



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

August 28, 2013

Robert B. Wells, WT 9B-K C

**REQUEST FOR FINAL ACTION – AUDIT 2013-14966 – OVERSIGHT AUDIT OF  
DISTRIBUTOR COMPLIANCE GROUP**

Attached is the subject final report for your review and final action. Your written comments, which addressed your management decision and actions planned, 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 Melissa M. Neusel, Audit Manager, at (865) 633-7357 or Rick C. Underwood, Director, Corporate Governance and Finance Audits, at (423) 785-4824. We appreciate the courtesy and cooperation received from your staff during the audit.

David P. Wheeler  
Deputy Assistant Inspector General  
(Audits)  
ET 3C-K

MMN:BSC  
Attachment  
cc (Attachment):

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OIG File No. 2013-14966



Office of the Inspector General

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## *Audit Report*

To the Vice President,  
Compliance and Policy  
Governance

# **OVERSIGHT AUDIT OF DISTRIBUTOR COMPLIANCE GROUP**

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Audit Team

Melissa M. Neusel  
Julie A. Poteet  
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Audit 2013-14966  
August 28, 2013

## **ABBREVIATIONS**

FY	Fiscal Year
IIA	Institute of Internal Auditors
OIG	Office of the Inspector General
RRA	Retail Regulatory Affairs
SVP	Senior Vice President
TVA	Tennessee Valley Authority

**TABLE OF CONTENTS**

EXECUTIVE SUMMARY ..... i

BACKGROUND..... 1

OBJECTIVES, SCOPE, AND METHODOLOGY ..... 2

FINDINGS ..... 3

    POSITIVE ATTRIBUTES OF DISTRIBUTOR COMPLIANCE  
    ASSESSMENTS ..... 3

    AREAS NEEDING IMPROVEMENT ..... 5

    SEGREGATION BETWEEN GROUPS IS ADEQUATE..... 10

RECOMMENDATIONS ..... 10

**APPENDICES**

- A. OBJECTIVES, SCOPE, AND METHODOLOGY
- B. MEMORANDUM DATED AUGUST 27, 2013, FROM ROBERT B. WELLS TO  
    DAVID P. WHEELER



# Audit 2013-14966 – Oversight Audit of Distributor Compliance Group

## EXECUTIVE SUMMARY

### Why the OIG Did This Audit

The Tennessee Valley Authority (TVA) established a Distributor Compliance department within the Compliance Office in the spring of 2011 to perform assessments and assist TVA management and the TVA Board of Directors in determining whether distributor customers were in compliance with the TVA Wholesale Power Contract and other regulatory policy.

We performed an oversight audit of Distributor Compliance assessments completed through December 31, 2012, to determine if (1) the assessments were adequately planned and performed to verify distributors' compliance with key provisions of the Wholesale Power Contract, (2) the assessments were performed in accordance with the Distributor Compliance *Charter* and applicable policies, and (3) there was adequate segregation between the groups charged with developing, interpreting, and implementing TVA's retail regulatory policy (Retail Regulatory Affairs) and assessing distributor compliance with TVA's regulatory policies and procedures (Distributor Compliance).

### What the OIG Found

Our audit of the Distributor Compliance assessments issued through December 31, 2012, found several positive attributes in Distributor Compliance's planning and performance of assessments but also noted areas where changes are needed to improve (1) planning and performance and (2) compliance with the Distributor Compliance *Charter* and other applicable professional standards and policies regarding the assessment reports. More specifically, we noted:

- Scope statements in reports did not always reflect the actual information that was reviewed in assessments.
- Documentation of sampling methodologies was inadequate.
- Sampling methodologies could be modified to provide more assurance assessment objectives are met.
- Some issues were not formally reported and tracked.
- Recommendations did not always help detect and/or prevent identified issues from recurring.
- Testing for misclassified residential accounts is not currently being performed.



## Audit 2013-14966 – Oversight Audit of Distributor Compliance Group

### EXECUTIVE SUMMARY

- Currently, distributors are not made aware of all issues identified during assessments.

Finally, we determined there is adequate segregation between Retail Regulatory Affairs and Distributor Compliance. However, certain work that is being performed by each TVA group at the distributors is duplicative in nature.

#### What the OIG Recommends

We recommend TVA's Director, Distributor Compliance:

1. Include testing for other provisions in Section 5(b), paragraph 2 of the Power Contract in all assessments.
2. Include testing to identify penalty exempt accounts in all assessments.
3. When possible, select a sample containing items from across the population instead of from a subset of the population.
4. Fully document sampling methodology in workpapers and report, including details on when replacement samples will be used and at what error rate a sample will be expanded.
5. Review and update process(es) for ensuring all applicable issues are included in the report.
6. Include recommendations that help improve distributors' compliance with the Power Contract by detecting and/or preventing identified issues or errors from recurring in the future.
7. Include testing for potentially misclassified residential customers in all assessments.
8. Inform distributors of all issues identified during assessments.

#### TVA Management's Comments

TVA Management agreed with our recommendations and will be implementing changes to address all recommendations by November 30, 2013.

#### Auditor's Response

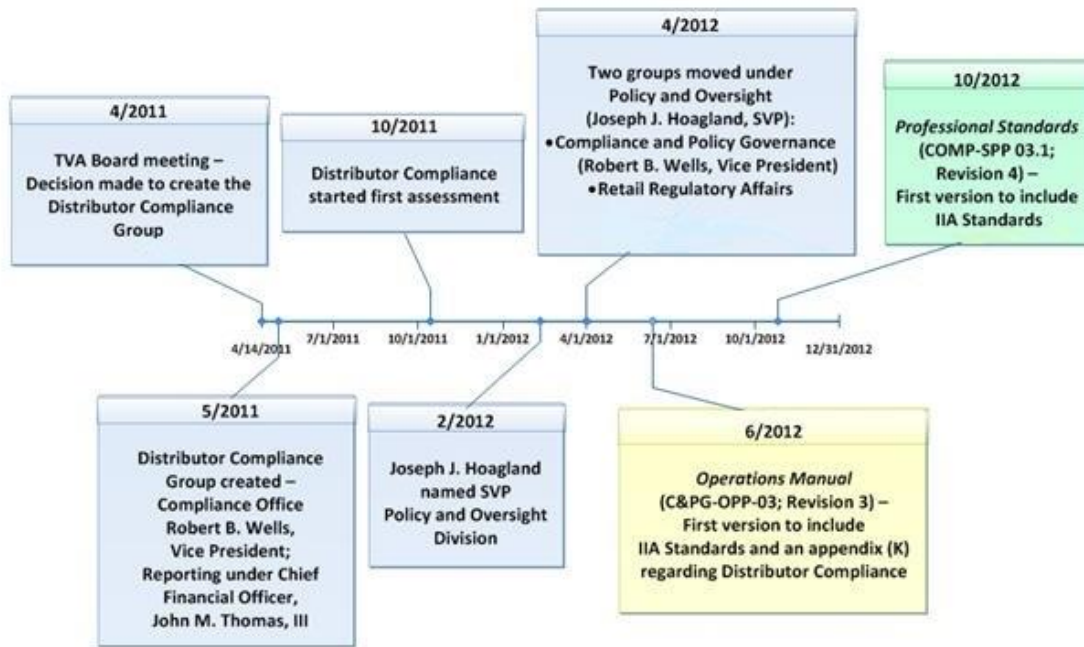
The OIG agrees with the actions planned by TVA management in regards to all recommendations.

## **BACKGROUND**

The Tennessee Valley Authority (TVA) established a Distributor Compliance department within the Compliance Office in the spring of 2011. Distributor Compliance was charged with conducting assessments at all 155 distributors during a recurring cycle (currently 4 years) from three regional offices strategically located in Knoxville, Nashville, and Memphis, Tennessee. When Distributor Compliance was created, the Compliance Office was positioned organizationally in the Financial Services division. In the spring of 2012, TVA reorganized and created a new division, Policy and Oversight. The Compliance Office was renamed Compliance and Policy Governance and was moved under the Policy and Oversight division reporting to the Senior Vice President (SVP) of Policy and Oversight. At that time, the Retail Regulatory Affairs (RRA) group, which is responsible for developing, interpreting, and implementing TVA's retail regulatory policy, was also moved under the Policy and Oversight division reporting to the SVP of Policy and Oversight.

According to the Distributor Compliance *Charter* (COMP-SPP-03.1.01), developed in December 2011, the purpose of Distributor Compliance is to drive the proactive, robust, and consistent management of TVA's regulation of the distributors of TVA power. Distributor Compliance assists TVA management and the TVA Board of Directors in determining whether distributor customers are in compliance with the TVA Wholesale Power Contract and other regulatory policy by conducting business in a manner that both promotes compliance and is generally effective in preventing, detecting, and remediating compliance-related violations. Distributor Compliance is also responsible for monitoring the distributors' follow-up on actionable recommendations to strengthen and improve compliance with the TVA contracts and regulatory requirements.

The Distributor Compliance *Charter* describes the fundamental principles, roles, and responsibilities of the department. Distributor Compliance personnel are supposed to perform assessments according to the Compliance and Policy Governance *Professional Standards* (COMP-SPP-03.1) and *Operations Manual* (C&PG-OPP-03). Both the *Operations Manual* and the *Professional Standards* adopted the Institute of Internal Auditors (IIA) Standards in June and October 2012, respectively. The Timeline on the following page shows the changes associated with the Distributor Compliance department.



### Timeline

The Distributor Compliance assessment program is standardized, and the same review steps are typically performed at each distributor to accomplish the assessment objectives. According to Distributor Compliance personnel, the original assessment program was used with minor changes by all three regional Distributor Compliance offices during the first year that assessments were performed (September 2011 through August 2012). Typical modifications were to change the program to fit the specific distributor more appropriately (e.g., applicable dates of the Wholesale Power Contract, scope of assessment, and sample size[s]). In September 2012, there was a substantial revision to the work steps in the assessment program.

During this first 4-year cycle, which will end in 2015, Distributor Compliance plans to perform an assessment (or follow-up on prior audits performed by the Office of the Inspector General [OIG]) on all 155 distributors. After the first cycle is completed, Distributor Compliance management plans to use a risk-based analysis methodology to select distributors for assessments.

## **OBJECTIVES, SCOPE, AND METHODOLOGY**

We performed an oversight audit of the assessments completed by Distributor Compliance through December 31, 2012, to determine if:

1. The assessments were adequately planned and performed to verify distributors' compliance with key provisions of the Power Contract.
2. The assessments were performed in accordance with the Distributor Compliance *Charter* and applicable policies.



3. There was adequate segregation between the groups charged with developing, interpreting, and implementing TVA's retail regulatory policy (RRA) and assessing distributor compliance with TVA's regulatory policies and procedures (Distributor Compliance).

Our scope included 32 assessments completed by Distributor Compliance through December 31, 2012. Distributor Compliance used its "original" assessment program for 31 of these assessments, and its "revised" program for 1 assessment. We reviewed a sample of 6 assessments, consisting of 5 that used the "original" assessment program, which were randomly selected, and the 1 that used the "revised" assessment program. A complete discussion of our audit objectives, scope, and methodology are included in the Appendix.

## **FINDINGS**

Our audit of the Distributor Compliance assessments issued through December 31, 2012, found several positive attributes in Distributor Compliance's planning and performance of assessments. However, we also identified areas where changes were needed to improve (1) planning and performance and (2) compliance with the Distributor Compliance *Charter* and other applicable professional standards and policies regarding the assessment reports. In addition, we determined there is adequate segregation between the groups charged with developing, interpreting, and implementing TVA's retail regulatory policy (RRA) and assessing distributor compliance with TVA's regulatory policies and procedures (Distributor Compliance). The following provides a detailed discussion of our findings.

## **POSITIVE ATTRIBUTES OF DISTRIBUTOR COMPLIANCE ASSESSMENTS**

During our oversight audit of Distributor Compliance, we noted several positive attributes in Distributor Compliance's planning and performance of assessments including:

- The identification and testing of appropriate contract provisions.
- The adequacy of testing to provide reasonable assurance assessment objectives were met in multiple work steps.
- The incorporation of testing related to bad debt write-off and disconnection/reconnection practices.
- A "value-add" step to review penalty exempt accounts that was performed during one assessment.

In addition, Distributor Compliance has staffed their department with personnel who have varied professional experiences that provide a good breadth of knowledge to the department.

**Appropriate Contract Provisions Used as Criteria for Testing**

Although the assessment programs used by Distributor Compliance do not cite specific Power Contract sections, based on the criteria stated in the reports, the provisions of the Wholesale Power Contract that Distributor Compliance tested against were primarily:

1. Section 4 – Wholesale Rate (distributor will pay in accordance with the wholesale power schedule with customers correctly classified as residential or one of the various commercial or manufacturing classifications).
2. Sections 5(a) and 5(b), paragraph 1 – Resale Rates (non-discrimination in providing power so all accounts in the same classification pay the same rate).
3. Section 6 – Use of Revenues (electric revenues are used only for approved purposes).
4. Terms and Conditions Sections 1(a), 1(b), and 1(c) (financial and accounting policies).

We agree including these contract provisions as criteria for testing compliance is appropriate.

**Testing Provided Assurance Objectives Were Met in Multiple Work Steps**

We found adequate testing was performed in the sampled assessments to obtain reasonable assurance distributors were using revenue from electric sales in compliance with the Power Contract and the TVA regulatory policy. Additionally, we noted steps for testing commercial accounts (correct classification and the need for specific metering based on energy usage) were added to the “revised” assessment program. We agree Distributor Compliance should be performing these tests.

**Bad Debt Write-Off and Disconnection/Reconnection Testing**

In all 6 of the assessments we sampled, Distributor Compliance included testing of bad debt write-offs and disconnection/reconnection of electric service to determine whether or not customers were receiving a preferential rate indirectly. These areas relate to one of the four Service Practice Standards adopted by TVA in 1979 under the authority of the *Public Utility Regulatory Policies Act*, specifically, the “Procedures for Termination of Electric Service.”

According to Distributor Compliance personnel, they included additional work steps for testing late fees in the January 2013 revision of the Distributor Compliance assessment program (subsequent to our audit scope). Late fee provisions are part of another one of the four Service Practice Standards adopted by TVA, "Billing," which is included in the Power Contract under Section 5(b), paragraph 2, "Resale Rates."<sup>1</sup> We consider testing for these areas to be appropriate and beneficial but also suggest Distributor Compliance include testing for the other Section 5(b), paragraph 2 contract provision requirements regarding when a payment may be considered late.

### **Penalty Exempt "Value-Add" Step**

In 1 of the 6 sampled assessments a "value-add" step was performed. An assessor was aware the distributor's billing agency could provide a report identifying penalty exempt accounts. Using the report, distributor personnel identified and corrected 2 accounts and requested the billing agency include the report on their Web portal so all distributors using the billing agency could generate and utilize the report. We consider this testing to be appropriate and beneficial in helping to ensure accounts are billed accurately. Distributor Compliance should consider including this work step, or work step(s) that accomplish the same objective, in the assessment program for all distributors that have customers with penalty exempt accounts.

### **Work Experience of Personnel**

Distributor Compliance has hired individuals who worked at various distributors, such as an electrical engineer, attorneys, and internal and external auditors, among other professionals to perform the distributor compliance assessments. This results in a good breadth of knowledge for the department to draw upon.

## **AREAS NEEDING IMPROVEMENT**

Based on our review of a sample of the 32 assessments issued through December 31, 2012, we identified several areas where improvements could be made in Distributor Compliance's processes for (1) planning and performing assessments and (2) reporting the results.

- Scope statements did not always reflect the actual information reviewed in assessments.
- Documentation of sampling methodology was inadequate.
- Sampling methodologies could be modified to provide more assurance assessment objectives are met.

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<sup>1</sup> [Distributor] shall designate in its standard policy periods of not less than (1) 15 days, for residential customers, and (2) 10 days, for all other customers, after date of the bill during which periods the bill is payable as computed by application of the charges for service under the appropriate resale schedule, and shall further designate in said policy the percentage or percentages, if any, not to exceed 5 percent of the bill, computed as above provided, which will be added to the bill as additional charges for payment after the periods so designated.

- Some issues were not formally reported and tracked.
- Recommendations did not always help detect and/or prevent identified issues from recurring.
- Testing for misclassified residential accounts is not currently being performed.
- Distributors are not made aware of all issues identified during assessments.

### **Scope Statements Do Not Always Reflect Actual Information Reviewed in Assessments**

According to the programs and reports we sampled, the scope of the assessments was the detailed wholesale and retail data, as well as related documentation, for one full distributor fiscal year (FY) (July through June) for 5 of the 6 assessments and 9 months (July 2011 through March 2012) for the remaining assessment. However, on many of the steps performed by Distributor Compliance, the sample for testing was pulled from a small subset of the population and Distributor Compliance's workpapers did not indicate if the subset selected was representative of the population.

- The 5 assessments conducted using the "original" assessment program had a total of 62 work steps that utilized sampling. In 36 of those work steps (58 percent), a subset of information was used as the population (typically 1 month) from which a sample was selected for testing, rather than using data/information from the entire FY as the population.
- The "revised" assessment program had a total of 13 work steps that utilized sampling. In 6 of those work steps (46 percent), a subset of information was used as the population (typically 1 month) from which a sample was selected for testing rather than using data/information from the entire FY as the population.

Using small subsets of populations to select samples may provide inadequate coverage for ensuring distributor's compliance with the TVA Wholesale Power Contract. Accordingly, Distributor Compliance should use the full population for sampling when possible. If subsets of populations are used for sampling, Distributor Compliance should ensure (1) the subset is representative of the population, and (2) reported scope statements accurately reflect the population samples are pulled from.

### **Inadequate Documentation of Sampling Methodology**

The assessment reports did not provide detailed explanations of the sampling methodology actually used during testing. Distributor Compliance did not document its tolerable error or an error rate at which they would expand the sample size of tests in its reports or workpapers. No samples were expanded when higher error rates were found in the 6 sampled assessments. For example, all 6 assessments contained testing related to adjustments. The testing results in the workpapers of 1 assessment indicated there were problems with 9 of the 20 adjustments in the sample (an error rate of 45 percent), but Distributor Compliance did not expand the sample size.

### **Sampling Methodology Could be Modified to Provide More Assurance Assessment Objectives Are Met**

In addition to the lack of documentation of the sampling methodology used, we noted instances where the sampling methodology that was followed could be modified to provide more assurance assessment objectives were met. For example, all 6 of the sampled assessment programs included:

- Testing for adjustments. However, 1 of the 6 assessments passed on testing because the sample month only contained 1 small adjustment. While we believe the testing sample should be selected from the whole population rather than 1 month, if Distributor Compliance continues to select its samples from a restricted population, a replacement sample month should be chosen so the testing could be performed.
- Testing of a random sample to verify distributor expenses/payments were for allowed uses of electric system revenues. Greater assurance would have been obtained if all disbursements for the year had been analyzed for potentially inappropriate vendors/payment amounts, and a judgmental sample of disbursements had been selected for testing.
- Testing to verify the accuracy of the retail rates for only 1 month. After the April 2011 wholesale rate change, each rate classification (i.e., residential, commercial, or manufacturing) has different prices for summer, winter, and transitional months. Therefore, testing of only 1 month during one of the rate periods provides limited assurance of the accuracy of retail rates during the remainder of the audit period.

### **Issues Were Not Always Reported Appropriately**

According to Distributor Compliance management, an "Issue" should be created in Distributor Compliance's automated system describing an identified error/problem, and an "Issue" may or may not have a corresponding "Action Plan." In addition to listing the issue, an "Action Plan" typically includes a recommendation, expected completion date, management's response, and the status (e.g., open or closed), which allows tracking of management's corrective actions.

We found the existence of an "Action Plan" in Distributor Compliance's automated system does not always result in a corresponding "Action Item" (recommendation) in the assessment report, especially if the distributor corrected the issue during the assessment. In the 6 assessments sampled for review, Distributor Compliance identified and recorded 47 issues in its automated system. Specifically, we found:

- Only 37 of the 47 issues were included in the final assessment reports:
  - 16 had an "Action Item" in the report.
  - 21 were corrected during fieldwork and/or were reported as "no action necessary."

- 2 of the 47 issues were included in an “Other Considerations” document<sup>2</sup> as an attachment to the report, and therefore, did not have an “Action Item” even though both indicated existing processes for entering rates needed improvement. Both of these issues should have had a related “Action Item” reported to the distributor and an “Action Plan” in Distributor Compliance’s automated system for distributor action:
  - One distributor’s “Power Cost Adjustment” for June 2011 was miscalculated by an immaterial amount.
  - The excess demand rate per a “Time of Day” manufacturing rate schedule was loaded incorrectly in the billing system during June 2011.
- 8 of the 47 issues were not included in the final assessment report. At a minimum, 3 of these issues should have been officially reported and a recommendation made; however, none had an “Action Plan” in the system, and no “Action Item” was communicated to the distributor or TVA. The issues that should have been reported were:
  - Distributor Compliance found the 12 month high field on a billing statement was incorrect and determined the distributor was billing some customers outside the billing system. This was considered a data entry error by Distributor Compliance.
  - Distributor Compliance found a distributor was transferring some uncollectable amounts from one account to another account using the energy field and determined this practice was skewing the distributor’s revenue. During fieldwork, Distributor Compliance suggested the distributor change how uncollectable amounts were transferred, and the distributor implemented the suggestion.
  - Distributor Compliance provided one distributor with a penalty exemption report. The distributor determined there were 2 accounts flagged incorrectly and corrected the accounts during the assessment.

### **Report Recommendations Need to Improve Distributor Compliance**

The Distributor Compliance *Charter, Professional Standards, and Operations Manual* state that part of Distributor Compliance’s responsibility is to continually help improve distributors’ compliance with the Wholesale Power Contract by preventing, detecting, mitigating, and remediating any compliance issues. Generally, we found Distributor Compliance complied with the Distributor Compliance *Charter, Professional Standards, and Operations Manual* while performing the assessments; however, the reporting of the assessment results did not always comply with the criteria mentioned above.

Typically, the reports we sampled either (1) stated the issues that had been found were corrected during the assessment, so no further action is recommended/required, or (2) recommended (per the action item) the distributor correct the specific issues found during the assessment rather than implementing a process

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<sup>2</sup> An “Other Considerations” document was used to report oversight or regulatory issues to TVA management.

or control to help reduce the possibility the error or issue will occur in the future. The following are examples of issues and recommended action items in the reports that would not help prevent the issue from recurring in the future:

- Distributor Compliance identified misclassified customers within their limited sample and recommended the distributor reclassify those specific accounts. However, no recommendations were made to (1) determine if other errors outside the sample occurred or (2) improve controls over the classification of customers.
- Distributor Compliance found contract demand in the billing system did not agree with the contract demand in the contract and recommended the distributor update the billing system information with the appropriate contract demand. However, no recommendations were made to improve controls over the accuracy of contract demand in the system.
- Distributor Compliance found a customer re-established service under a new name after being written off as bad debt and the distributor subsequently transferred the old debt to the new account during the assessment. However, no process improvement recommendations were made regarding establishing customer accounts.

According to the Manager of Distributor Compliance, if assessors determined an error or issue occurred because an existing policy was not followed, Distributor Compliance would not typically recommend an action plan. He stated having an action plan recommending the distributor follow an existing policy adds little value because Distributor Compliance must track and record distributors' remediating action(s), and it would be difficult to put a specific date as to when such an action plan would be completed. However, Distributor Compliance's workpapers did not indicate whether the above examples were the result of not following an existing policy or if there was no policy currently in place.

To improve compliance with the Power Contract, Distributor Compliance should make recommendations to improve controls over the processes that allowed identified errors, not just recommend that identified errors be corrected. Because this reporting aspect is so integral to Distributor Compliance's mission to improve distributor compliance with the Power Contract, we consider this a significant issue.

### **Testing for Misclassified Residential Accounts Not Currently Being Performed**

Testing for residential misclassifications should be performed to provide assurance no discriminatory rates exist between residential customers. Testing to identify misclassified residential customer accounts in the "original" assessment program was not always performed, and it was not included in the "revised" assessment program. The testing performed per the "original" program would rarely identify misclassified residential accounts because a small sample (i.e., 20 or 25) was randomly selected from a 1-month subset of the population of residential accounts.

Reasonable assurance that discrimination is not occurring could be obtained by identifying accounts that appear to be commercial based on name (e.g., "&," "Company," "Funeral," "LLC," "Inc.," etc.) and then selecting a sample from those questionable accounts. Verifying residential customers are correctly classified is ultimately beneficial to TVA, because only 1 hydro credit is allowed for each primary residence. Therefore, accounts for non-primary residences (i.e., pool houses, barns, gates, small businesses, etc.) are considered small commercial and are not eligible to receive a hydro credit.

### **Distributors Not Made Aware of All Issues Identified During Assessments**

The "Other Considerations" document used by Distributor Compliance to report issues to TVA management was included as an attachment in 1 of the 6 sampled assessment reports. However, according to Distributor Compliance management, the current practice is to provide the information to TVA management but not to distributors. RRA indicated in some instances distributors were confused when RRA contacted them to address items included in the "Other Considerations" document, especially in instances where the Distributor Compliance assessment report stated there were no issues and the distributor was in compliance.

## **SEGREGATION BETWEEN GROUPS IS ADEQUATE**

As noted in the Background section of this report, both Distributor Compliance and RRA are currently in TVA's Policy and Oversight division. In order to determine if there was adequate segregation between Distributor Compliance and RRA, we met with the Director, RRA, and Manager, Distributor Analysis, RRA, to discuss the work they perform. Although we determined there was adequate segregation between Distributor Compliance and RRA, we also noted certain work being performed at the distributors by each group is duplicative in nature. We plan to issue a separate memo to the SVP of Policy and Oversight regarding this observation.

## **RECOMMENDATIONS**

We recommend TVA's Director, Distributor Compliance:

1. Include testing for other provisions in Section 5(b), paragraph 2 of the Power Contract in all assessments.

**TVA Management's Comments** – Distributor Compliance agreed with the recommendation and will add a verification that the number of days from the bill date to payable date is in accordance with Section 5(b), paragraph 2 of the Power Contract. The new test step will be implemented by November 30, 2013. See Appendix B for Distributor Compliance's complete response.

**Auditor's Response** – The OIG agrees with management's planned actions.



2. Include testing to identify penalty exempt accounts in all assessments.

**TVA Management's Comments** – Distributor Compliance agreed adding the recommended testing made sense and will incorporate a test step that identifies penalty exempt accounts if the third party billing system has the functionality. The new test step will be implemented by November 30, 2013. See Appendix B for Distributor Compliance's complete response.

**Auditor's Response** – The OIG agrees with management's planned actions.

3. When possible, select a sample containing items from across the population instead of from a subset of the population.

**TVA Management's Comments** – Distributor Compliance stated when there is a recurring billing cycle with less than 1 percent deviation in its population from month to month, the sample risk of choosing a representative sample is *de minimis*. However, Distributor Compliance agreed with the recommendation that expanding their sample to multiple billing periods within a rolling 12-month period would give them better assurance for detecting both monthly and seasonal variable billing attributes. As a result, while considering the time and cost of examination, Distributor Compliance will implement testing a recurring cycle from the summer, winter, and transition periods by November 30, 2013. See Appendix B for Distributor Compliance's complete response.

**Auditor's Response** – The OIG agrees with management's planned actions.

4. Fully document sampling methodology in workpapers and report, including details on when replacement samples will be used and at what error rate a sample will be expanded.

**TVA Management's Comments** – Distributor Compliance stated their sampling methodology is outlined in their assessment program, and they will include their replacement sample methodology in their sampling methodology as an Appendix in their reports. This will be implemented by November 30, 2013. See Appendix B for Distributor Compliance's complete response.

**Auditor's Response** – The OIG agrees with management's planned actions.

5. Review and update process(es) for ensuring all applicable issues are included in the report.

**TVA Management's Comments** – Distributor Compliance stated prior to the issuance of the OIG draft report, a quality control function to complement their normal reporting fact check process had been implemented. In addition, a step will be added to their fact check process to ensure all issues have been captured appropriately. This will be implemented by November 30, 2013. See Appendix B for Distributor Compliance's complete response.

**Auditor's Response** – The OIG agrees with management's planned actions.

6. Include recommendations that help improve distributors' compliance with the Power Contract by detecting and/or preventing the identified issues or errors from recurring in the future.

**TVA Management's Comments** – Distributor Compliance stated when possible, they will identify potential root cause activity and make recommendations to help prevent or detect errors from occurring in the future. This will be implemented by November 30, 2013. See Appendix B for Distributor Compliance's complete response.

**Auditor's Response** – The OIG agrees with management's planned actions.

7. Include testing for potentially misclassified residential customers in all assessments.

**TVA Management's Comments** – Distributor Compliance stated based on the recommendation, they will add a test identifying potentially misclassified residential customers and report those to the Distributor. This will be implemented by November 30, 2013. See Appendix B for Distributor Compliance's complete response.

**Auditor's Response** – The OIG agrees with management's planned actions.

8. Inform distributors of all issues identified during assessments.

**TVA Management's Comments** – Distributor Compliance stated they have agreed-upon criteria established based on contract provisions. Observations made outside the agreed-upon criteria are noted in the workpapers, entered into the automated audit software, and given one of several dispositions, not all of which are intended to be in the report as defined by the criteria. Based on the recommendation, Distributor Compliance will add the observations as an Appendix to the final reports to distributors for informative purposes. This will be implemented by September 30, 2013. See Appendix B for Distributor Compliance's complete response.

**Auditor's Response** – The OIG agrees with management's planned actions.

## **OBJECTIVES, SCOPE, AND METHODOLOGY**

As part of our annual audit plan, we scheduled an oversight audit of the distributor assessments performed by Tennessee Valley Authority's (TVA) Distributor Compliance group. Our specific audit objectives were to determine if:

1. The Distributor Compliance group assessments of distributors were adequately planned and performed to verify distributors' compliance with key provisions of the Power Contract. Specifically:
  - Did the assessments determine if distributors' retail rates were appropriately approved.
  - Did the assessments review the appropriate contract provisions.
  - Was information reviewed sufficient and appropriate to support the findings and conclusions.
  - Were the identified issues reported in the appropriate manner to the appropriate individuals/groups.
  - Were the identified issues recorded in a manner that allows tracking of managements' actions to address the issues.
2. The Distributor Compliance group assessments of distributors comply with the Distributor Compliance group *Charter* and applicable policies.
3. There is adequate segregation between the groups charged with developing, interpreting, and implementing TVA's retail regulatory policy (Retail Regulatory Affairs) and assessing distributor compliance with TVA's regulatory policies and procedures (Distributor Compliance).

Our objective was not to assess TVA's system of internal controls related to Distributor Compliance. Therefore, controls associated with Distributor Compliance were not tested as part of this audit. To achieve our objectives, we:

- Reviewed a sample of 6 Distributor Compliance performed assessments to determine compliance with stated criteria as well as adequacy of performing the assessments. We judgmentally chose to sample 1 assessment because it used the newer version of the Distributor Compliance assessment program. We then stratified the remaining assessments by the region they were performed in and chose a random sample of 5 additional assessments of the 31 assessments performed during our audit period using a random number generator. We chose this method of sampling due to the small size of the population. Because we included other sample items with our random selections, the results cannot be projected to the population.
- Reviewed organizational charts and interviewed personnel to determine if there was adequate segregation between the groups that develop, interpret, and implement TVA's retail regulatory policy versus those that assess distributors' compliance.

- Obtained the first and last assessment work programs applicable to our audit period to determine what steps were added or removed and if the action was appropriate.
- Reviewed all Distributor Compliance assessment reports performed during our audit period to gain an understanding of the consistency as well as the changes that occurred to the reports.
- Reviewed all reports issued during our audit period as well as “Issues” identified to gain an understanding of the clarity and consistency of the reporting of the “Issues.”

When evaluating the results of our audit work, we used qualitative factors when considering the significance of an item. The qualitative factors to be considered in determining an item’s significance were:

- Error(s) in calculations or logic used in multiple assessments, which may or may not result in inaccuracy of information reported on multiple assessments.
- Reporting only the problem or issue noted and not making a recommendation that would prevent the issue or error from recurring, and therefore, help improve compliance with the Power Contract.
- Reporting only the problem or issue noted in the sample tested and not assessing the effect of the issue on the associated population (i.e., treating the issue as an isolated instance with no adverse effects if corrected).
- Reporting on the problem or issue noted and not assessing whether it is an isolated problem at one distributor or an issue that should be addressed and corrected for multiple distributors (oversight issue).

The scope of our audit was all distributor assessments completed by Distributor Compliance between October 1, 2011, and December 31, 2012, a total of 32 assessments. Distributor Compliance also performed “follow-up” reviews on 9 Office of the Inspector General distributor audits during this time; however, these reviews were not included in our population of 32 assessments. Our fieldwork was conducted between February 2013 and July 2013.

This performance audit was conducted in accordance with generally accepted government auditing standards. Those standards require 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 the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

August 27, 2013

David P. Wheeler, ET 3C-K

RESPONSE FOR COMMENTS - DRAFT AUDIT 2013 - 14966 - OVERSIGHT AUDIT OF  
DISTRIBUTOR COMPLIANCE GROUP

Reference: OIG memorandum to VP, Compliance and Policy Governance dated August 16,  
2013

This is in response to your draft audit report regarding the Distributor Compliance function.

We would like to thank the Office of Inspector General (OIG) for identifying the positive attributes of the Distributor Compliance program. We concur with the OIG that our testing provides reasonable assurance of objectives being met for appropriate contract provisions between TVA and its Distributors. However, we also concur that there are some areas for improvement to modify the program to provide greater assurance for TVA management and its Distributors.

As a result, Compliance and Policy Governance has reviewed your draft findings and agrees to implement changes based on all recommendations outlined in the report.

**Recommendation:** Include testing for other provisions in Section 5 (b), paragraph 2 of the Power Contract in all assessments.

**Response:** Distributor Compliance currently confirms that Distributors are charging rate payers the appropriate late fee percentage from Section 5(b), paragraph 2 of the Power Contracts. We agree with the recommendation and will add a verification that the number of days from bill date to payable date is in accordance with this section. This new test step will be implemented by November 30, 2013.

**Recommendation:** Include testing to identify penalty exempt accounts in all assessments.

**Response:** We agree that adding this test makes sense. However, we have not determined that all third party billing systems have this system functionality available. As a result, we will incorporate a test step that identifies penalty exempt accounts if system capability allows. This new step will be implemented by November 30, 2013.

**Recommendation:** When possible, select a sample containing items from across the population instead of from a subset of the population.

**Response:** By definition, a representative sample is a subset of a statistical population that accurately reflects the members of the entire population. When you have a recurring billing cycle with less than 1 percent deviation in its population from month to month, the sample risk of choosing a representative sample is *de minimis*. The justification for accepting some level of uncertainty arises from the relationship between such factors as the cost and time required to examine all of the data. It was based on these factors that we chose to use representative samples in some tests. However, we do agree that expanding our sample to multiple billing periods within a rolling 12-month period gives us better assurance for detecting both monthly and seasonal variable billing attributes. As a result of this recommendation, while also considering the time and cost of examination, we will test a recurring cycle from the summer, winter and transition periods. The testing of additional months will be implemented by November 30, 2013.

David P. Wheeler  
Page 2  
August 27, 2013

**Recommendation:** Fully document sampling methodology in workpapers and reports, including details on when replacement samples will be used and at what sample rate a sample will be expanded.

**Response:** Our sampling methodology is outlined in our assessment program. We will document our sampling methodology as an appendix in our reports to include our replacement sample methodology. This will be implemented by November 30, 2013.

**Recommendation:** Review and update process(es) for ensuring all applicable issues are included in the report.

**Response:** Prior to the issuance of the OIG draft report, we implemented a quality control function to complement our normal reporting fact check process. The purpose of which is to identify any opportunities for improvement in the completion and reporting of our assessment work. In addition, we will also add a step to our fact check process to ensure that all issues have been captured appropriately. This will be implemented by November 30, 2013.

**Recommendation:** Include recommendations that help improve Distributors' compliance with the Power Contract by detecting and/or preventing identified issues or errors from recurring in the future.

**Response:** We have found errors that are the result of manual controls that lack ready solutions that would prevent or detect a reoccurrence in the future. These typically involve an individual making an error or deviating from the prescribed policy. However, when possible, we will identify potential root cause activity and make recommendations to help prevent or detect errors from occurring in the future. This will be implemented effective September 30, 2013.

**Recommendation:** Include testing for potentially misclassified residential customers in all assessments.


**Response:** Based on the recommendation, we will add a test identifying potentially misclassified residential customers and report those to the Distributor. This will be implemented by November 30, 2013.

**Recommendation:** Inform Distributors of all issues identified during assessments.

**Response:** We have agreed-upon criteria established when we engage a Distributor for an assessment based on contract provisions. Observations made outside of the agreed-upon criteria are noted in the workpapers, entered into the automated audit software and given one of several dispositions, not all of which are intended to be in the report as defined by the criteria. Based on the recommendation, we will add these observations as an appendix to the final reports to the Distributors for informative purposes. This will be implemented by September 30, 2013.

David P. Wheeler  
Page 3  
August 27, 2013

We would like to thank Melissa Neusel, Julie Poteet, Jennifer Torregiano and the OIG staff for their professionalism and cooperation in conducting the audit. If you have any questions, please contact Windle Morgan at 865-632-3280.



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