



Memorandum from the Office of the Inspector General

August 7, 2008

Anda A. Ray, WT 11A-K

FINAL REPORT – INSPECTION 2007-11428-05 – REVIEW OF LICENSE AGREEMENT FOR CITY OF LENOIR CITY

At the request of the Chief Financial Officer's (CFO) office, we initiated reviews of selected marina and campground contracts to determine whether (1) payments to TVA were accurate and timely and (2) key provisions of the license agreement were complied with. This report presents the results of our work regarding Fort Loudon Marina (FLM). The Vice President (VP) of Environmental Stewardship and Policy (ES&P) specifically requested FLM be included as one of the marinas/campgrounds reviewed. The City of Lenoir City (Licensee) entered into a license agreement with TVA for the use of TVA land on Fort Loudon Reservoir. The City of Lenoir City subsequently entered into an agreement with a third party for the operations of FLM.¹ TVA was to be paid a fee for the use of the property which was the greater of a minimum base payment or a percentage of gross revenue. TVA refers to these contracts as "percentage of gross" contracts.

In summary, we found nothing to indicate noncompliance with the license payment terms or other key provisions of the agreement. However, opportunities may exist to improve documentation related to contract changes and/or deviations. In addition, while TVA accounting practices² provide guidance on the invoicing and receiving of lease and license payments, they contain no documented guidance on the management of the "percentage of gross" contracts (i.e., licenses and leases) including the verification of the accuracy of Licensee and Lessee payments. While not reflected in license and lease agreements for campgrounds and marinas, ES&P has implemented new payment control activities requiring supporting documentation for revenues.

BACKGROUND

TVA entered into a License Agreement, RLR-166446, with the City of Lenoir City on April 28, 2005. The Licensee has an agreement with a third party for the operations of the site. Operations include a marina, restaurant, and office/ship store. The license does not have a fixed term but requires the Licensee to give a 60-day notice before terminating the

¹ A third party was licensed use of FLM. For the purposes of this report, the licensed entity is referred to as FLM.

² TVA applicable TVA accounting practices were External Billing (Standard Principles and Practices [SPP] 13.7) and Accounts Receivable (SPP 13.15).

agreement. The licensed premises located in Lenoir City, Tennessee, is owned by TVA, Tract No.XTFL-109RE.

Per the agreement, the Licensee:

- Must make an annual payment which is 50 percent of the greater of \$55,000 or five percent of the annual gross revenues. The gross revenue calculation only applies to the commercial operator's businesses. In addition to the annual base rent or percentage of gross revenue, payment is also due for 50 percent of 30 percent of all income derived from other commercial sublicense/rental income of the licensed area.³
- Has the right to make improvements, erect structures, and install equipment on the premises with advanced written approval from TVA. The Licensee will not reconstruct, relocate, or structurally alter any structure or fixed improvement except with the prior written approval of TVA.
- Is required to maintain commercial general liability insurance for the property at limits established by TVA.

OBJECTIVES, SCOPE, AND METHODOLOGY

The objectives of our review were to determine whether (1) payments to TVA were accurate and timely and (2) key provisions of the license agreement were complied with. To achieve our objectives, we:

- Identified and documented key agreement provisions by (1) reviewing the license and (2) interviewing key TVA personnel.
- Interviewed applicable TVA ES&P employees to (1) determine whether payments have been made to TVA under the license agreement; (2) determine whether TVA granted written approval for any improvements, new structures, or equipment on the premises; (3) identify key control activities; (4) ascertain whether any opportunities exist to improve contract language and controls; and (5) identify any other potential issues pertaining to the license.
- Obtained supporting documentation for license payments to determine whether license payments have been made in accordance with the contract provisions.
- Obtained and reviewed documentation to ensure commercial general liability insurance was maintained as required by the agreement.
- Performed a site visit and walkdown of the property to (1) document FLM operations, (2) review documentation applicable to the key contract provisions, and (3) visually observe structures and equipment. An ES&P employee escorted us on our walkdown of FLM.

³ Per ES&P personnel, TVA and the City of Lenoir City share equally the required annual payments from the third-party operator.

The scope of the inspection included payments made to TVA under the license and other provisions of the license from January 1, 2005, through December 31, 2007. This inspection was conducted in accordance with the "Quality Standards for Inspections."

FINDINGS

During our review of FLM, we found that the license payment terms were generally complied with or TVA had approved contract provision deviations. Our review of TVA policies and procedures found TVA Accounting Practices External Billing (SPP 13.7) and Accounts Receivable (SPP 13.15) provide guidance on the invoicing and receiving of lease and license payments. However, we found no documented guidance on the management of the "percentage of gross" licenses and leases including the verification of the accuracy of Licensee and Lessee payments. While not reflected in the agreements, ES&P has implemented new payment control activities requiring supporting documentation for revenues. In addition, we found nothing to indicate that FLM was not in compliance with other key provisions of the agreement that we reviewed. However, opportunities may exist to improve documentation related to agreement changes and deviations.

ACCURACY AND TIMELINESS OF PAYMENTS

We reviewed revenue and payment documentation obtained for the 2005 and 2006 operating seasons and found (1) annual payments were made in accordance with agreement provisions or deviations were agreed to by TVA, and (2) documentation provided to TVA and maintained by the third party supported annual payment amounts. Data for 2007 was not yet available during our testing. ES&P personnel provided income statements and payment calculations (submitted by FLM to TVA) and also TVA invoices and payment records to support payment amounts. During our walkdown of the facilities, we also reviewed FLM's weekly and monthly Marina Program reports⁴ along with the associated FLM General Ledger entry for each month, the financial statements compiled by their accountant, and credit card receipts and deposit slips by month. According to the marina operator, receipts are only issued when requested by the customer.

Our review of the invoices and revenue reports provided by TVA identified that the following payments were made during the scope of our review:

- For the license year of 2005, which began April 28th, a prorated payment in the amount of \$32,352 was made on July 20, 2006.
- For the license year of 2006, a payment in the amount of \$51,559 was made on June 29, 2007.
- For the license year of 2007, data was not yet available.

To verify the revenue report's gross revenues, we traced the revenue from the Marina Program report and FLM General Ledger to the revenue report sent to TVA. The revenue reported in 2005 appears accurate, and the revenue reported in 2006 appears to be understated by an immaterial amount. We also recalculated the payment due based on the

⁴ The Marina Program is used at the marina to track payments and billings for the slip rentals.

revenue reports submitted to TVA using the payment terms identified in the contract and additional documentation provided by ES&P personnel. We then compared our recalculations to payment calculations and payments submitted by FLM. In 2005, FLM underpaid TVA by an immaterial amount, and in 2006, they overpaid TVA by an immaterial amount.

Per the contract, no due date was set for the receipt of payments, only that the Licensee shall pay TVA each year. TVA invoices were available for 2005 and 2006 with an established due date for the license payment. It was noted that the 2005 payment was made after the due date listed on the invoice. This payment was, however, submitted by the City of Lenoir City, not FLM.

Operating Year	Invoice Due Date	Check Date	TVA Collection Report Date
2005	June 30, 2006	July 20, 2006	July 25, 2006
2006	June 30, 2007	June 29, 2007	July 18, 2007

Our review also noted that the license payment calculation relating to specific revenue items did not agree with the contract terms but was agreed to by TVA without modification of the contract. Specifically:

- In 2005, the revenue generated from the sales of jet ski lifts was included in the payment calculation at the rate of one percent instead of the five percent rate stated in the contract. The only documentation pertaining to this exception was a handwritten note on the 2005 income statement. ES&P personnel confirmed that an allowance was made in 2005. For 2006, the jet ski lifts were included at the five percent rate in compliance with the license agreement.
- Revenue from dock utilities and other operating income was excluded from the payment calculation. The only documentation pertaining to these exceptions was a handwritten note on the 2005 income statement. Per ES&P personnel, the other operating income was excluded because it related to revenue not generated from the licensed property.

Policies and Procedures

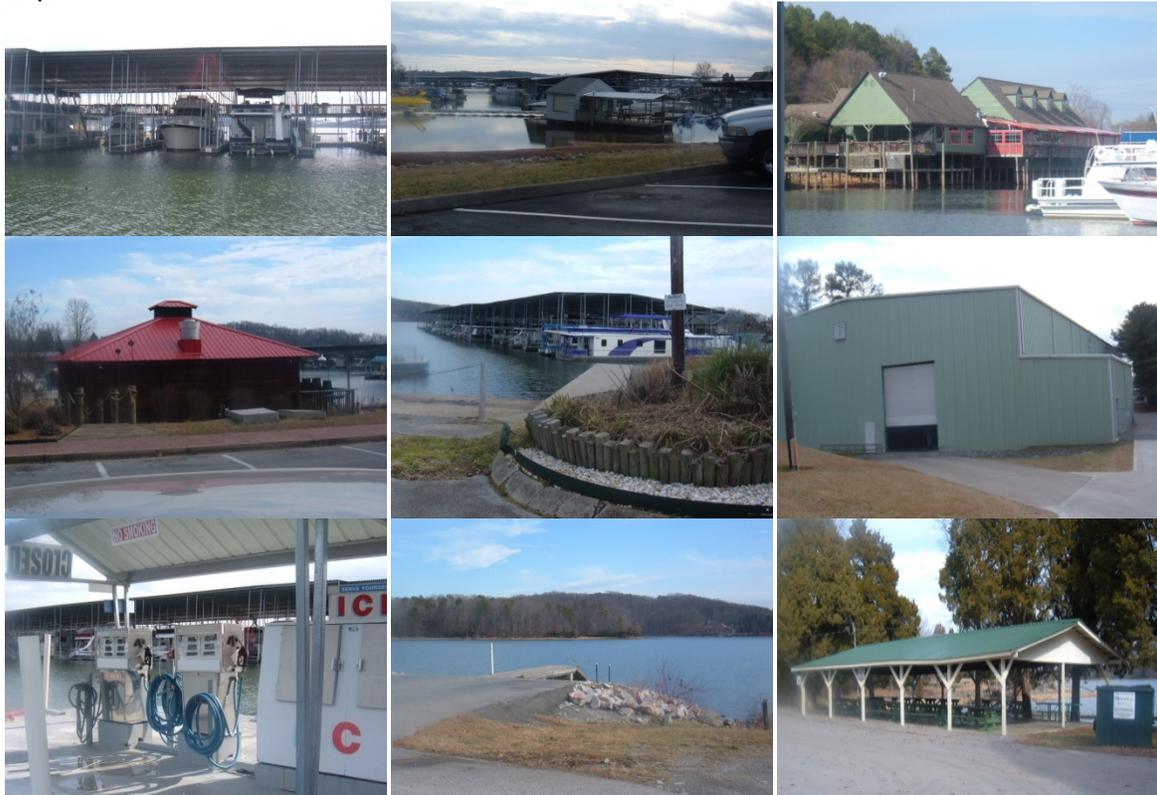
TVA accounting practices External Billing (SPP 13.7) and Accounts Receivable (SPP 13.15) provide guidance on the invoicing and receiving of lease and license payments. We found no documented guidance on the management of the "percentage of gross" licenses and leases including the verification of the accuracy of Licensee and Lessee payments. TVA Operations' Business Services personnel recently took over the invoicing and payment process for the "percentage of gross" licenses and leases from the individual watershed teams. According to Operations' Business Services personnel, key control activities relating to the payment process were implemented in 2007 including requiring Licensees and Lessees to provide gross revenue documentation prior to being invoiced by TVA. These new activities appear to address certain invoicing and payment controls. However, the licenses and leases have not been amended to reflect these changes.

COMPLIANCE WITH KEY CONTRACT PROVISIONS

We performed a walkdown of FLM and found (1) no modifications had been made to the property that were not approved in advance by TVA, and (2) the marina appeared well maintained and clean as evidenced in the pictures below. Per ES&P personnel, there have been no problems with the marina or contract.

According to ES&P personnel, FLM has submitted only one request to make modifications to the property since the license agreement took effect in April 2005. This request was to make an addition to an existing waterside bar. This request received proper written approval but had not been implemented at the time of our site visit.

We also obtained and reviewed a copy of the required commercial general liability insurance policy. The insurance policy reviewed appears to be in compliance with the contract requirements.



RECOMMENDATIONS

We recommend the VP, ES&P:

- Require adequate documentation for any modifications to agreement terms.

- Implement written guidance, as deemed necessary, regarding the management of recreational facilities' "percentage of gross" contracts. This recommendation also applies to the other six "percentage of gross" contracts in which separate reports were issued.
- Determine whether licenses and leases should be amended based on the implementation of new key control activities. This recommendation also applies to the other six "percentage of gross" contracts in which separate reports were issued.

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This final report is for your review and final action. Please advise us of your planned actions (i.e., management decision) in response to our findings within 60 days of the date of this report.

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, please contact Michael A. Driver, Project Manager, at (423) 751-8158 or Gregory C. Jaynes, Deputy Assistant Inspector General, Inspections, at (423) 751-7821. We appreciate the courtesy and cooperation received from your staff during this review.



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