Memorandum from the Office of the Inspector General

April 6, 2011

Kimberly S. Greene, WT 7B-K

REQUEST FOR FINAL ACTION – AUDIT 2010-13284 – DISTRIBUTOR AUDIT OF FLORENCE ELECTRICITY DEPARTMENT

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

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

If you have any questions, or wish to discuss our findings, please contact me or Richard C. Underwood, Acting Director, Distributor Audits, at (423) 785-4824. We appreciate the courtesy and cooperation received from your staff during the audit.

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

RCU:HAC
Attachment
cc (Attachment):
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OIG File No. 2010-13284

Office of the Inspector General

Audit Report

To the Group President, Strategy and External Relations

DISTRIBUTOR AUDIT OF FLORENCE ELECTRICITY DEPARTMENT

Audit Team
Richard C. Underwood
Jessica L. Monroe
Stephanie L. Simmons

Audit 2010-13284
April 6, 2011

ACRONYMS AND ABBREVIATIONS

FY	Fiscal Year
kW	Kilowatt
kWh	Kilowatt Hour
MW	Megawatt
OIG	Office of the Inspector General
TVA	Tennessee Valley Authority

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APPENDICES

EXECUTIVE SUMMARY

Why the OIG Did This Audit

As part of our annual audit plan, we audited Florence Electricity Department's compliance with the power contract between the Tennessee Valley Authority (TVA) and the City of Florence. Florence, a TVA power distributor based in Florence, Alabama, had revenue from electric sales of about $116 million in fiscal year (FY) 2009. In addition to the Electricity Department, Florence also operates water, waste water, and gas departments and provides billing services for these utilities and other municipalities. The objective of our audit was to determine compliance with key provisions of the power contract between TVA and Florence.

What the OIG Found

Our audit of Florence found improvements were needed in the areas of (1) customer classification, (2) metering, (3) contract compliance, and (4) distributor internal controls as follows:

- **Customer Classification** – 26 out of 460 (5.7 percent) customer accounts we selected for further review were not classified correctly. Although the monetary impact of the misclassifications would not be significant to Florence or TVA, the misclassifications could impact (1) the proper reporting of electric sales and/or (2) nondiscrimination in providing power to customers. Florence reclassified the 26 customers during the audit.
- **Metering** – We noted 44 customer accounts self-reporting their energy usage to Florence. Of these 44, the meters had not been read for 27 accounts within 365 days of the date that the data was extracted from the billing system, and 4 accounts did not have a meter read date recorded in the billing system.
- **Contract Compliance** – Florence did not always meet TVA's power contract requirements for obtaining contracts for customers as required by the GSA rate schedule. Specifically, 3 of 14 (about 21 percent) customer accounts with demand in excess of one megawatt during the audit period did not have a contract on file with Florence.
- **Distributor Internal Controls** – We noted a control improvement Florence agreed to implement in response to the FY 2009 SAS 70 report had not been implemented.

In addition, we found Florence had enough cash on hand at June 30, 2009, to cover actual FY 2010 capital expenditures and provide a cash reserve equivalent to a cash ratio of about 8 percent, which is within TVA's established guidelines for an adequate cash ratio of 5 to 8 percent.

Finally, we found two opportunities to enhance TVA's oversight of the distributors that have been reported in previous OIG (Office of the Inspector General) distributor audits. TVA is in the process of addressing these findings, which include (1) providing definitive guidance for distributors on what constitutes prudent expenditures and (2) updating joint cost allocations in the time period recommended by the TVA Accountants' Reference Manual.

What the OIG Recommends

We recommend the Group President, Strategy and External Relations, work with Florence to (1) implement controls to prevent classification issues from recurring, (2) improve compliance with contract provisions related to customer contracts, and (3) implement agreed-upon control improvements from the FY 2009 SAS 70 report.

Management's Comments

Florence and TVA management agreed with our recommendations and have taken or are taking actions to address the recommendations. The target completion date for all corrective actions is September 2012. See Appendix B for Florence's complete response and Appendix C for TVA's complete response.

Auditor's Response

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

BACKGROUND

The Florence Electricity Department[1] is a distributor for Tennessee Valley Authority (TVA) power based in Florence, Alabama, with revenues from electric sales of approximately $116 million in fiscal year (FY) 2009. TVA relies on distributors to self-report customer usage and subsequently the amount owed to TVA (Schedule 1). Customers are generally classified as residential, commercial, manufacturing, and lighting. Within these classes are various rate classifications based on the customer type and usage. Table 1 shows the customer mix for Florence as of June 2009.

Florence's Customer Mix as of June 2009

Customer Classification	Number of Customers	Revenue	Kilowatt Hours Sold
Residential	39,535	$62,096,112	651,210,607
General Power – 50 Kilowatts (kW) and Under (Commercial)	6,719	11,476,260	103,868,296
General Power – Over 50 kW (Commercial or Manufacturing)	731	40,145,131	443,474,770
Street and Athletic	115	1,492,204	7,682,272
Outdoor Lighting[2]	320	674,164	4,892,569
Total	**47,420**	**$115,883,871**	**1,211,128,514**

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. Florence uses Daffron Consumer Information Systems software applications for its end-use billing and invoice processing. This system generates various reports that provide management with an understanding of the transactions that occur within the normal course of business. All other accounting and finance responsibilities are handled by Florence, which has a Mayor and City Council providing oversight and a manager and accountant managing the daily activities. In addition to the Electricity Department, Florence also operates water, waste water, and gas departments and provides billing services for these utilities and other municipalities (i.e., the sanitation departments of Lauderdale County and the Town of Lexington as well as the West Lauderdale Water Authority).

1 The wholesale power contract is between the "City of Florence, Alabama," and TVA. We will use "Florence" rather than the "City of Florence, Alabama," in this report.

2 The "Number of Customers" represents those customers who only have Outdoor Lighting accounts with Florence at June 30, 2009. In addition, another 5,135 customers had Outdoor Lighting accounts as well as accounts for other services with Florence. The totals for "Revenue" and "Kilowatt Hours Sold" include both categories of Outdoor Lighting customers.

FINDINGS

Our audit of Florence found issues involving customer classification and metering that could impact (1) the proper reporting of electric sales and/or (2) nondiscrimination in providing power to customers of the same rate class. In addition, we found Florence had enough cash on hand at June 30, 2009, to cover actual FY 2010 capital expenditures and provide a cash reserve equivalent to a cash ratio of about 8 percent, which is within TVA's established guidelines for an adequate cash ratio of 5 to 8 percent.

We also found improvements were needed to comply with contract provisions related to obtaining customer contracts as required by the GSA rate schedule. In addition, we identified an opportunity to strengthen Florence's internal controls that had been identified in the FY 2009 SAS 70 report but not yet implemented. Finally, we found certain opportunities to enhance TVA's oversight of the distributors that have been reported in previous distributor reports.

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

As discussed below, we identified a customer classification issue and a metering issue that could impact (1) the proper reporting of electric sales and/or (2) the ability to ensure nondiscrimination in providing power to members of the same rate class.[3] Although the monetary effect of the classification issue on Florence and TVA would not be significant, correcting classification and metering issues is important to ensure all customers are placed in the correct rate classification and charged the same rate as other customers with similar circumstances.

Customer Classification Issue
We noted 460 customer accounts that appeared to be improperly classified based on customer name and/or the existence of multiple accounts at the same address. At our request, Florence reviewed these accounts and determined 26 accounts were improperly classified. The 26 customer accounts were classified as Residential Rate – Schedule RS,[4] although they should have been classified

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

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

under the General Power Rate – Schedule GSA.[5] The GSA schedule is divided into three parts—Part 1, Part 2, and Part 3—based on electric usage and demand.[6] The monetary impact of the misclassifications would not be significant to Florence or TVA. Florence personnel reclassified the 26 customers from residential to commercial (GSA schedule) in October 2010.

Metering Issue

During discussions with Florence personnel, we noted 44 accounts that were self-reporting their usage to Florence. At our request, Florence management provided us with data from the billing system as of October 21, 2010, showing the last date Florence personnel read the meter for the 44 customer accounts self-reporting usage. Our review of this billing system data noted (1) 4 accounts with no meter reading date, (2) 27 accounts whose last read date was more than 365 days prior to the date the data was extracted from the billing system, and (3) 13 accounts whose last read date was 365 days or less from the date the data was extracted.

Florence management indicated the self-reporting customers were good customers. Therefore, Florence management did not feel a sense of urgency to keep actual meter readings documented. As a result of our audit, Florence management implemented a program to make an appointment to visit and replace the customers' current meter with a meter that can be read remotely. Florence management stated that as of January 26, 2011, all but 12 of the self-reporting customers' meters had been replaced with meters that can be read remotely. Florence plans to send out a second request to the 12 remaining customers to make appointments to install meters that can be read remotely. We concur with the actions taken and planned by Florence management.

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

[6] Demand is a measure of the rate at which energy is consumed. The demand an electric company must supply varies with the time of day, day of the week, and the time of year. Peak demand seldom occurs for more than a few hours or fractions of hours each month or year, but electric companies must maintain sufficient generating and transmission capacity to supply the peak demand. Demand charges represent the high costs electric companies pay for generating and transmission capacity that sits idle most of the time. Demand charges are based on the amount of energy consumed in a specified period of time known as a demand interval. Demand intervals are usually 15 or 30 minutes. (Engineering Tech Tips, December 2000, Dave Dieziger, 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."

USE OF ELECTRIC SYSTEM REVENUES

Under the TVA power contract, approved uses of revenues from electric system operations, including any surplus, are (1) operating expenses, (2) debt service, (3) tax equivalent payments, and (4) reasonable reserves for renewals, replacements, and contingencies. As discussed on the following page, we noted Florence had enough cash on hand at June 30, 2009, to cover actual FY 2010 capital projects and provide a cash reserve equivalent to a cash ratio of about 8 percent, which is within TVA's established guidelines for an adequate cash ratio of 5 to 8 percent.[7]

As of June 30, 2009, Florence reported about $5.8 million in its cash and cash equivalent accounts. Florence management provided the actual FY 2010 capital expenditures as shown in Table 2 below.

Florence's FY 2010 Actual Capital Expenditures

Actual Capital Expenditures	Cost
Station Equipment	$283,798
Poles, Towers, and Fixtures	617,836
Overhead Conductors and Devices	14,788
Underground Conduit	104,545
Underground Conductors and Devices	949,182
Line Transformers	272
Services	107,673
Meters	72,992
Installations on Customers' Premises	59,246
Street Lighting and Signal Systems	72,547
Land and Land Rights	41,768
Structures and Improvements	132,962
Office Furniture and Equipment	52,481
General Plant Equipment	598,910
Total Actual Capital Expenditures	**$3,109,000**

Table 2

When compared to Florence's actual capital expenditures for FY 2010, the balance in Florence's cash accounts at June 30, 2009, was enough to pay for these items and leave about $2.7 million as a reserve.

When performing rate reviews, TVA calculates the cash ratio (footnote 7). Values in the cash ratio formula's denominator include purchased power cost. Because

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

the balance in the TVA Power Invoice Prepayment Account is used to pay TVA for the distributor's purchased power, we included the Prepayment balance in our calculation of the cash ratio in Table 3. At June 30, 2009, the balance in the Prepayment account was $6,248,500.

Table 3 shows Florence's cash ratio percentage, including this Prepayment account balance, was 11 percent before accounting for actual FY 2010 capital expenditures and about 8 percent after accounting for them.

Florence's Cash Accounts Compared to Actual Capital Expenditures

	Cash and Cash Equivalents Plus Prepayment Account	Actual Capital Expenditures	Reserve After Actual Capital Expenditures
FY 2009	$ 12,027,595	$3,109,000	$8,918,595
Cash Ratio	11.00%		8.15%

Table 3

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

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

Cash on Hand Equivalent to an 8% Cash Ratio	Cash and Cash Equivalents as Reported and Cash Ratio		Rate Increase[8]		
	With Prepay Balance	Without Prepay Balance	Change in Revenue	Percent	Effective Date
$7,548,723	$10,150,939 CR = 10.76%	$3,997,217 CR = 4.24%	$3,031,194	3.21%	10/01/2008

Table 4

Discussions with Florence management indicated their operating philosophy has historically been to issue debt. However, Florence management stated that they have recently tried to pay for capital additions out of retained earnings.

CONTRACT COMPLIANCE ISSUE

We noted one area where Florence was not meeting the power contract requirements with TVA. Specifically, we found Florence was not obtaining contracts for customers as required by the GSA rate schedule. The GSA schedule from TVA requires all customers who exceed 50 kW per month to sign a formal contract. However, TVA management, in response to previous reports, indicated the threshold of 50 kW for requiring customer contracts is too low.

8 This is the rate increase enacted by the distributor. This increase does not include any rate increases or decreases made by TVA, including fuel cost adjustments, which were passed through by the distributor to the customer.

Accordingly, TVA management recommended to the TVA Board that a higher threshold be established as part of the rate change process with distributors.[9] On February 2, 2011, TVA sent a letter to the distributors noting the contract requirement threshold in the default GSA resale rate schedules would be changed from 50 kW to 1 MW (megawatt).

We noted 3 of 14 (or approximately 21 percent) customers with demand in excess of 1 MW during the audit period did not have a contract on file with Florence. The contract demand[10] amount in the billing system is used to calculate both the monthly demand charge and the minimum bill amount.

DISTRIBUTOR INTERNAL CONTROL ISSUE

We found Florence's internal controls could be strengthened in the area of billing system monitoring. We noted that a control improvement Florence agreed to perform in response to the FY 2009 SAS 70 report had not been implemented.

Issue Identified in the SAS 70 Report

The FY 2009 SAS 70 report recommended Florence run and review a report on nonmetered services to improve controls over the end-use billing process. Florence responded in the SAS 70 that it would review current nonmetered services to the extent documentation was available.

We found Florence has not been regularly running or reviewing a report on nonmetered services even though it was able to run such a report from the Daffron billing system at our request.

TVA OVERSIGHT OPPORTUNITIES

We found two opportunities to enhance TVA's oversight of the distributors that have been reported in previous distributor reports. Specifically, we noted TVA has not:

- Provided definitive guidance for distributors on what constitutes prudent expenditures.
- Performed a joint cost study since 1986 although the TVA Accountants' Reference Manual calls for one to be performed every three to four years or when major changes occur that affect joint operations.

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

[10] A customer's contract demand is the amount of power a customer agrees to pay to have available at all times. Because this refers to power that must be made available, as opposed to energy that can actually be consumed, contract demand is measured in kW, not kWh.

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 Office of the Inspector General (OIG) distributor reports on our Web site, www.oig.tva.gov.

RECOMMENDATIONS

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

1. Implement controls to assist in identifying accounts that need to be reclassified and prevent classification issues from recurring.

   Florence's Response – Florence agreed with the need to have accounts properly classified and stated it feels it does a good job in this area. Florence feels a major cause of the misclassifications found was due to repurposing of the property by existing customers without notifying Florence. Florence is exploring methods of reviewing existing accounts to determine proper classification with a reasonable effort, commensurate with risk. The target completion date for this is March 2012. See Appendix B for Florence's complete response.

   TVA Management's Comments – TVA agreed that the Power Contract requires consistent classification of customers in accordance with the provisions of the applicable rate schedule. The target completion date for this is March 2012. See Appendix C for TVA's complete response.

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

2. Obtain contracts for all customers with actual or contract demand in excess of 1 MW.

   Florence's Response – Florence agreed with the need to obtain power contracts for those customers whose service requires them, and the three customer accounts identified in the finding with demand in excess of 1 MW now have a contract.

   Florence stated it will obtain signed contracts as required in its Rate Schedule going forward and is obtaining contracts as required on new services. Florence will review its files to determine which customers will be required to furnish a signed contract and anticipates obtaining contracts required on existing services by September 2012 or earlier. See Appendix B for Florence's complete response.

TVA Management's Comments – TVA management agreed that the Distributor should obtain contracts with customers in accordance with the Distributor's rate schedule requirements regarding written contracts. The Distributor will work to obtain signed contracts with all customers to comply with the requirements of their rate schedule requirements regarding written contracts. The target completion date for this is March 2012. See Appendix C for TVA's complete response.

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

3. Implement the review of nonmetered services report(s) agreed to in the response to the FY 2009 SAS 70 report.

   Florence's Response – Florence agreed with the need to ensure the billings for nonmetered services are correct. Florence is revising the nonmetered services report and refining its procedures for the monthly review. The existing report for February 2011 has been reviewed, and Florence will continue to review the report monthly. See Appendix B for Florence's complete response.

   TVA Management's Comments – TVA management agreed and recommends that Florence should generate and review reports on the billing of nonmetered services. The target completion date for this is June 2011. See Appendix C for TVA's complete response.

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

OBJECTIVE, SCOPE, AND METHODOLOGY

This audit of Florence Electric Department 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 Florence including:

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

To achieve our objective, we:

- Obtained electronic billing data for the audit period. To validate the reliability of the billing data, we compared the data to the information reported to TVA on the Schedule 1. No significant differences were noted; therefore, the data was deemed reliable.
- Performed queries on data to identify classification, metering, and contract compliance issues. We reviewed results of the queries and selected accounts using nonstatistical sampling for further analysis and follow-up to determine whether misclassification, metering issues, or noncompliance with contract requirements occurred. Since nonstatistical sampling was used, projection of the results was not appropriate.
- Limited our work on internal controls to those control deficiencies identified as contributing to noted instances of noncompliance with the power contract and/or the TVA Act.
- Determined through inquiry and review of documentation whether Florence had any nonelectric, system-related business interests supported by electric system funds.
- Obtained disbursements listing for the audit period. We reviewed and analyzed disbursements to identify instances where electric system funds may have been used for purposes not allowed under the TVA power contract. We used nonstatistical sampling to select questionable disbursements for further analysis and follow-up. Since nonstatistical sampling was used, projection of the results was not appropriate.
- Reviewed cash and cash equivalents in relation to actual capital expenditures and other business uses of cash.

OBJECTIVE, SCOPE, AND METHODOLOGY (cont.)

When evaluating results of our audit work, we used both qualitative and quantitative factors when considering the significance of an item. For the purposes of this audit, the quantitative factor considered in determining an item's significance is whether the item exceeds 3 percent of the average annual purchased power from TVA for the audit period. For this audit, the amount was $2,676,449. Also for the purposes of this audit, we considered any errors identified as systemic or intentional as significant.

The scope of the audit was for the period July 2007 through June 2009. Fieldwork was conducted October 2010 through November 2010 and included a site visit to Florence's offices in Florence, Alabama. 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.

CITY OF FLORENCE, ALABAMA

Florence Utilities
Controller's Department

March 25, 2011

Mr. Robert E. Martin, Assistant Inspector General (Audits and Inspections)
Office of the Inspector General
Tennessee Valley Authority
400 West Summit Hill Drive
Knoxville, TN 37902-1401

Dear Mr. Martin:

Subject: Response to Draft Audit Report 2010-13284 – Distributor Review of Florence Electricity Department

Florence Electricity Department (FED) has received the February 17, 2011, draft report of the Distributor Review Audit prepared by your office. We have reviewed the report and recommendations. Our comments and our actions, planned or taken, for each specific recommendation are shown below.

1. **Implement controls to assist in identifying accounts that need to be reclassified and prevent classification issues from recurring.**
   Response: FED agrees with the need to have accounts properly classified. We feel we do a good job in this area. The audit finding stated the monetary impact of the classifications would not be significant to Florence or TVA. However, we understand misclassification could impact other non-financial areas.

   We will continue our vigilance to correctly classify accounts when they are established. However, we feel a major cause of the misclassifications found was due to repurposing of the property by existing customers without notifying FED. We are exploring methods of reviewing existing accounts to determine proper classification with a reasonable effort, commensurate with risk. We hope to have this procedure by March 2012.

2. **Obtain contracts for all customers with actual or contract demand in excess of 1 MW.**
   Response: FED agrees with the need to obtain power contracts for those customers whose service requires them. The audit finding referenced three customer accounts with demand in excess of one megawatt during the audit

period which did not have a contract. At this point, there are none of these three customers remaining without a contract.

We will obtain signed contracts as stated in our Rate Schedule. We are obtaining contracts as required on new services. We will review our files to determine which customers will be required to furnish a signed contract. Obtaining contracts from existing customers may be a lengthy process. We anticipate obtaining contracts required on existing services by September 2012, but we hope to have significant progress on this project much earlier.

3. **Implement the review of nonmetered services report(s) agreed to in the response to the FY 2009 SAS 70 report.**
   Response: FED agrees with the need to insure the billings for nonmetered services are correct. We are revising the nonmetered services report and refining our procedures for the monthly review. However, we have reviewed the existing report for February 2011, and will continue to review the report monthly.

We appreciate the professionalism of the audit team, consisting of Richard Underwood, Jessica Monroe, and Stephanie Simmons. If you have any questions, please feel free to contact me.

Sincerely,

Vance Young

Vance Young
Florence Utilities
Controller of Utilities

Cc: Kimberly S. Greene
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March 30, 2011

Robert E. Martin, ET 3C-K

REVISED RESPONSE TO DRAFT AUDIT REPORT 2010-13284 – DISTRIBUTOR REVIEW OF FLORENCE ELECTRICITY DEPARTMENT

This is in response to your memorandum dated February 17, 2011. We have revised our response to recommendation number 2. The responses to all other recommendations are unchanged.

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

A. Recommendations

1. Implement controls to assist in identifying accounts that need to be reclassified and prevent classification issues from recurring.
    - TVA management agrees that the Power Contract requires consistent classification of customers in accordance with the provisions of the applicable rate schedule.
    - **Actions taken or planned and completion dates**: Florence personnel plan to have procedures in place to detect and prevent classification issues from recurring. Target completion date for this is March 2012.
2. Obtain contracts for all customers with actual or contract demand in excess of 1 megawatt (MW).
    - TVA management agrees that Distributor should obtain contracts with customers in accordance with the Distributor's rate schedule requirements regarding written contracts.
    - **Actions taken or planned and completion dates**: The distributor will work to obtain signed contracts with all customers to comply with the requirements of their rate schedule requirements regarding written contracts. Target completion date is March 2012.

3. Implement the review of nonmetered services report(s) agreed to in the response to the fiscal year 2009 SAS 70 report.

    - TVA management recommends that Florence should generate and review reports on the billing of nonmetered services.
    - **Actions taken or planned, and completion dates**: Florence will start running and reviewing these monthly reports. Target completion date is June 2011.

John G. Trawick
Senior Vice President
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WT 3D-K

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