



Memorandum from the Office of the Inspector General

February 19, 2010

Kimberly S. Greene, WT 7B-K

REQUEST FOR FINAL ACTION – AUDIT 2008-12038 – DISTRIBUTOR REVIEW OF MURPHY ELECTRIC POWER BOARD

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, please contact Andrea L. Williams, Senior Auditor, at (865) 633-7375 or Jill M. Matthews, Deputy Assistant Inspector General, Audits and Support, at (865) 633-7430. We appreciate the courtesy and cooperation received from your staff during the audit.

Robert E. Martin
Assistant Inspector General
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Attachment

cc (Attachment):

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OIG File No. 2008-12038



Office of the Inspector General

Audit Report

To the Group President,
Strategy and External
Relations

DISTRIBUTOR REVIEW OF MURPHY ELECTRIC POWER BOARD

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- A. LETTER DATED DECEMBER 17, 2009, FROM LARRY KERNEA TO ROBERT E. MARTIN
- B. MEMORANDUM DATED DECEMBER 23, 2009, FROM KIMBERLY S. GREENE TO ROBERT E. MARTIN
- C. MEMORANDUM DATED FEBRUARY 5, 2010, FROM JOHN G. TRAWICK TO ROBERT E. MARTIN



TVA Office of the Inspector General

Why the OIG Did This Review

As part of the annual audit plan, the OIG performed a review of the Murphy Electric Power Board (Murphy), which is a distributor for Tennessee Valley Authority (TVA) power based in Murphy, North Carolina. Annual revenues from electric sales were approximately \$12.9 million in fiscal year 2008. 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 classifications are various rate classes based on the customer type and usage.

The objective of the review was to determine compliance with key provisions of the power contract between TVA and Murphy including (1) proper reporting of electricity sales by customer class to facilitate proper revenue recognition and billing by TVA; (2) nondiscrimination in providing electricity to members of the same rate class; and (3) use of revenues, including any surplus, for approved purposes, such as operating expenses, debt service, tax equivalent payments, and reasonable reserves for renewals, replacements, and contingencies.

What the OIG Recommends

We recommend the Group President, Strategy and External Relations (S&ER), take action to ensure Murphy (1) remediates classification and metering issues and institutes controls to prevent the issues from recurring; (2) complies with contract provisions related to customer contracts and application of joint cost studies; and (3) improves internal controls. In addition, the Group President, S&ER, should (1) recover amounts incorrectly credited to Murphy and (2) determine if other Competitive Index Rate (CIR) customers with other distributors have been credited appropriately.

TVA and Murphy management generally agreed with and are taking actions to address the recommendations. However, TVA management did not agree with the recommendation to recover incorrectly credited CIR amounts from Murphy since the customer receiving the credit is no longer in business and recovery through litigation is unlikely. In addition, TVA stated they have been focused on putting procedures and processes in place to better assure that TVA rates and pricing programs are implemented and carried out as intended in the future. See Appendices for complete responses.

For more information, contact Andrea L. Williams, Senior Auditor, at (865) 633-7375 or Jill M. Matthews, Deputy Assistant Inspector General, Audits and Support, at (865) 633-7430.

February 2010

Audit 2008-12038 Murphy Electric Power Board

What the OIG Found

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

- **Customer Classification and Metering** – We identified nine customers not classified correctly and two metering issues that could impact (1) the proper reporting of electric sales and (2) nondiscrimination in providing electricity to members of the same rate class. We were unable to estimate the monetary effect of all the classification and metering issues because in some instances information was not available; however, for those where information was available, the monetary effect on Murphy and TVA would not be material.
- **Contract Compliance** – We identified two areas where Murphy was not meeting power contract requirements with TVA. Specifically, we found (1) the most recent joint cost study was not being used to charge rent by Murphy and (2) customer contracts were not in place.
- **Internal Control Improvements** – We identified three areas where Murphy could strengthen internal controls. Specifically, we found improvements could be made in the (1) billing practices associated with well pumps, (2) accuracy of contract demand data entered in the system, and (3) enhancing of policies to improve the control environment.

In addition, we found Murphy had more than enough cash on hand to cover planned capital projects and provide a cash reserve of about 12 percent. While TVA has established guidelines to determine if a distributor has adequate cash reserves (cash ratio of 5 percent to 8 percent), TVA has not established guidelines to determine if a distributor's cash reserves are excessive.

- As of June 30, 2008, Murphy reported about \$4.4 million in cash and prepayments and planned capital expenditures of about \$3 million which left cash reserves of about \$1.4 million.

We identified one instance where TVA incorrectly billed Murphy on the Schedule 1. Specifically, we noted TVA incorrectly credited Murphy approximately \$174,000 for the CIR credit. Finally, we identified certain opportunities to enhance TVA oversight of the distributors that were also identified in previous distributor audits. TVA is in the process of addressing these findings which include the lack of: (1) guidance on when a demand meter is required for a distributor's customer, (2) criteria for evaluating when a distributor's cash is excessive, and (3) guidance for distributors on what constitutes prudent expenditures.

BACKGROUND

The Murphy Electric Power Board (Murphy) is a distributor for Tennessee Valley Authority (TVA) power based in Murphy, North Carolina, with revenues from electric sales of approximately \$12.9 million in fiscal year (FY) 2008. TVA relies on distributors to report customer usage and subsequently the amount owed to TVA (Schedule 1). Customers are generally classified as residential, commercial, manufacturing, and lighting. Within these classifications are various rate classes based on the customer type and usage. Table 1 shows the customer mix for Murphy as of June 2008.

Murphy's Customer Mix as of June 2008

Customer Classification	Number of Customers	Revenue	Kilowatt Hours Sold
Residential 3,346		\$4,097,330	45,208,387
General Power – 50 Kilowatt (kW) and Under (Commercial)	1,498	2,530,422	22,308,255
General Power – Over 50 kW (Commercial or Manufacturing)	110	6,044,779	81,962,470
Street and Athletic	3	38,459	439,696
Outdoor Lighting ¹ 0		163,328	1,272,789
Total	4,957	\$12,874,318	151,191,597

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. Murphy, like many other distributors, outsources its billing and invoice processing to a third-party processor, Central Service Association (CSA). Murphy uses CSA systems to establish and set up new customers, input customer meter information, perform the monthly billing process, and execute customer account maintenance. Additionally, CSA provides Murphy with management reporting (e.g., exception reports). All daily accounting and finance responsibilities are handled by a general manager and accountant. A three-member Board of Directors, which included two independent directors as well as the General Manager² during the audit period, provides oversight. Murphy does not have any nonelectric business interests.

¹ This customer count represents those customers who only have Outdoor Lighting accounts with Murphy. Another 630 customers at June 30, 2008, had Outdoor Lighting accounts with Murphy as well as accounts for other services. The kilowatt hours sold include all kilowatt hours for all accounts.

² This person was the Murphy General Manager during our audit period; however, he is currently the Murphy Assistant General Manager.

OBJECTIVE, SCOPE, AND METHODOLOGY

This audit 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 Murphy including:

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

To achieve our objective, we:

- Obtained Murphy electronic billing information from CSA for the audit period. The information was not complete because CSA does not maintain historical information for inactive customers. We used the information available to generate reports of exceptions related to classification and metering and conducted further review of documentation or discussed with management.
- Documented and tested the procedures and controls in place to ensure complete and accurate invoicing of payments to TVA.
- Determined through inquiry and review of documentation whether Murphy had any nonelectric system-related business interests supported by electric system funds.
- Reviewed disbursements to determine if electric system funds were used for any items not allowed under the TVA power contract.
- Reviewed cash and cash equivalents in relation to planned capital expenditures and other business uses of cash.
- Used nonstatistical sampling methods as needed to perform the tests above.

The scope of the review was for the period July 2006 through June 2008. Fieldwork was conducted February through May 2009. 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. In performing this audit, nothing came to our attention that indicated noncompliance with applicable laws and regulations.

FINDINGS

Our review of Murphy found issues involving customer classification and metering that could impact (1) the proper reporting of electric sales and (2) nondiscrimination in providing electricity to members of the same rate class. In addition, we found Murphy had more than enough cash on hand to cover planned capital projects and provide a cash reserve of about 12 percent. While TVA has established guidelines to determine if a distributor has adequate cash reserves (cash ratio of 5 percent to 8 percent), TVA has not established guidelines to determine if a distributor's cash reserves are excessive.

We also found improvements were needed to comply with contract provisions in the areas of (1) customer contracts and (2) use of joint cost studies. We identified three areas where Murphy's internal controls could be strengthened including (1) billing practices associated with well pumps, (2) accuracy of contract demand data entered in the system, and (3) enhancing policies to improve the internal control environment. Finally, as we explain herein, we found one TVA billing error as well as certain opportunities to enhance TVA oversight of the distributors.

PROPER REPORTING OF ELECTRIC SALES AND NONDISCRIMINATION IN PROVIDING ELECTRICITY TO MEMBERS OF THE SAME RATE CLASS

As discussed below, we identified issues involving the classification of customers and metering which could impact the proper reporting of electric sales. In addition, these issues impact the ability to ensure nondiscrimination in providing electricity to members of the same rate class.³ We were unable to estimate the monetary effect of all the issues because in some instances information was not available; however, for those where information was available, the monetary effect on Murphy and TVA would not be material. Additionally, correction of classification and metering issues is necessary to ensure all customers are placed in the correct rate classification and treated like other customers with similar circumstances.

Customer Classification Issues

We found nine customers that were not classified properly. One was a commercial customer classified within the General Power Service (GSA) Schedule of the General Power Rate. The GSA Schedule is divided into three

³ Section 5 Resale Rates subsection (a) of the power contract between TVA and Murphy 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."

parts—Part 1, Part 2, and Part 3—based on electric usage and demand,⁴ and this customer was incorrectly assigned within the GSA Schedule. The remaining eight customers were classified as residential although they should have been classified under the GSA Schedule. The monetary impact of the classification issues below would not be material to Murphy or TVA. Specifically, we noted:

- One customer was classified as GSA Part 1⁵ instead of GSA Part 2. According to the General Power Rate - Schedule GSA, a customer should be classified as a GSA Part 2 if (1) usage is over 15,000 kilowatt hours (kWh), (2) metered demand exceeds 50 kW, or (3) contract demand is greater than 50 kW. When a customer is moved to GSA Part 2, they must remain at that classification for 12 months after the usage meets the Part 2 criteria. This customer had metered demand of 50.12 kW in January 2008; therefore, the customer should have been classified as a GSA Part 2 for the next 12 months. Based on information provided by billing agency personnel, the legacy CSA system used by Murphy does not change a customer from GSA Part 1 to GSA Part 2 based on metered demand until after demand exceeds 50.499 kW rather than the 50 kW as stated by the GSA Part 2 rate schedule. Murphy personnel were not aware the threshold for metered demand in the CSA system was 50.499 kW rather than 50.01 kW.
- We found eight customers classified as residential customers that should have been classified as GSA Schedule customers. Specifically, we noted:
 - Two customers were group homes. The Residential Rate Schedule applies "only to electric service to a single-family dwelling." According to TVA personnel, a group home is not considered a single-family dwelling; therefore, the Residential Rate Schedule does not apply. Group homes

⁴ 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."

⁵ Under the General Power Rate - Schedule GSA between Murphy and TVA, 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.

should be classified using the appropriate GSA Schedule based on energy and demand takings.

- One customer was a cemetery which is a commercial operation. Murphy personnel reclassified the customer under the GSA Schedule when it was brought to their attention during our audit.
- Five customers with commercial names were classified inconsistently with other Murphy customers. According to Murphy personnel, a property has to be occupied by an individual tenant in order to be classified as a residence on the Murphy system. Based on Murphy's classification philosophy, properties in the names of landlords or properties that are rentals or temporary/transient housing where more than one tenant could occupy the property in a month should be classified using the appropriate GSA Schedule.

Metering Issues

In addition to the customer classification issues, our review of billing agency data noted the following two issues related to metering of customers at Murphy. We were unable to estimate the monetary effect because in some instances meters were not in place which would provide information to make the estimates. We found:

- Fifteen customers classified as a GSA Part 2 had energy usage in excess of 15,000 kWh but were not measured for demand. In addition, one of these customers had a contract on file at Murphy with contract demand of 168 kW. Under Part 2 of the GSA Schedule and the Wholesale rate schedule with TVA, there would be no effect on the revenues for TVA or the distributor unless the customer's demand exceeded 50 kW. Without demand meters in place or evidence indicating other circumstances exist which would prevent a customer from exceeding demand of 50 kW, we could not determine if any of these customers would have exceeded 50 kW.⁶
- Two older meters that require the demand reading to be manually reset each month were not being reset by the meter readers. According to Murphy personnel, the meter readers did not think the demand would go over 50 kW, so the meters were not reset. If the meter is not reset each month and the current month's peak demand does not exceed the previous month's peak demand, the peak demand reading may not represent the customer's actual peak demand for the month. Although demand for these two customers did not exceed 50 kW and no additional charges were incurred, the meters did not report the actual demand peak for the customer each month. According to Murphy personnel, Murphy has five of these type meters that must be manually reset each month still in use.

⁶ In response to a finding in a previous report, TVA indicated guidance will be issued to distributors to evaluate whether a demand meter is needed when usage reaches 25,000 kWh for a customer. Two of the fifteen customers' usage reached 25,000 kWh during the audit period.

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. While TVA has established guidelines to determine if a distributor has adequate cash reserves (cash ratio⁷ of 5 percent to 8 percent), TVA has not established guidelines to determine if a distributor's cash reserves are excessive.⁸

We found Murphy had more than enough cash on hand to cover planned capital projects and provide a cash reserve. As of June 30, 2008, Murphy reported about \$4.4 million in its cash and cash equivalent accounts, and the cash reserve after planned capital projects was about 12.1 percent. Table 2 shows information about plans for major capital expenditures obtained from Murphy's General Manager and our review of Murphy's Board of Directors meeting minutes.

Murphy's Planned Capital Expenditures

Capital Expenditure Plans	Project Cost
Completion of Substation	\$3,000,000
Total Planned Capital Expenditures	\$3,000,000

Table 2

When compared to Murphy's capital expenditure plans for the foreseeable future, the balance in Murphy's cash accounts was enough to pay for these items and leave about \$1.4 million as a reserve, as shown in Table 3. Table 3 also shows Murphy's cash ratio percentage was about 37.7 percent before accounting for planned capital expenditures and about 12.1 percent after accounting for them.

Murphy's Cash Accounts Compared to Planned Capital Expenditures

	Cash and Cash Equivalents Plus Prepayment Account	Planned Capital Expenditures	Reserve After Planned Capital Expenditures
FY 2008	\$4,426,164	\$3,000,000	\$1,426,164
Cash Ratio Percentage	37.68%		12.14%

Table 3

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

⁸ In separate reports issued on other distributors in May 2009, we recommended TVA develop criteria to be used in determining whether a distributor's cash reserves are excessive and incorporate the criteria into the rate setting process. TVA management agreed and will make recommendations to the TVA Board that additional financial metrics be employed for purposes of administering the resale rate provisions in Section 5 of the wholesale power contracts. The need to consider cash reserves will be included in TVA management's recommendations to the Board. A change in the current guidelines to include these additional financial metrics requires Board action. Target completion date is December 2010.

Discussions with Murphy's management indicated the operating philosophy of the Board of Directors and management was to use a conservative, generally debt-averse approach. According to TVA records, over the past five years, Murphy was approved for rate increases in 2005, 2006, and 2008. Table 4 shows the rate increases received by Murphy, the cash position, and cash ratio at June 30 prior to the effective date of the rate increase.

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

Cash on Hand Equivalent to an 8% Cash Ratio	Cash and Cash Equivalents ¹⁰ and Cash Ratio	Rate Increase ⁹		
		Additional Revenue	Percent	Effective Date
\$803,745	\$4,458,920 (CR - 44.38%)	\$174,000	1.61%	10/1/2005
\$886,383	\$4,342,825 (CR - 39.20%)	\$283,771	2.61%	7/1/2006
\$914,164	\$4,312,962 (CR - 37.74%)	\$351,272	2.81%	04/1/2008

Table 4

Coupled with this debt-averse philosophy, distributors consider cash reserves as a hedge against the risks of unforeseen costs from an aging infrastructure (e.g., equipment failure), potential loss of revenue from the economic impact on commercial and industrial customers, and unpredictable weather.

Examples of weather events¹¹ TVA distributors have incurred include damage from (1) the recent January 27, 2009, ice storm in Kentucky and Tennessee where about 130,000 of TVA distributor consumers lost their electricity and (2) tornados and the impact of tropical storms, such as the 2005 damage to Mississippi systems resulting from hurricane Katrina.

CONTRACT COMPLIANCE ISSUES

We noted two areas related to customer contracts where improvements could be made by Murphy. Specifically, we found (1) the most recent joint cost study performed by TVA was not being used by Murphy to charge rent to the City of Murphy and (2) required contracts for Murphy customers with demand greater than 50 kW were not in place for all customers. Below is further discussion on these items.

⁹ These are the rate increases requested by and approved for the distributor. These increases 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.

¹⁰ The cash and cash equivalents and cash ratio were computed based on information from Murphy's annual report as of June 30 prior to the effective date of the rate increase.

¹¹ After a severe weather event, utilities launch massive and costly round-the-clock restoration efforts. In addition to costs for miles of new wire, new poles, new transformers, and its own crews, utilities often have to pick up the bill for other utility crews providing assistance in the restoration effort.

Allocation of Joint Costs

We found Murphy did not apply the allocations from the 2005 TVA joint cost study when charging rent on the portion of Murphy's building occupied by the City of Murphy. Under the power contract, the distributor is allowed to "use property and personnel jointly for the electric system and other operations, subject to agreement between Municipality and TVA as to appropriate allocations." Murphy rents a portion of their building to the City of Murphy for use as City Hall. The monthly rent of \$1,672 being charged to the City of Murphy is based on a joint cost study performed by TVA in 1991. A more recent joint cost study performed by TVA for Murphy in 2005 determined the monthly rent should be \$3,148.35. According to Murphy personnel, the rent increase determined in the 2005 joint cost study was not applied because the City of Murphy is furnishing Murphy with 1,750 square feet of dry storage. The City of Murphy occupies 7,364 square feet of Murphy's building.

Customer Contracts When Demand Exceeds 50 kW

Under Murphy's contract with TVA, all customers that exceed 50 kW monthly are required to sign a formal contract. We randomly selected 36 customer accounts with billed demand in excess of 50 kW and requested the contract for each customer. Of these 36, Murphy did not have contracts for 25 customer accounts. Of the 25 customer accounts without contracts, 1 customer was classified as a GSA Part 3 and 1 was classified under the Manufacturing Service Rate – Schedule MSB.¹² We subsequently received a copy of the MSB customer's contract from TVA. Each customer contract includes a contract demand which is used in placing the customer in the correct classification. For example, a customer becomes a GSA Part 2 when either (1) the customer's currently effective contract demand or its highest billing demand during the latest 12 month period is more than 50 kW but less than 1,000 kW, or (2) the customer's billing demand is less than 50 kW and its energy takings for any month during such period exceed 15,000 kWh. Contract demand is also used in calculating the customer's billed demand and minimum bill. TVA management, in previous reports, indicated the threshold of 50 kW for requiring customer contracts was too low. TVA management will recommend to the Board that a new and higher threshold be established as part of the rate change process with the distributors.¹³ In further discussions with TVA personnel, the proposed threshold for requiring a contract is 1 megawatt (MW) which would include customers classified as GSA Part 3 or higher. Our sample included one GSA Part 3 customer exceeding the 1 MW threshold without a contract.

¹² Under the Manufacturing Service Rate – Schedule MSB between Murphy and TVA, customers are classified as MSB where (a) a customer's currently effective contract demand is greater than 5,000 kW but not more than 15,000 kW and (b) the major use of electricity is for activities conducted at the delivery point serving that customer which are classified with a 2-digit Standard Industrial Classification Code between 20 and 39, inclusive.

¹³ 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 October 2010.

DISTRIBUTOR INTERNAL CONTROL ISSUES

We identified three areas where Murphy's internal controls could be strengthened. Specifically, we found improvements could be made with respect to (1) billing practices associated with well pumps, (2) accuracy of contract demand data entered in the system, and (3) enhancing policies to improve the control environment.

Billing Practices

Murphy's billing practices regarding well pumps need to be improved. Murphy (1) did not have documentation supporting the retail rates for well pumps previously classified as Drainage Pump services, (2) gave customers with well pumps a credit to their customer charge that is not stated as allowed under the rate schedule, and (3) charged one customer the wrong customer charge. Specifically, we found:

- No documentation supporting the retail rates for well pumps previously classified as Drainage Pump services in Murphy's billing system. Retail rates are entered into the billing system based on rate schedules included as part of the power contract. Murphy did not have a rate schedule for Drainage Pump services included in its power contract with TVA; however, Murphy classified well pumps under the Drainage Pump rate schedule until July 2007 when well pumps were reclassified to GSA Part 1. Since there was no documentation supporting the retail rates for Drainage Pump services before July 2007, we could not verify the correct rates were entered into the billing system for these customers prior to July 2007.
- Customers with well pumps were given an \$11 credit to their monthly GSA Part 1 customer charge. This credit was given to customers to reduce the customer charge when well pumps were converted from the Drainage Pump Rate Schedule to General Power Rate – GSA Schedule as Part 1 customers. According to TVA personnel, the credit to the customer charge was supposed to be temporary; however, the credit was never phased out by Murphy. Murphy appears to apply the credit consistently to all well pump customers, including new well pump customers. The General Power Rate – GSA Schedule allows for adjustments to be made to the base energy and demand charges in accordance with the current Adjustment Addendum issued by TVA but does not state adjustments may be made to the customer charge.
- One customer was charged an additional \$11 on their residential bill each month from January 2008 through June 2008. According to Murphy personnel, this customer has a residential meter as well as a well pump classified as GSA Part 1. The customer received the \$11 credit to the GSA Part 1 customer charge all well pump customers receive, but \$11 was erroneously added to the customer's residential customer charge. The Office Manager stated Murphy thought the error had been corrected and the customer bill had been adjusted; however, based on the results of our testing, Murphy personnel indicated the customer is owed \$66.

Contract Demand in Billing Agency System

We noted two issues related to entering contract demand in the billing system. Specifically, while performing our review of customers with demand in excess of 50 kW (see "Customer Contracts When Demand Exceeds 50 kW" on page 8), we noted (1) ten customers with a contract did not have contract demand entered into the system, and (2) one GSA Part 3 customer did not have a contract on file but had a contract demand amount entered in the billing system. Contract demand should be entered into the billing system based on the agreed-upon contract amount to ensure proper calculation of the customer's bill.

Policy Enhancement to Improve Control Environment

We noted there were no formal policies at Murphy over expenditures. Formalizing policies is a prudent business practice that will help the distributor ensure expenditures are properly controlled and are used for electric system purposes. Specifically, we noted enhancing policies would be beneficial in several areas, including:

- **Use of Petty Cash** – The petty cash fund was established to provide customer refunds of deposits; however, we found the petty cash fund was used for other purposes including (1) general operating and maintenance expenses, (2) travel per diem, and (3) meals and entertainment expenses. Meals and entertainment expenses included frequent in-office meals as well as restaurant visits by front office personnel.¹⁴
- **Contributions** – We noted Murphy made contributions to various organizations or individuals by making a direct cash contribution or a direct payment to a vendor for an event. However, Murphy does not have written guidance for (1) the types of organizations eligible for contributions, (2) approval levels/limits for contributions, and (3) handling approvals for contributions when Murphy personnel are also affiliated with the receiving organization to prevent the perception of a conflict of interest. For example, contributions in-kind of over \$11,000 were made to the community college where Murphy directly paid a vendor for a portion of an event in lieu of a cash donation. A person in Murphy management was also on the college's board of directors. Other contributions were to (1) other civic organizations in smaller amounts and (2) individuals, specifically to members of the Murphy police force and scholarship recipients. According to Murphy personnel, contributions to each member of the police force were provided for helping Murphy by directing traffic when necessary during the year.
- **Other Benefits** – We noted employees received benefits including allowances for yearly home telephone service for employees as well as an annual clothing allowance for front office personnel. According to Murphy personnel, the phone service is paid for each employee, including office personnel, so employees may be contacted at home in the event of an emergency. Murphy

¹⁴ Four employees make up the front office personnel, including two cashiers, the accountant, and office manager.

personnel also stated the front office personnel receive an annual clothing allowance since the service personnel¹⁵ are provided uniforms by Murphy.

- Travel – We noted employee travel was paid for in multiple ways, and policies did not exist on approval of travel, travel expense limits (i.e., a per diem amount or reimbursement for actual expenses up to a daily limit, whether overnight stay is required, etc.), and allowable methods for payment of expenses, such as using a Murphy credit card, reimbursed from petty cash, or through an employee reimbursement process.

TVA BILLING ISSUES

We found one instance where TVA incorrectly billed Murphy on the monthly Schedule 1s. Specifically, we found the Competitive Index Rate (CIR) was incorrectly calculated for the Schedule 1s during the audit period. According to the contract between TVA and Murphy, the retail rates used in calculating the CIR credit were to be changed in line with the rate changes of competing system Nantahala Power and Light (NP&L). However, Murphy's contract with the end-use MSB customer provided fixed retail rates for a five-year period regardless of rate changes made by NP&L.

In May 2006, NP&L increased rates. TVA knew of the rate change and that TVA's contract with Murphy called for an upward adjustment in the rates used in the CIR. While Murphy could not increase the retail rate charged to the customer, TVA should have increased the rates used in the CIR credit calculation at that time. However, TVA decided at that time not to do so because (1) the inconsistencies between the wholesale and retail contracts may have resulted from poor communications between TVA and Murphy about program requirements, and (2) TVA customer service personnel had signed the retail contract between Murphy and the MSB customer. While the signatures reflected approval to only one section of the contract and not of the contract in its entirety, TVA took the position that the signatures could compromise its legal position in the event of litigation. If the rates had been adjusted in accordance with the wholesale contract provisions, TVA would have reduced the amount credited to Murphy by approximately \$174,000 during the audit period. The position TVA took on this issue in 2006 would likely compromise its ability to pursue recovery of the \$174,000 at this time. According to Murphy personnel, the MSB customer left Murphy in 2008.

TVA OVERSIGHT OPPORTUNITIES

We found opportunities to enhance TVA's oversight of this distributor; however, the issues noted for this distributor were the same as those reported in previous Office of the Inspector General (OIG) distributor reports. Specifically, we noted TVA has not:

¹⁵ Service personnel provide installation and maintenance for the Murphy electric system.

- Provided adequate guidance on when a demand meter is required,
- Provided definitive guidance for distributors on what constitutes prudent expenditures, and
- Defined criteria for evaluating when a distributor's cash is excessive.

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

RECOMMENDATIONS

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

1. Work with the billing agency to ensure that the software system appropriately classifies customers when demand is greater than 50 kW.

Murphy's Response – Murphy agreed with the recommendation and has contacted the billing agency to resolve the issue. See Appendix A for Murphy's complete response.

TVA Management's Comments – TVA agreed with our recommendation and stated Murphy was in the process of addressing this issue with the billing agency. See Appendix B for TVA's complete response.

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

2. Develop controls to properly classify group homes and consistently classify properties that are not in an individual tenant's name.

Murphy's Response – Murphy agreed with the recommendation and has reclassified the properties identified in the review. Murphy also stated the criteria for classifying properties have been defined and training provided to employees. See Appendix A for Murphy's complete response.

TVA Management's Comments – TVA agreed with our recommendation and stated Murphy had resolved the classification issues identified in the review. See Appendix B for TVA's complete response.

Auditor's Response – The OIG concurs with the actions taken, and no further action is necessary.

3. Install demand meters for customers with contract demand but no demand meter.

Murphy's Response – Murphy agreed with the recommendation and stated the customer identified in the review was mistakenly assigned a contract demand. Murphy stated procedures for assigning contract demand are being reviewed. Murphy also stated employees were working with the billing agency to review all contract demands in the billing system. See Appendix A for Murphy's complete response.

TVA Management's Comments – TVA agreed with our recommendation and stated Murphy was in the process of resolving contract demand issues. See Appendix B for TVA's complete response.

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

4. Review the customers with usage greater than 15,000 kWh and install demand meters, if needed.

Murphy's Response – Murphy agreed with the recommendation and stated employee refresher training was provided for the calculation and field monitoring of accounts. See Appendix A for Murphy's complete response.

TVA Management's Comments – TVA agreed with our recommendation and stated TVA would encourage Murphy to develop procedures to review accounts. See Appendix B for TVA's complete response.

Auditor's Response – The OIG concurs with the actions taken, and no further action is necessary.

5. Implement a procedure to (1) identify and document those customers that have circumstances (i.e., maximum load for the installed electrical configuration) which would never allow the customer to reach the 50 kW threshold and (2) routinely monitor demand or place demand meters at customer service addresses where usage could potentially reach the demand threshold.

Murphy's Response – Murphy agreed with the recommendation and stated employee refresher training was provided for the calculation and field monitoring of accounts. In addition, Murphy requested additional exception reporting from the billing agency to identify customers with over 15,000 kWh and no reported demand to be used in monitoring those accounts. Murphy also stated demand meters were installed for all customers nearing the 50 kW threshold. See Appendix A for Murphy's complete response.

TVA Management's Comments – TVA agreed with our recommendation and stated Murphy was in the process of installing demand meters for customers nearing the 50 kW threshold. In addition, TVA management stated guidance will be provided to distributors to advise that customers be evaluated for demand meters once the usage reaches 25,000 kWh. See Appendix B for TVA's complete response.

Auditor's Response – The OIG concurs with the actions taken, and no further action is necessary.

6. Implement a procedure to ensure all meters are manually reset each month.

Murphy's Response – Murphy agreed with the recommendation and stated meters are now being manually reset each month. See Appendix A for Murphy's complete response.

TVA Management's Comments – TVA agreed with our recommendation and stated Murphy is now manually resetting the demand reading on all meters each month. See Appendix B for TVA's complete response.

Auditor's Response – The OIG concurs with the actions taken, and no further action is necessary.

7. Use the most current joint cost study in determining rent charged to the City of Murphy or obtain TVA approval for deviations.

Murphy's Response – Murphy agreed with the recommendation and stated the most current joint cost study is now being used to charge rent. See Appendix A for Murphy's complete response.

TVA Management's Comments – TVA agreed with our recommendation and stated Murphy is using the joint cost study performed in October 2009 to charge rent. See Appendix B for TVA's complete response.

Auditor's Response – The OIG concurs with the actions taken, and no further action is necessary.

8. Obtain customer contracts for those with demand exceeding 1 MW.

Murphy's Response – Murphy agreed with the recommendation and stated it is in the process of obtaining a contract from the customer with more than 1 MW of demand identified in the review. See Appendix A for Murphy's complete response.

TVA Management's Comments – TVA agreed with our recommendation and stated TVA management will recommend to the Board to revise the threshold for requiring customer contracts to 1 MW. The target completion date for this revision will coincide with the wholesale rate change expected to be in place by October 2010. See Appendix B for TVA's complete response.

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

9. Review all GSA Part 1 customers with well pumps and ensure all are charged the customer charge set forth in the rate schedule.

Murphy's Response – Murphy agreed with the recommendation and stated well pump customers have been notified the credit to the customer charge will end March 2010. See Appendix A for Murphy's complete response.

TVA Management's Comments – TVA agreed with our recommendation and stated the distributor should charge well pump customers according to the rate schedule. See Appendix B for TVA's complete response.

Auditor's Response – The OIG concurs with the actions taken, and no further action is necessary.

10. Implement a process to ensure all customers with contracts have the appropriate contract demand entered into the billing system, and the contract demand in the system agrees with the customer's contract.

Murphy's Response – Murphy agreed with the recommendation and stated a filing process was implemented to ensure new customer contracts are received and contract demand is accurately entered into the billing system. See Appendix A for Murphy's complete response.

TVA Management's Comments – TVA agreed with our recommendation and stated Murphy is working to ensure contract demand is accurately entered into the billing system. See Appendix B for TVA's complete response.

Auditor's Response – The OIG concurs with the actions taken, and no further action is necessary.

11. Enhance policies to improve internal controls over expenditures including the use of petty cash, contributions, employee benefits, and employee travel.

Murphy's Response – Murphy agreed with the recommendation and stated an employee handbook addressing these issues is in development. See Appendix A for Murphy's complete response.

TVA Management's Comments – TVA agreed with our recommendation and stated that TVA will rely on Murphy and its independent auditor to ensure internal controls are developed for expenditures. See Appendix B for TVA's complete response.

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

The Group President, S&ER, should:

12. Review the CIR credit and recover any amounts incorrectly credited to the distributor.

TVA Management's Comments – TVA stated they evaluated recovery mechanisms; however, recovery of the amount was not possible because the customer receiving the credit is no longer in business. In addition, TVA stated Murphy did not agree the CIR was subject to adjustment due to (1) inconsistencies in TVA communications with Murphy about CIR program requirements and (2) approval by TVA representatives, after the wholesale contract was in place, of a retail contract with additional language providing for no adjustments. TVA also stated it was unlikely litigation to recover the incorrectly credited CIR amount would be successful. TVA has been focused on putting procedures and processes in place to better assure TVA rates and pricing programs are implemented and carried out as intended in the future. See Appendices B and C for TVA's complete response.

Auditor's Response – The OIG concurs with TVA's stated focus on putting procedures and processes in place to better assure the rates and pricing programs are implemented as intended in the future. No further action is necessary.

We amended the TVA Billing Issue section of this report to provide additional information on the circumstances surrounding the decision by TVA personnel in 2006 not to pursue rate changes in the calculation of the CIR credit.

13. Determine if other CIR customers with other distributors have been credited appropriately.

TVA Management's Comments – TVA agreed with our recommendation and stated contracts with CIR customers were reviewed in FY 2009 to determine if charges were correctly applied. Any necessary adjustments were made at that time. In addition, TVA staff plan to review customers with CIR contracts annually to ensure charges are being applied correctly. See Appendix B for TVA's complete response.

Auditor's Response – The OIG concurs with the actions taken, and no further action is necessary.

William F. Forsyth, Jr., Chairman
Henry Simmons, Board Member
John Carringer, Board Member, Assistant Manager
Larry Kernea, Manager

— *Murphy Electric* —
Power Board

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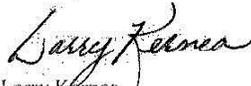
December 17, 2009

Mr. Robert E. Martin, Asst. Inspector General
Office of the Inspector General
Tennessee Valley Authority
400 West Summit Hill Drive, Knoxville, TN 37902-1401

Dear Mr. Martin:

We have reviewed the Draft Audit 2008-12038. Please find following our comments relative to recommendations for improvements. Please call or email me if you have questions.

Sincerely,



Larry Kernea
Manager

Cc: Mrs. Kimberly S. Greene, Chief Financial Officer and Executive Vice President,
Financial Services
Tennessee Valley Authority
400 West Summit Hill Drive, WT 7B
Knoxville, Tennessee 37902-1401

REQUEST FOR COMMENTS-DRAFT AUDIT 2008-12038 MEPB

1. Agree with recommendation. Billing agency has been contacted.
2. Agree with recommendation. Accounts identified have been reclassified. Criteria for classification have been clearly defined and employees trained.
3. Agree with recommendation. Customer identified in audit was mistakenly assigned a contract demand. Procedures for assigning contract demand have been reviewed and employees are working with billing agency to review all contract demands.
4. Agree with recommendations. Refresher training has been provided for employees for the calculation and field monitoring of accounts near the threshold. Billing research produced many accounts with kWh usage greater than 15000 and metered demand lower than 50 KW.
5. Agree with recommendation. Refresher training has been provided for employees for the calculation and field monitoring of accounts near the threshold. Quarterly reports of accounts with usage greater than 15000 kwhs with no demand field entry have been requested from billing agency to be used in future monitoring. Demand meters have been installed on all customers nearing the demand threshold.
6. Agree with recommendation. Action complete.
7. Agree with recommendation. The current cost study is in use and approval has been obtained from TVA.
8. Agree with recommendation. The customer identified is in the process of providing a customer contract.

9. Agree with recommendation. All GSA Part 1 customers with well pumps have been reviewed. All customers (242 individuals and subdivisions) with rural water pumps will be notified that the billing credit will end on March 1, 2010 unless a suitable arrangement is made with TVA to allow MEPB to continue the credit from the customer charge.
10. Agree with recommendation. MEPB employees have reviewed the customer contract process and have implemented a filing process to ensure new customer contracts are received with appropriate contract demand and accurately entered into the billing system. Filing system supports future monitoring with all information centrally located.
11. Agree with recommendation. The use of petty cash, contributions, employee benefits and employee travel were reviewed with MEPB directors on December 7, 2009 in a review of draft-audit 2008-12038.

PETTY CASH: The petty cash fund has been approved for and used for each of the purposes listed for the past 20 years. The answer as given or as received relative to the approved use of petty cash was incorrect.

CONTRIBUTIONS: All contribution requests are reported to MEPB directors and made if approved with the amount listed monthly on line 85 of the TVA revenue and expense statement. The activity is reviewed and approved as a part of the financial report. With regard to the recommendation in the exit interview to list individually the recipients of contributions, a list has been developed for consideration by management and directors that will show annual activity.

OTHER BENEFITS: MEPB pays the home telephone bill for those employees willing to have their home telephone number published in the local telephone directory and a regional advertising directory under the Murphy Electric Power Board heading. Customers call the numbers on nights and weekends to report outages and to seek customer service information.

Travel: In recognition of the value of interaction through classes, offsite meetings and association participation MEPB policy for payment of travel expenses was established in a meeting of the directors September 28, 1984. As recommended in the audit an employee handbook describing and defining employee benefits is in development.

December 23, 2009

Robert E. Martin, ET 3C-K

RESPONSE TO DRAFT AUDIT REPORT 2008-12038 – DISTRIBUTOR REVIEW OF
MURPHY ELECTRIC BOARD

This is in response to your memorandum dated November 30, 2009.

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.

1. Work with the billing agency to ensure that the software system appropriately classifies customers when demand is greater than 50 kW.
 - o TVA management agrees that the Power Contract requires consistent classification of customers.
 - o **Actions taken or planned, and completion dates:** Distributor is working with Central Service Association (CSA) to evaluate the cost and benefits of changing these classification and billing issues.
2. Develop controls to properly classify group homes and consistently classify properties that are not in an individual tenant's name.
 - o TVA management agrees that the Power Contract requires consistent classification of customers in accordance with the applicable rate schedule.
 - o **Actions taken or planned, and completion dates:** Distributor is working with Central Service Association (CSA) and has resolved the classification issues on the accounts in question.
3. Install demand meters for customers with contract demand but no demand meter.
 - o TVA management agrees that distributors should monitor demand to be sure that they comply with the GSA rate schedule requirements. The rate schedule states, "Distributor shall meter the demands in kW of all customers having loads in excess of 50 kW."
 - o **Actions taken or planned, and completion dates:** The Distributor is in the process of installing demand meters on customer accounts that might fall into this classification. One customer that was specifically identified with a contract demand of 168 kW was incorrectly identified and is no longer a customer.

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4. Review the customers with usage greater than 15,000 kWh and install demand meters, if needed.
 - TVA management agrees that distributors should monitor demand to be sure that they comply with the GSA rate schedule requirements. The rate schedule states, "Distributor shall meter the demands in kW of all customers having loads in excess of 50 kW."
 - **Actions planned or taken, and completion dates:** TVA will encourage the Distributor to develop such procedures as a matter of good business practice. (See response for recommendation no. 5 below).

5. Implement a procedure to (1) identify and document those customers that have circumstances (i.e., maximum load for the installed electrical configuration) which would never allow the customer to reach the 50 kW threshold and (2) routinely monitor demand or place demand meters at customer service addresses where usage could potentially reach the demand threshold.
 - TVA management agrees that distributors should monitor demand to be sure that they comply with the GSA rate schedule requirements. Guidance is provided in the Determination of Demand section of the GSA Rate Schedule. Said schedule states, "Distributor shall meter the demands in kW of all customers having loads in excess of 50kW."
 - **Actions planned or taken, and completion dates:** The Distributor is in the process of installing demand meters on customers that might fall into this classification. In addition, TVA will provide guidance to all distributors and advise that they evaluate the installation of a demand meter once a customer's monthly usage exceeds 25,000 kWh since it is probable that such a customer would meet the 50 kW thresholds for demand charges for GSA Part 2 customers. A distributor should also consider factors such as the nature of the customer's business, operating patterns, electrical equipment and building specifications when considering the installation of a demand meter.

6. Implement a procedure to ensure all meters are manually reset each month.
 - TVA management agrees that Distributor should adopt a procedure to manually reset meters each month.
 - **Actions planned or taken, and completion dates:** Meter readers are resetting the demand meters each month as meter reading.

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7. Use the most current joint-cost study in determining rent charged to the City of Murphy or obtain TVA approval for deviations.
 - o TVA management agrees that Distributor should use the most current joint-cost study in determining rent charged by the City of Murphy or obtain TVA approval for deviations.
 - o **Actions planned or taken, and completion dates:** TVA management and distributor reviewed the joint-cost allocations for the City of Murphy and implemented the joint-cost allocations in October 2009.

8. Obtain customer contracts for those with demand exceeding 1 MW.
 - o TVA management agrees that the resale schedules of the standard Schedule of Rates and Charges to the wholesale contract with distributors require that retail contracts be executed with all customers whose contract demand exceeds 50 kW. TVA management finds that the contract size threshold of 50 kW was established in 1963, and the relative customer size in 2009 versus 1963 is very different. Likewise, requiring contracts with small commercial customers is a time-consuming and difficult task which may provide little benefit for distributors or the TVA system. TVA management will recommend to the Board that a new and higher threshold be established as part of the rate change process with distributors. The current threshold proposed is demand in excess of 1 MW. When the rate change is put into effect all retail customers above the new threshold will be expected to have executed contracts.
 - o **Actions taken or planned, and completion dates:** TVA management will recommend to the TVA Board that a higher contract demand threshold for the contract requirement be established through the rate change process. The current threshold proposed is demand in excess of 1 MW. The actual threshold agreed to may be higher or lower than 1 MW. Distributors will be required to execute retail contracts for customers with contract demands above the threshold level that the TVA Board approves. Target completion date will coincide with the rate change efforts that are currently underway with the distributors and is expected to be in place by October 2010.

9. Review all GSA Part 1 customers with well pumps and ensure all are charged the customer charge set forth in the rate schedule.
 - o TVA management agrees that the Distributor should charge GSA Part 1 customers with well pumps according to the customer charges set forth in the rate schedule.

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- **Actions taken or planned, and completion dates:** The Distributor has checked all GSA Part 1 customers with well pumps to ensure that they are being charged the customer charges set forth in the rate schedule and confirmed that the charges are being applied correctly.
10. Implement a process to ensure all customers with contracts have the appropriate contract demand entered into the billing system, and the contract demand in the system agree with the customer's contract.
- TVA management agrees that the Distributor should ensure that all customers with contracts have the appropriate contract demand entered into the billing system and that the contract demand is consistent with the customer's contract.
 - **Actions taken or planned, and completion dates:** Distributor is working with CSA to ensure that customer contracts have the appropriate contract demand entered into the system and the contract demand agrees with the customer contract.
11. Enhance policies to improve internal controls over expenditures including the use of petty cash, contributions, employee benefits, and employee travel.
- TVA management agrees that proper internal controls over expenditures are necessary and will encourage the Distributor to develop internal controls for expenditures such as those described as a matter of good business practice.
 - **Actions taken or planned, and completion dates:** TVA will rely on the Distributor and its independent auditor to ensure that internal controls are developed for these expenditures.
12. Review the CIR credit and recover any amounts incorrectly credited to the distributor.
- This recommendation is in response to the calculation of CIR credit applied to a particular customer. TVA field accountants have reviewed the CIR credit and agree with the amount determined to have been incorrectly credited.
 - **Actions taken or planned, and completion dates:** TVA has evaluated recovery mechanisms but recovery of the amount at issue is not possible since the customer of the distributor has closed.

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13. Determine if other CIR customers with other distributors have been credited appropriately.
- o TVA management agrees that it is appropriate to review contracts containing CIR provisions to determine whether proper credits have been applied.
 - o **Actions taken or planned, and completion dates:** TVA field accountants and Contracts staff have reviewed the contracts with CIR customers in FY 09 to determine whether the charges were applied correctly, and any necessary adjustments have been made. TVA staff plan to review these charges every year as a matter of routine business practice to ensure that the charges are being applied correctly.



Kimberly S. Greene
Chief Financial Officer and
Executive Vice President, Financial Services
WT 7B-K

VB: JSE
cc: Peyton T. Hairston Jr., WT 7B-K
John P. Kernodle, WT 6A-K
John E. Long, Jr., WT 7B-K
Jill M. Matthews, ET 3C-K
Richard W. Moore, ET 4C-K
John M. Thomas III, WT 4B-K
John G. Trawick, WT 3D-K
Benny R. Wagner, ET 4C-K
EDMS

February 5, 2010

Robert E. Martin, ET 3C-K

**AMENDMENT TO RESPONSE TO ITEM NUMBER 12 – DRAFT AUDIT
REPORT 2008-12038-DISTRIBUTOR REVIEW OF MURPHY ELECTRIC
BOARD**

This follows up on your request to me for a further explanation of response number 12 on page 4 of Kimberly Greene's memorandum, Response to Draft Audit Report 2008-12038 – Distributor Review of Murphy Electric Board, dated December 23, 2009, which asserted that recovery of the CIR wholesale credit amount at issue is not possible.

Management's conclusion is based in part on the facts that the distributor customer has ceased operations and that there is no legal basis for the distributor to recover corresponding CIR retail credits from the former customer. In addition, the distributor does not agree with TVA's position that the CIR rates at issue (either the wholesale rates or the resale rates) were subject to adjustment to reflect increases in Nantahala Power and Light rates during the term of the CIR arrangements. The facts relied upon by the distributor to support its position include (i) inconsistencies in TVA communications with Murphy about CIR program requirements and (ii) approval by TVA representatives, after the wholesale contract was in place, of a retail contract with additional language providing for no adjustments. These and other facts we described to you more fully during the audit process make it unlikely that litigation to recover CIR wholesale credits could be successfully concluded.

Our focus has been on putting procedures and processes in place to better assure that TVA rates and pricing programs are implemented and carried out as intended in the future. These include, but are not limited to, the CIR program actions described in response number 13 on page 5 of the December 23 memorandum.



John G. Trawick
Senior Vice President
Commercial Operations and Pricing
WT 3D-K

VB:JSE

cc: See list on page 2

Robert E. Martin
Page 2
February 5, 2010

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