather than the "Town of Newport, Tennessee," in this report.

<sup>2</sup> The "Number of Customers" represents those customers who only have Outdoor Lighting accounts with Newport at June 30, 2009. In addition, another 5,926 customers had Outdoor Lighting accounts as well as accounts for other services. However, the totals for "Revenue" and "Kilowatt Hours Sold" include both categories of Outdoor Lighting customers.

## **FINDINGS**

Our audit of Newport found one issue involving customer classifications that could impact (1) the proper reporting of electric sales and/or (2) nondiscrimination in providing power to consumers of the same rate class. In addition, we found Newport had enough cash on hand to provide a cash reserve equivalent to a cash ratio of about 8 percent, which is within TVA's established guidelines for an adequate cash ratio of 5 to 8 percent.

We also found improvements were needed to comply with contract provisions regarding (1) maintenance of written customer contracts and (2) adherence to the Federal Energy Regulatory Commission (FERC) chart of accounts for classifying certain accounts. In addition, we identified one area where Newport could strengthen internal controls. Finally, we found an opportunity to enhance TVA's oversight of distributors. This opportunity was also reported in previous Office of the Inspector General (OIG) distributor audit reports, and TVA has agreed to take corrective action.

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

As discussed below, we identified one customer classification issue that could impact (1) the proper reporting of electric sales and/or (2) the ability to ensure nondiscrimination in providing power to members of the same rate class.<sup>3</sup> We were unable to estimate the monetary effect of the issue because, in some instances, information was not available; however, for those instances where information was available, the monetary effect on Newport and TVA would not be significant. However, 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 Issue**

We found 56 customer accounts, of 392 customer accounts selected for further review, that were not classified properly. The 56 customer accounts were classified as Residential Rate – Schedule RS,<sup>4</sup> although they should have been

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<sup>3</sup> Section 5 Resale Rates subsection (a) of the power contract between TVA and Newport, dated December 14, 1979, 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."

<sup>4</sup> Under the Residential Rate – Schedule RS adopted by Newport, customers are classified based on the following requirements: "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.<sup>5</sup> The GSA schedule is divided into three parts—Part 1, Part 2, and Part 3—based on electric usage and demand.<sup>6</sup> The monetary impact of the classification issues below would not be significant to Newport or TVA. Specifically, we noted:

- Forty-two customer accounts were separately metered structures, such as a barn, workshop, shed, etc., that should be classified as commercial.
- Ten customer accounts were commercial businesses that should be classified as commercial.
- Four customer accounts were for commercial lighting, such as security lighting that should be classified as commercial.

According to Newport personnel, 52 of the 56 accounts were reclassified from residential to commercial (GSA schedule) as of August 2010. The four commercial lighting accounts were still being investigated by Newport personnel. Newport plans to adjust customer bills for inaccurate charges resulting from the misclassifications.

## 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, replacements, and contingencies. As discussed on the following page, we noted Newport had enough cash on hand at June 30, 2009, to cover estimated FY 2010 capital expenditures and provide a cash reserve equivalent to a cash

<sup>5</sup> Under the General Power Rate – Schedule GSA adopted by Newport, 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.

<sup>6</sup> 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."

ratio of about 8 percent, which is within TVA's established guidelines for an adequate cash ratio of 5 to 8 percent.<sup>7</sup>

As of June 30, 2009, Newport reported about \$8 million in its cash and cash equivalent accounts. Newport personnel provided the planned FY 2010 capital expenditures as shown in Table 2 below.

### Newport's FY 2010 Planned Capital Expenditures

Planned Capital Expenditures	Project Cost
Transmission Plant	\$3,160,000
Distribution	\$3,149,754
General Plant	\$215,500
<b>Total Planned Capital Expenditures</b>	<b>\$6,525,254</b>

Table 2

In May 2010, Newport personnel indicated \$2.2 million of the "Transmission Plant" project had been delayed, but all other projects were completed or scheduled for completion by fiscal year-end (June 30, 2010). Therefore, estimated capital expenditures for FY 2010 were approximately \$4,325,254.

When compared to Newport's estimated capital expenditures for FY 2010, the balance in Newport's cash accounts at June 30, 2009, was enough to pay for these projects and leave a reserve of about \$3.68 million, as shown in Table 3. Table 3 also shows Newport's cash ratio percentage was about 17.5 percent before accounting for estimated FY 2010 capital expenditures and about 8 percent after accounting for them.

### Newport's Cash Accounts Compared to Estimated Capital Expenditures

	Cash and Cash Equivalents	FY 2010 Estimated Capital Expenditures	Reserve After FY 2010 Estimated Capital Expenditures
<b>FY 2009</b>	\$8,006,585	\$4,325,254	\$3,681,331
<b>Cash Ratio</b>	17.5%		8.05%

Table 3

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

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

### Newport's Rate Increases/Decreases, Cash Position, and Cash Ratio

Cash on Hand Equivalent to an 8% Cash Ratio	Cash and Cash Equivalents <sup>8</sup> and Cash Ratio	Rate Increase/Decrease <sup>9</sup>		
		Change in Revenue	Percent	Effective Date
\$3,081,490	\$14,276,947 CR = 24.2%	\$17,664	.04%	07/1/2008
\$7,991,429	\$13,647,685 CR=26.7%	\$(41,237)	(.01)%	10/1/2005

Table 4

Discussions with Newport management indicated their operating philosophy is generally conservative. Newport management prefers maintaining cash reserves and limiting the use of financing.

## CONTRACT COMPLIANCE ISSUES

We identified two areas where Newport was not meeting the power contract requirements with TVA. Specifically, we found Newport (1) had three customers without an effective and/or signed contract for all 24 months of the audit period and (2) did not follow the FERC chart of accounts to correctly classify two accounts. Below is further discussion on these items.

### Customer Contracts When Demand Exceeds Threshold

We found Newport did not have customer contracts for all customers with demand above one megawatt (MW) for the entire audit period. Specifically, we found the GSA schedule from TVA requires all customers who exceed 50 kW per month to sign a formal contract. However, TVA management, in response to previous reports, indicated the threshold of 50 kW for requiring customer contracts is too low. TVA management will recommend to the TVA Board that a new and higher threshold be established as part of the rate change process with distributors.<sup>10</sup> In further discussions with TVA personnel, the proposed threshold for requiring a contract is 1 MW.

<sup>8</sup> The cash and cash equivalents and cash ratio were computed based on information from Newport's annual report as of June 30 prior to the effective date of the rate increase/decrease.

<sup>9</sup> 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.

<sup>10</sup> When the rate change is put into effect, all retail customers above the new threshold will be expected to have executed contracts. Target completion date will coincide with the rate change efforts that are currently under way with the distributors and is expected to be in place by April 2011.

We found three of ten customer accounts with metered demand in excess of 1 MW did not have an effective contract for all 24 months of our audit period, and the preceding contract was not maintained as part of the contract documentation. Newport provided a copy of each customer's current contract; however, two of the customers' contracts were not signed.<sup>11</sup> Maintenance of customer contract documentation is important to ensure customers are correctly classified and billed in accordance with the contract terms.

After the Newport exit conference, Newport personnel provided copies of signed contracts covering the missing portion(s) of the audit period for two of the three customers. Therefore, we were unable to obtain a signed contract effective for all 24 months of our audit period for one customer.

### **FERC Compliance**

We noted two instances where Newport's accounting records did not follow the FERC chart of accounts to correctly classify two accounts. Specifically, we found (1) one accrued liability account was recorded in an incorrect account, and (2) one payable account (with 23 subaccounts) was recorded in an incorrect account. We determined the accounts were reported correctly on the distributor annual report submitted to TVA. According to Newport personnel, the two accounts (including the 23 associated subaccounts), as well as an additional subaccount identified by Newport, were reclassified to comply with FERC during the audit.

## **DISTRIBUTOR INTERNAL CONTROL ISSUE**

We found Newport's internal controls could be strengthened in one area. Specifically, we found improvements could be made with respect to remediating a NISC programming error that resulted in customers not receiving correct refunds. According to Newport, occasionally monthly meter readings were estimated for certain accounts (e.g., new account, missed meter readings). The next month, when an actual meter reading was obtained and the account was adjusted, the resulting usage could be negative. We noted 30 customer accounts with negative usage (kWh) at some point during the audit period. We determined the appropriate charges were applied to each of these accounts on the estimated usage amounts, and when the account was adjusted, the appropriate amounts were refunded on the accounts' power bill, except for the fuel cost adjustment (FCA). We found 29 of the 30 accounts did not receive a refund for the FCA.

Newport personnel identified an error in NISC's programming code causing customers with negative usage (kWh) to receive a refund for all applicable charges except the FCA. Newport personnel manually credited the one customer account when it was discovered and indicated they would manually credit other accounts as they were identified. While the amount would not be

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<sup>11</sup> The contract for one of these customers was dated September 1, 2009, which is after our audit period, and it was not signed.

significant to TVA and Newport, it is important to correct this programming error to ensure customers receive appropriate refunds.

After the exit conference, Newport personnel provided documentation indicating, as of November 24, 2010, NISC had found the programming error and was correcting the program code.

## **TVA OVERSIGHT OPPORTUNITY**

We found one opportunity to enhance TVA's oversight of this distributor that has been reported in previous OIG distributor reports. Specifically, we noted TVA has not provided definitive guidance for distributors on what constitutes prudent expenditures.

In response to the previous reports, TVA agreed to take corrective action on this issue. Full discussion of this issue and TVA's planned actions can be found in prior OIG distributor reports on our Web site, [www.oig.tva.gov](http://www.oig.tva.gov).

## **RECOMMENDATIONS**

We recommend the Group President, Strategy and External Relations, work with Newport to improve compliance with the contract and/or strengthen internal controls. Specifically, Newport should:

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

**Newport's Response** – Newport agreed with the recommendation and stated all 56 customer accounts identified during the audit were reclassified, and 36-month adjustments were made on all but 4 accounts. The last 4 accounts will be adjusted before April 2011. Newport stated they requested search guidelines from the OIG to identify rate class misclassifications and, based on these guidelines, they will require NISC to implement reports to review rate classes on a yearly basis. See Appendix B for Newport's complete response.

**TVA Management's Comments** – TVA agreed the power contract requires consistent classification of customers in accordance with the provisions of the applicable rate schedule. 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 and provided Newport with a listing of criteria used to identify residential customer misclassifications.

2. Ensure all customers who require a contract have a signed/executed contract and maintain contract documentation for at least four years after expiration in accordance with FERC guidelines.

**Newport's Response** – Newport agreed with the recommendation and will be executing a signed contract, before April 2011, with the customer that was missing documentation. The distributor has purchased scanning equipment and implemented procedures that will permanently attach the contract to the customer record. See Appendix B for Newport's complete response.

**TVA Management's Comments** – TVA agreed the resale rate schedules of the power contract required the distributor to obtain retail contracts with all customers whose contract demand exceeds 1,000 kW. According to TVA management, the distributor is not required by the power contract to maintain contract documentation in accordance with the FERC periods of retention. However, TVA recommends the distributor follow either FERC recommended retention period of four years for contracts or a retention period set by their independent auditor. Implementation of this recommendation has occurred. See Appendix C for TVA's complete response.

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

3. Implement corrected program code to ensure customers with negative usage (kWh) receive a refund for amounts applicable to the FCA and identify and credit customers who previously did not receive an FCA refund.

**Newport's Response** – Newport agreed with the recommendation and worked with NISC to correct the program in December 2010. All customers previously billed in error will be corrected by April 2011. See Appendix B for Newport's complete response.

**TVA Management's Comments** – TVA agreed the power contract requires that the distributor sell power to its customers in accordance with the rates and charges set forth in the applicable resale rate schedules. 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 Newport Utilities 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 Newport including:

- Proper reporting of electric sales by customer class to facilitate proper revenue recognition and billing by TVA.
- Nondiscrimination in providing power to consumers to 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 electronic billing data for the audit period. To validate the reliability of the billing data, we compared the data to the information reported to TVA on the Schedule 1. No significant differences were noted, therefore, the data was deemed reliable.
- Performed queries on data to identify classification, metering, and contract compliance issues. We reviewed results of the queries and, using nonstatistical sampling, selected accounts for further analysis and follow-up to determine whether misclassification, metering issues, or noncompliance with contract requirements occurred. Since nonstatistical sampling was used, projection of the results was not appropriate.
- Limited our work on internal control 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 Newport had any nonelectric, system-related business interests supported by electric system funds.
- Obtained disbursements listing for the audit period. We reviewed and analyzed disbursements to identify instances where electric system funds may have been used for purposes not allowed under the TVA power contract. We used nonstatistical sampling to select questionable disbursements for further analysis and follow-up. Since nonstatistical sampling was used, projection of the results was not appropriate.
- Reviewed cash and cash equivalents in relation to planned capital expenditures and other business uses of cash.

## **OBJECTIVE, SCOPE, AND METHODOLOGY (cont.)**

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. For this audit, the amount was \$1,141,721. Also for the purposes of this audit, we considered any errors identified as systemic or intentional as significant.

The scope of the audit was for the period July 2007 through June 2009. Fieldwork was conducted May 2010 through October 2010 and included visiting the distributor's offices in Newport, Tennessee. 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.





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January 10<sup>th</sup>, 2011

Robert E. Martin, ET 3C-K  
TVA

RESPONSE TO DRAFT AUDIT REPORT 2010-13024 – DISTRIBUTOR AUDIT OF NEWPORT UTILITIES

This is in response to your memorandum dated December 14, 2010.

Recommendations from the OIG are stated first, followed by Newport Utilities actions planned or taken and completion dates for each of the 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 (i.e., business or separately metered structure)
  - **In Agreement**
  - **Actions taken or planned, and completion dates:** Distributor has reclassified all of the 56 customer accounts that were found during the audit. We have made 36 month adjustments on all but 4 accounts, the last 4 accounts will be adjusted before April 2011. We have requested search guidelines from the OIG office to identify rate class misclassifications and based on these guidelines we will require our software provider (NISC) to implement reports to review rate classes on a yearly basis.
  
2. Ensure all customers who require a contract have a signed/executed contract and maintain contract documentation for at least four years after expiration in accordance with FERC guidelines.
  - **In Agreement**
  - **Actions taken or planned, and completion dates:** Distributor has sent signed contracts back to the OIG office for all but one of the customers that were missing contract documentation. We will be executing a signed contract with the customer that was missing documentation before April 2011. NU has purchased scanning equipment and implemented procedures that will permanently attach contracts to the customer record.



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3. Implement corrected program code to ensure customers with negative usage (kwh) receive a refund for amounts applicable to the FCA and identify and credit customers who previously did not receive an FCA refund.

- **In Agreement**
- **Actions taken or planned, and completion dates:** Distributor worked with our software provider (NISC) and the program was corrected in December, 2010. Accounts will no longer bill negative usage for FCA. All customers previously billed in error will be corrected by April 2011.

Sincerely,

A handwritten signature in black ink that reads "Sherry M. Frisbee".

Sherry M. Frisbee  
Manager of Finance and Accounting  
Newport Utilities  
PO Box 519  
Newport, TN 37822

cc: Kimberly S. Greene  
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Knoxville, Tennessee 37902-1401

January 24, 2011

Robert E. Martin, ET 3C-K

REVISED RESPONSE TO DRAFT AUDIT REPORT 2009-12594 – DISTRIBUTOR  
REVIEW OF NEWPORT UTILITIES

This is in response to your memorandum to Kim Greene dated December 14, 2010. We have revised our response to recommendation number 2. The responses to all other recommendations are unchanged.

**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.**

A. 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 (i.e., business or separately metered structure).
  - TVA management agrees that the power contract requires consistent classification of customers in accordance with the provisions of the applicable rate schedule.
  - **Actions taken or planned, and completion dates:** Newport is currently working to remedy inaccurate account charges for four of their commercial lighting accounts. The planned completion date is April 2011.
2. Ensure all customers who require a contract have a signed/executed contract and maintain contract documentation for at least four years after expiration in accordance with Federal Energy Regulatory Commission (FERC) guidelines.
  - TVA management agrees that the resale rate schedules of the power contract require the distributor to obtain retail contracts with all customers whose contract demand exceeds 1,000 kW. However, the distributor is not required by the power contract to maintain contract documentation in accordance with the FERC periods of retention listed in 18 CFR Part 125.3. The power contract only requires that the distributor keep the general books of accounts of the electric system according to the FERC Uniform System of Accounts. TVA recommends that the distributor follow either FERC recommended retention period of four years for contracts or a retention period set by their independent auditor.
  - **Actions taken or planned, and completion dates:** The distributor has implemented procedures for contract documentation and retention.

Robert E. Martin  
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January 24, 2011

3. Implement corrected program code to ensure customers with negative usage (kWh) receive a refund for amounts applicable to the fuel cost adjustment (FCA) and identify and credit customers who previously did not receive an FCA refund.
  - o TVA management agrees with this recommendation. The power contract requires the distributor sell power to its customers in accordance with the rates and charges set forth in the applicable resale rate schedules.
  - o **Actions taken or planned, and completion dates:** Accounts will no longer bill negative usage for FCA. All customers previously billed in error are being corrected. The target completion date is April 2011.



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