
STATE OF TENNESSEE

SPECIAL REPORT ON THE
NASHVILLE ELECTRIC SERVICE
FOR THE PERIOD JANUARY 1, 2010
THROUGH DECEMBER 31, 2011



Division of Local Government Audit



**SPECIAL REPORT ON THE
NASHVILLE ELECTRIC SERVICE
TABLE OF CONTENTS**

Transmittal Letter	3
Special Report on the Nashville Electric Service: Findings, Recommendations, and Management's Responses	4 – 23



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December 12, 2012

To the Metropolitan Nashville Mayor,
Nashville Electric Service Board of Directors, and the
Metropolitan Council
Davidson County, Tennessee

The Nashville and Davidson County Metropolitan Council requested their Office of Internal Audit conduct a review of certain expenses related to travel, procurement card usage, the use of per diem rates similar to continental United States (CONUS) guidelines, and the ability of the utility's internal audit function to operate in an unbiased manner at Nashville Electric Service. In lieu of the Office of Internal Audit performing the review, the Comptroller of the Treasury directed the Division of Local Government Audit to address the Council's request. The Tennessee Bureau of Investigations (TBI) assisted us in our review, and we expanded our scope to include a review of certain transactions related to bidding and contracting. We have also reported on another matter related to an employee theft, which was self-reported to us by the utility. The period of our review was January 1, 2010 through December 31, 2011.

We reviewed the findings resulting from this review with the Nashville Electric Service Board of Directors and the district attorney general. These findings, with our recommendations and management's responses, are presented in this report.

Sincerely,

A handwritten signature in black ink that reads "Jim Arnette".

Jim Arnette, Director
Division of Local Government Audit

cc: Honorable Victor S. Johnson, District Attorney General

SPECIAL REPORT ON THE NASHVILLE ELECTRIC SERVICE

For the Period January 1, 2010 through December 31, 2011

Our findings and recommendations, along with management's responses, as a result of our review, are presented below. We reviewed these findings and recommendations with the Nashville Electric Service Board of Directors to provide an opportunity for their response. We have also reviewed this report with the district attorney general.

NASHVILLE ELECTRIC SERVICE

The Electric Power Board of the Metropolitan Government of Nashville and Davidson County, d/b/a Nashville Electric Service (NES), is a public electric utility that provides energy to more than 360,000 customers in middle Tennessee. The NES service area includes Davidson County and portions of six surrounding counties. The Electric Power Board was established in 1939 as a separate administrative agency of the City of Nashville to operate the electric distribution system. In 1963, the Metropolitan Government of Nashville and Davidson County was created consolidating the governments of the City of Nashville and Davidson County, and provisions regarding the Electric Power Board were included in Articles 42 and 43 of the Metropolitan Charter. The stated purpose of NES is to deliver electric energy to the homes, businesses, and industries in the utility's service area at the lowest possible cost, while maintaining an efficient electrical distribution system with a strong financial base.

NES is governed by a board composed of five members appointed by the Metropolitan Mayor and confirmed by the Metropolitan Council. Members of the board serve staggered five-year terms and serve without pay, with the chairman and vice-chairman each elected for a one-year term by the board. Pursuant to the Metropolitan Charter, the board appoints the president and chief executive officer. The president and chief executive officer is responsible for the day-to-day operations of the utility, including hiring of employees. NES is a component unit of the Metropolitan Government of Nashville and Davidson County.

BACKGROUND

The Nashville and Davidson County Metropolitan Council requested the Office of Internal Audit conduct a review of certain expenses related to travel, procurement card usage, the use of per diem rates similar to continental United States (CONUS) guidelines, and the ability of the utility's internal audit function to operate in an unbiased manner at Nashville Electric Service. In lieu of the Office of Internal Audit performing the review, the Comptroller of the Treasury directed the Division of Local Government Audit to address the Council's request. The Tennessee Bureau of Investigations (TBI) assisted us in our review, and we expanded our scope to include a review of certain transactions related to bidding and contracting. We have also reported on another matter related to an employee theft, which was self-reported to us by the utility. The period of our review is January 1, 2010 through December 31, 2011; however, we expanded this period in certain instances to determine the validity of certain transactions occurring in the current period. Findings and recommendations, as a result of our review, are presented below. We reviewed these findings and recommendations with management, and their responses to the findings and

recommendations are included or paraphrased in this report. We have also reviewed this report with the district attorney general.

CONTRACTS AND AGREEMENTS

During our review we became aware of allegations related to bidding and contracting, and we expanded our scope to include these matters. We reviewed NES' bidding of cable and a contract with Gaylord Entertainment. Deficiencies related to these matters are described in findings 12.01 to 12.04 below.

FINDING 12.01 **COMPETITIVE BIDS WERE NOT SOLICITED FOR POWER CABLE**

NES has used one manufacturer, the Kerite Company, (a member of the Marmon Group of companies) and one distributor for the Kerite Company (Utilicor). NES has purchased a variety of power cable directly from the Kerite Company or through Utilicor. This arrangement has been in existence since approximately 1998; however, NES could only provide records for cable purchases beginning fiscal year 2005. The following schedule details the amount of cable purchased by fiscal year:

Year	Vendors		Total
	Kerite/Marmon	Utilicor	
2005	\$ 736,992	\$ 0	\$ 736,992
2006	1,576,754	0	1,576,754
2007	3,145,214	814,815	3,960,029
2008	698,354	765,559	1,463,913
2009	766,212	2,165,050	2,931,262
2010	0	42,529	42,529
2011	2,810,000	243,361	3,053,361
2012	3,301,830	0	3,301,830
Total	\$ 13,035,356	\$ 4,031,314	\$ 17,066,670

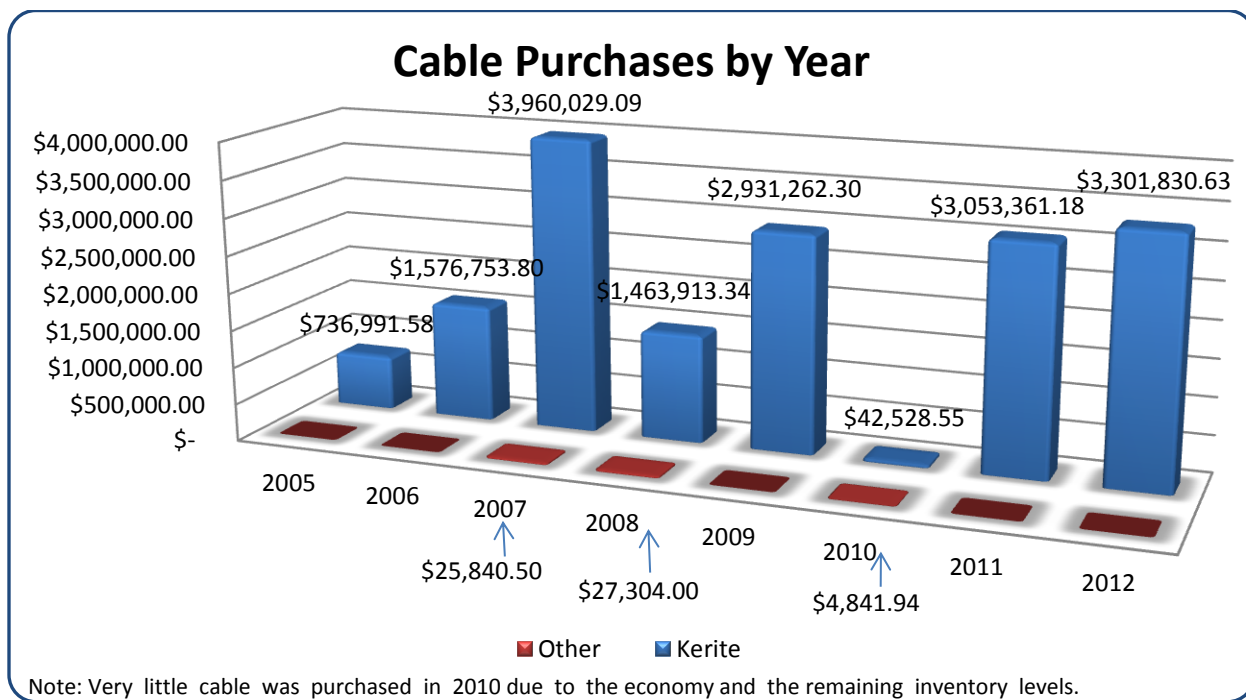
NES purchasing policies require competitive bids to be solicited from approved vendors for expenditures that are anticipated to exceed \$10,000, except for purchases from sole source suppliers. Sole source supplier items must be documented by the requesting department and must be verified and approved by the procurement manager. Our examination of records provided by the accounting department and interviews of NES employees in both the engineering and procurement departments disclosed the following deficiencies related to the purchase of power cable:

- A. The standards group in the engineering department develops bid specifications for power cable acquisition. During interviews, we were informed by the engineers responsible for developing these specifications that

the cable bids were tailored for cable manufactured by the Kerite Company, and that the cable specifications were tailored at the request of the former NES department vice-president. In our interview with the former vice-president, he informed us that Kerite Company's cable was the best cable on the market. However, he could not provide us with data to support his claim.

The Kerite Company representative for NES advised during an interview that NES specifications for power cable were tailored for the Kerite Company. The representative recalled several conversations with former NES employees about writing the specifications where only Kerite Company cable could be used by NES.

- B. Our examination of the procurement department related to the procurement of power cable revealed that this department relinquished its responsibility for approving Kerite Company as a sole source vendor. The procurement department allowed the vice-president of the engineering department to permit the Kerite Company to act as a sole source supplier without documentation, in violation of NES' procurement and materials management policies.



RECOMMENDATION

Competitive bids should be solicited on all purchases for goods and/or services expected to exceed \$10,000, unless an exception for a sole source supplier can be properly documented. Bid specifications should not be tailored to one vendor to circumvent bid procedures. NES policies should be monitored and enforced by each applicable department.

MANAGEMENT'S RESPONSE

NES agrees with the recommendation. We are currently revising power cable specifications. Procurement staff is involved in this process and will continue to oversee the procurement of power cable going forward. If multiple vendors are not found to meet our requirements, a sole source vendor will be properly documented. To assist in the specification revision, NES has solicited input from area electric utilities and from Burns & McDonnell, a nationally recognized engineering firm.

FINDING 12.02 **AN EMPLOYEE FAILED TO DISCLOSE POTENTIAL CONFLICT OF INTEREST INFORMATION ON HIS DISCLOSURE STATEMENT**

The NES "Conflict of Interest Disclosure Statement" form requires an employee to provide information on any other paid or volunteer activities outside the scope of NES duties, such as consulting, part-time jobs, self-employment, or participation in professional, civic, or charitable organizations. A field superintendent for Underground Network Distribution does consulting work for other electric utilities and also for Continuum Education. When questioned about why this was not disclosed as required by company policy, he stated that it was "no ones' business what I do outside of NES." He has written "None" on the Conflict of Interest Disclosure Statement form for the last three years that we reviewed. The field superintendent also promotes the vendor for power cable (Kerite Company) used by NES to other electric utilities and at seminars. He is also involved in reviewing and evaluating other cable manufacturers trying to get approval to bid at NES. Presently, the Kerite Company, the company the field superintendent promotes, is the only company allowed to bid at NES. According to the NES policy, failure to accurately complete this Conflict of Interest Disclosure Statement may result in disciplinary action.

RECOMMENDATION

NES should ensure that employees understand the seriousness of accurately filling out the Conflict of Interest Disclosure Statement and work to minimize potential conflicts of interest of employees.

MANAGEMENT'S RESPONSE

Agreed. This individual is now retired.

FINDING 12.03 **A CONTROL FILE FOR SOLE SOURCE CONTRACTS OR SERVICES IS NOT MAINTAINED**

NES does not maintain proper documentation to support contractors who are awarded sole source contracts. Sole source contractors provide goods and/or services that are not bid as required by state statutes. These services are such that no other contractor or supplier can provide them other than a sole source. We asked for information related to sole source

contractors and were advised by NES that this information could not be provided. NES could not readily identify which services, supplies, or construction is provided by sole source contractors. We were advised that any documentation of a sole source provider is filed with the purchase order and not documented or tracked anywhere else.

RECOMMENDATION

Documentation for sole source contractors or suppliers should be maintained in a control file detailing the information such as contractor name, the amount and type of each contract, and a listing of supplies, services, or construction procured under each sole source contract.

MANAGEMENT'S RESPONSE

A control file for sole source contracts and services will be maintained, and a copy will be kept with the purchase order file. A spreadsheet will be created to detail the contractor name, the dollar amount and type of each contract, and a listing of supplies, services, or construction procured under each sole source contract.

FINDING 12.04 **CONTRACTUAL ARRANGEMENTS BETWEEN NES AND GAYLORD ENTERTAINMENT ARE OF QUESTIONABLE VALUE TO RATEPAYERS**

NES and Gaylord Entertainment agreed to two contractual arrangements as noted below:

- A. On December 13, 2006, NES President and Chief Executive Officer entered into a three-year contractual agreement with Gaylord Entertainment effective December 1, 2007, through December 31, 2009. The agreement provided that NES would receive marketing sponsorship, a hospitality package that included 15 tickets to the Gaylord's VIP Country Christmas Opening night ceremony (each valid for two persons); ten tickets to Gaylord's ICE! at Opryland Hotel; and eight rounds of golf at Gaylord Springs Golf Links for a package value of \$17,280 (\$5,760 per year). Gaylord Entertainment would be provided the use of a NES transformer to supply power for its Country Christmas Lighting Ceremony for three years. NES would be responsible for the maintenance, upkeep, and replacement of the transformer. The lease value of a transformer for three years was \$15,660 (\$5,220 per year).

- B. On March 15, 2009, NES President and Chief Executive Officer entered into a three-year contractual agreement with Gaylord Entertainment effective December 1, 2009, through December 31, 2012. The agreement was amended on September 17, 2010, to revise the marketing elements provided by Gaylord Entertainment for the upcoming contract period from December 1, 2010, through December 31, 2012. The agreement provided that NES would receive marketing sponsorship, a hospitality package that included 15 tickets to the Gaylord's VIP Country Christmas Opening night

ceremony (each valid for two persons); 100 tickets to Gaylord's ICE! at Opryland Hotel; 50 Run of Show Rockettes tickets; 20 dinner show tickets on the General Jackson; 25 room nights and parking passes at Opryland Hotel; and 20 rounds of golf at Gaylord Springs Golf Links for a package value of \$57,000 (\$19,000 per year). Gaylord Entertainment would be provided the use of a NES transformer(s) to supply power for its Country Christmas Lighting Ceremony for three years. NES would be responsible for the maintenance, upkeep, and replacement of the transformer(s). The lease value of the transformer(s) for three years was \$56,000 (\$18,667.67 per year).

Our review of these contractual arrangements totaling \$71,660 determined the hospitality packages were not accounted for by NES. Therefore, we were unable to ascertain the disposition of the packages, or whether NES actually received \$71,660 in exchange for the services provided. We were informed by NES management that a portion of these packages went to senior staff personnel and other employees within NES.

The NES policy manual (section 2.02 B) prohibits the acceptance of gifts, hospitality, or entertainment in excess of \$100 from customers, suppliers, contractors or other parties doing business with NES. We question the legitimacy of this type of contractual arrangement since there is no apparent economic benefit for NES ratepayers.

RECOMMENDATION

Management should determine the propriety of the above-noted arrangements since the arrangements appear to violate provisions of the NES policy manual that prohibits the acceptance of gifts, hospitality, or entertainment.

MANAGEMENT'S RESPONSE

Under the NES Contribution in Aid of Construction Policy, Gaylord Entertainment receives the use of the transformer because the ICE exhibit generates approximately \$200,000 of additional revenue to NES during the months of operation. The contract language does not adequately reflect the economic substance of the transaction. NES entered into the contract with Gaylord Entertainment, not the President & CEO specifically. NES receives in-kind advertising and a hospitality package in exchange for the transformer lease. We now document that the hospitality items are donated to charity.

REVIEW OF PROCUREMENT CREDIT CARDS

The procurement credit card policy provides for the purchase of small, non-stock, non-recurring items; however, our review revealed procurement credit cards were not always used for these types of purchases. The procurement credit card system was designed to supplement the purchasing system. For the period under review, approximately 160 NES procurement credit card holders spent approximately \$3,800,000. The top seven procurement credit card users spent over \$900,000 for the period January 1, 2010 through December 31, 2011. Many of the items purchased could have been obtained from the NES storeroom either as a stock item or as a requested stock item.

We reviewed the monthly procurement credit card charge statements and associated documentation for adherence to the procurement card policy. We initially reviewed 63 procurement credit card transactions. Due to additional concerns noted in reviewing the Vice-President Chief Information Officer's use of his procurement credit card, we reviewed an additional 239 transactions.

The Vice-President Chief Information Officer spent \$120,877.47 on his procurement credit card from January 1, 2010 to December 31, 2011, of which \$22,972.27 was to Amazon. We expanded our scope of review to determine current activity, and from January 1, 2012 to May 4, 2012, he made \$28,145.69 of purchases, of which \$9,533.30 was to Amazon.

FINDING 12.05 THE VICE-PRESIDENT CHIEF INFORMATION OFFICER DID NOT USE THE NES PROCUREMENT CREDIT CARD IN COMPLIANCE WITH NES POLICIES

We noted the following activity:

- A. The NES Vice-President Chief Information Officer, has an assigned procurement credit card and uses the card to purchase items in a variety of ways. We determined that he was using his procurement credit card to make purchases on eBay and Amazon through a PayPal account. We met with him on a number of occasions to try and determine the facts related to his use of the card.

On March 26, 2012, we met with him to discuss Amazon and eBay purchases made with his NES procurement card. At this meeting, he admitted to using his NES card on an account he had established in the name of NES. He stated that he keeps his personal and business accounts separate. NES personnel had been unaware of these accounts. We also asked to see some of the items that were purchased with the NES card. Out of ten items we asked to see, he could only provide us one computer tablet and a "Check-Out Form" for a laptop computer assigned to an NES contractor. After this meeting, we reviewed additional transactions on his card and determined he had more Internet accounts.

On May 7, 2012, we met with him to discuss the additional accounts we discovered and to determine if there were more Internet accounts. We also asked for access to additional accounts to verify if his NES card had been used. He initially denied using the NES card on his personal Amazon account, then advised he had on occasion purchased NES items through his personal account, and then used his procurement credit card to pay the account off, thereby, commingling his personal and business accounts. He also advised that he uses his NES card directly on Amazon, but had used several different email addresses and/or user log-ins that contained the NES naming convention (i.e., @nespower.com). He stated no more accounts existed on eBay or Amazon other than the four accounts we had knowledge of. On May 15, 2012, we received information from NES Vice-President

Internal Auditor, that NES had found an additional Internet account under the Vice-President Chief Information Officer's name. At this point, we contacted the district attorney general and requested assistance from the Tennessee Bureau of Investigation (TBI) to retrieve any additional accounts the vice president may have established. As a result of TBI assistance, we were able to determine additional accounts. A total of five accounts were identified. Management and accounting were unaware that he had set up the various accounts with the NES procurement credit card or that he was commingling business and personal purchases. Due to the lack of documentation to support these purchases, we were unable to determine their validity.

- B. The Vice-President Chief Information Officer set up a PayPal Extras MasterCard in his name, but attached the NES procurement credit card as collateral, creating a potential liability for NES. The account had a credit limit of \$6,000, and neither accounting nor management was aware of the MasterCard, the credit limit, or the potential liability.
- C. While originally denying selling NES items over the Internet, Vice-President Chief Information Officer admitted to selling NES surplus on eBay, without prior authorization, and without the knowledge of his supervisor. He stated he turned money over to accounting from these sales, but bypassed NES procedures for selling surplus property.
- D. On June 20, 2012, we met with an information systems contractor with NES. We were advised by this contractor that he had been given an NES procurement credit card number and access code by the Vice-President Chief Information Officer to make purchases on behalf of NES, and that he had been doing this for the past 12 years. We and the TBI met again with the Vice-President Chief Information Officer to discuss with him delegating purchasing authority to the NES contractor. The Vice-President Chief Information Officer acknowledged delegating authority to NES contractor to make purchases on his behalf. The Vice-President Chief Information Officer also advised he was told "no" by NES management when he requested a procurement card for the NES contractor. The Vice-President Chief Information Officer confirmed that management was not aware of this activity. The procurement credit card agreement signed by the Vice-President Chief Information Officer states that it is against the procurement credit card agreement policy to transfer authority to use a procurement credit card to another person.
- E. The NES contractor has an NES computer that has been permanently assigned to him. On March 26, 2012, we asked the Vice-President Chief Information Officer to see this computer. It was one of the ten items we asked to see that is referred to in item A. The Vice-President Chief Information Officer provided us with a "Check-Out Form" showing that NES provided the computer to the NES contractor. We determined that the signature on the "Check-Out Form" was actually not the NES contractor's signature. The Vice-President Chief Information Officer stated that he

created the form on the same day we asked to see the computer. Therefore, the Vice-President Chief Information Officer fabricated this form for our inspection.

- F. Lack of management oversight contributed to the issues involving our review of the procurement credit card usage of the Vice-President Chief Information Officer. His immediate supervisor, the Executive Vice-President and Chief Operating Officer, reviewed and signed-off on the Credit Card Charge Reports monthly, but did not question why the purchases were necessary or review the detail associated with the questionable charges. The accounting manager who supervises the day-to-day operations of the accounting department, became aware of the Internet charges with eBay, PayPal, and of surplus items sold on Amazon, after the Vice-President Chief Information Officer had turned proceeds from the sales over to accounting.
- G. In some instances, the procurement department was circumvented by the use of the procurement credit cards by the Vice-President Chief Information Officer. We noted numerous purchases that collectively should have been processed through the procurement department for required quotes or bids, and there was no documentation on file to support why these purchases did not flow through the purchasing department.
- H. We noted recurring monthly charges for on-line file sharing and storage that were not approved by management. We were advised by Vice-President Chief Information Officer that this file-sharing site was no longer needed, but had not yet been discontinued.
- I. We noted multiple instances where in-stock items, such as printer ink and computer supplies, were purchased rather than requisitioned from the NES storeroom. This practice defeats the purpose of the storeroom and may cause in-stock items to become obsolete.
- J. We noted purchases made for software and equipment licenses that did not have the required approved purchase order with pertinent information attached and the required copy filed in the Office of the Chief Information Officer.

RECOMMENDATION

Employees should not commingle business and personal accounts. Accounting and management should be made aware of and approve all accounts that are established in the name of NES. Personal accounts should not be guaranteed by an NES procurement credit card. All items should be declared surplus and sold in compliance with NES policy. The authority to use an NES procurement credit card should not be transferred to any individual other than the person authorized to use it. Records should not be falsified under any circumstances. Management should provide proper oversight of procurement credit card purchases. Procurement credit cards should not be used for items that should be purchased through the procurement department. On-line file sharing and storage should be approved by management and charges should not continue to be incurred for

functionality no longer used. Procurement cards should not be used to purchase items that are in stock in the NES storeroom. Purchases of software and equipment licenses should have a purchase order with pertinent information attached and should be on file in the Office of Chief Information Officer. The Purchasing Department should have final approval for all purchases.

FINDING 12.06 GIFT PURCHASES WERE CHARGED TO A PROCUREMENT CARD

The NES Chief Financial Officer purchased a gift (\$104.50) from Babies-R-U's for a board member using her procurement credit card. The propriety for the purchase of gifts as a business expense is not addressed in the procurement credit card policy.

RECOMMENDATION

The NES procurement credit card policy should address the propriety of the purchase of gifts by company representatives that are charged to procurement credit cards.

MANAGEMENT'S RESPONSE

We agree that \$104.50 was charged to an NES procurement card to purchase a gift. We will modify the NES credit card guidelines to prohibit the purchase of gifts by company representatives using credit cards.

FINDING 12.07 PROCUREMENT CREDIT CARD USAGE WAS NOT IN COMPLIANCE WITH NES POLICY

The following deficiencies were pervasive throughout our review of procurement credit card transactions:

- A. The procurement credit card policy requires monthly statements to be reviewed by a section supervisor/manager for employees that are assigned procurement credit cards before accounting pays the bills. The card holder is responsible for maintaining documentation for each transaction charged to their procurement credit card. Our examination revealed that procurement credit card statements were not always signed as evidence of supervisory review of the statements and supporting documentation.
- B. We noted numerous instances where documentation was not available to support purchases made with procurement credit cards. The failure to attach receipts or other supporting documentation could lead to a loss or abuse of funds by the credit card user.
- C. The procurement credit card policy requires a brief description of the purpose of each transaction to be provided on the Credit Card Charges report. We

noted numerous instances where an explanation was not provided, but only a listing of the items purchased. Without the description of the purpose of the transaction, management does not have sufficient information to justify the purchase.

- D. We noted numerous meal purchases by employees that were not on travel status. Because there was no description or explanation for the charges, we were unable to determine if the charges were legitimate expenses.
- E. We noted numerous purchases of clothing items charged to the procurement credit cards that should have been purchased from the protective clothing vendor and paid for by the individual.

RECOMMENDATION

Procurement credit cards should be used to purchase small, non-stock, non-recurring items. Monthly procurement card statements should be reviewed and approved by a section supervisor/manager as evidence that the statement is accurate, supporting documentation was available, and the purpose of each transaction was noted. The review should address the propriety of claims for meals for employees not on travel status and for clothing purchases.

MANAGEMENT'S RESPONSE TO FINDINGS 12.05 AND 12.07

All credit card purchases were for the benefit of NES, and no misappropriation was discovered. NES concurs with the recommendations in 12.05. We agree that the VP/CIO did not always abide by the NES credit card guidelines, and that he delegated authority for credit card use to another individual. The matter has been addressed internally. Preventive and detective controls in place did not detect that these policies and guidelines were not being followed. We believe this is a result of a lack of proper segregation of duties in the area of purchases of IT equipment. NES will move the responsibility for these purchases under the scope of the Procurement section. Technology-related services such as web conferencing and file-sharing and storage are needed at NES. Technology has changed dramatically since NES credit card guidelines were developed, and NES will amend its policies to reflect that NES credit cards may be used to pay for these services. The additional procedures and training detailed in 12.07 will address necessary approvals and the appropriate use of NES credit cards.

To ensure the propriety of credit card purchases, additional procedures have been instituted. These include a quarterly review for payment of sales tax, violations of single transaction limits, and a review of the top five vendors by dollars spent to determine if the item should be bid. In addition, the credit card charges report is reviewed, along with the receipt, for transactions with vendors that appear inappropriate. As an additional control, a random monthly audit of five cardholders is now conducted. Training has also been developed for credit cardholders to advise/remind them of credit card use guidelines and changes that occur. The previous report provided only a small space to write an explanation for purchases. As pointed out, most cardholders wrote a short description of what they purchased. The credit card charges report is being modified to provide a larger space to write explanations of purchases. For group meals, we have added the requirement

that all diners and the business purpose of the meal be noted on the credit card charges report. There were limited situations where protective clothing purchases were made with a credit card, and we have confirmed that those purchases were appropriate. Going forward, we have asked the vendor to code the NES account so that NES credit cards are not accepted. We have a few operations employees who receive clothing allowances for uniforms, and there is a contract with a vendor for clothing for male employees. The selection of women's clothing is very limited, however, and the female employees' uniforms are ordered online and purchased using the supervisor's credit card. These purchases are tracked to ensure they do not exceed the uniform allowance. The only other instance of a clothing purchase via a credit card occurred during the flood of 2010. A set of clothing was purchased from Wal-Mart for an employee who was working in contaminated water.

AUDITOR'S REBUTTAL FOR FINDINGS 12.05 AND 12.07

We could not determine that all procurement credit purchases were for the benefit of NES or determine that misappropriations occurred due to the lack of documentation on file to support the purchases and the credibility of the NES Vice-President Chief Information Officer. The NES Vice-President Chief Information Officer provided false and misleading information, commingled personal accounts with business accounts, and did not maintain an adequate inventory of items purchased.

NES should determine the propriety of claims for meals by employees that were not on travel status.

FINDING 12.08 **WE NOTED SEVERAL DEFICIENCIES RELATED TO INVENTORY ITEMS**

The board has policies (Electric Power Board (EPB/T) Number Control Policies) that provide for equipment, tools, and/or computer items costing more than \$500 to be issued a tracking number and added to the EPB inventory listing. It is the responsibility of the Facilities and Security (F&S) Section of Human Resources and Corporate Services to maintain proper equipment records and to ensure that all items, new and used, are identified by means of an EPB number or tag. There is a space for the tag number to be written on the Credit Card Charge Report to prompt the reviewer of the report to obtain the EPB number based on the cost of the item. It is the responsibility of the Information Systems Department (IS) to notify F&S to ensure that all applicable items are tagged and properly identified.

- A. We noted eight items purchased by the Vice-President Chief Information Officer, who is in charge of IS, which had not been issued EPB tag numbers and added to the inventory listing. Management failed to follow-up or question the missing EPB numbers. Failure to add inventory items to the appropriate inventory listing increases the risk of theft and/or misuse.
- B. Inventory records were not verified by personnel who are independent of maintaining the inventory records. F&S asks contract IS personnel, who are responsible for purchasing, installing, relocating, tracking, and maintaining

computer hardware and software, to also perform the annual inventory of computer hardware and software, including the lost and stolen listing.

- C. NES allows employees to “check-out” miscellaneous NES property (e.g., chain saw, laptop computer, dolly carts, etc.) for personal use.
- D. F&S gives IS an allotment of EPT numbers to assign as needed, delegating the responsibility of appropriately tagging and reporting new inventory items to IS. There are no internal controls in place to identify when IS fails to tag and report new items.

Generally accepted accounting principles require accountability for all NES owned assets, such as equipment, furniture, and vehicles. The failure to properly maintain inventory records results in a loss of control over assets and potentially a waste of ratepayer funds.

RECOMMENDATION

NES should improve internal controls over assets. All equipment, tools, and/or computer items costing more than \$500 should be issued an EPB number and added to the inventory listing. Management should ensure inventory tracking procedures are followed properly. NES property should not be used for the personal benefit of its employees. NES should ensure that inventory lists include all of the assets and that the descriptions are sufficient to identify the assets. Also, NES should ensure that personnel independent of the record-keeping process periodically verify inventory records.

MANAGEMENT’S RESPONSE

We are in the process of reviewing and revising our equipment inventory procedures and will take steps to enhance those controls as suggested by this recommendation. The revised procedure will address the proper segregation of duties relating to the purchasing, installing, relocating, tracking, and maintaining of computer hardware and software. NES policy allows employees to check-out NES equipment for personal use as long as it does not interfere with the day-to-day operation of NES. Prior authorization is required, and use is tracked and monitored. Few employees take advantage of this provision, however, and it will be removed from the policy manual.

REVIEW OF TRAVEL

Former President and Chief Executive Officer Don Kohanski developed an operating memorandum for travel expense procedures for all departments dated June 6, 2001. This operating memorandum provided that board members and NES employees be reimbursed at actual costs when out-of-town on utility business. The policy did not include any maximum reimbursement levels. Therefore, no limitations were placed on employee lodging and meal expense reimbursements. As part of our review, we compared the actual travel costs incurred by board members and NES employees with the per diem rates in the continental United States (CONUS), as provided by the United States General Services Administration. The federal government considers CONUS guidelines to be fair and

reasonable for governmental entities. In addition, the Internal Revenue Service, Revenue Ruling 2006-56, provides that if an employer routinely pays expense allowances that exceed CONUS per diem rates, the excess amounts may be subject to personal income and employment taxes.

For the period January 1, 2010 through December 31, 2011, we reviewed travel claims of NES board members, management, and employees totaling \$93,384.66. Of this amount, \$72,849.32 related to 56 travel claims submitted by the five NES board members, three members of executive management, and eight vice-presidents, which included travel to Toronto, Canada; and various travel to Philadelphia, Pennsylvania; Pittsburg, Pennsylvania; Washington DC; Orlando, Florida; New York, New York; Chattanooga, Tennessee; Memphis, Tennessee; Cleveland, Ohio; Columbus, Ohio; Houston, Texas; Dallas, Texas; Sacramento, California; San Francisco, California; Atlanta, Georgia; Erlanger, Kentucky; Indianapolis, Indiana; Las Vegas, Nevada; and Florence, Alabama for conferences and NES business.

In addition to the 56 travel claims submitted by NES board members and management, we sampled 23 travel claims of non-management employees totaling \$20,535.34. All of these claims were reviewed for adherence to the NES travel policy and to their use or nonuse of per diem rates in the continental United States (CONUS).

FINDING 12.09 PERSONAL PURCHASES TOTALING \$1,729.42 WERE REIMBURSED WHILE ON TRAVEL STATUS

We noted the following travel claim submissions that contained personal purchases. It should be noted that portions of these travel expenses were paid with NES procurement credit cards.

- A. A former NES board member traveled to a legislative rally in Washington, DC, in February 2011, two days prior to the beginning of the rally. The former board member was reimbursed by NES for these two non-business related days. We addressed this matter with the NES President, and he informed us that this issue had been discussed with the former board member; however, NES personnel could not remember why she traveled to the rally early. On November 18, 2011, the former board member reimbursed NES \$638.92 for the non-business lodging costs.
- B. NES Vice-President Chief Customer Care Officer attended a conference in Orlando, Florida, in October 2011. Our examination of her travel expense statement noted seven instances totaling \$251.15 where hotel bar expenses were charged to her hotel room and later charged to her NES procurement credit card. On November 15, 2011, she reimbursed NES for these personal charges. It should be noted that the purchasing credit card agreement that the employee signed on December 5, 1996, prohibits personal charges by employees to NES procurement cards.
- C. We noted a memorandum dated February 29, 2012, to NES Vice President Chief Financial Officer from the NES President stating that he was

reimbursing NES \$839.35 for certain expenses incurred during a trip to Toronto, Canada. Some of the purchases included in the reimbursement were for alcohol (\$466.50 for board members and senior management), a dinner for two (\$225.00), appetizers (\$87.35), and a movie card (\$13.00) charged to his hotel room. According to the NES President, the event included an evening dinner meeting on May 5, 2011. In the memorandum, the NES President stated that these purchases did not violate NES policy.

RECOMMENDATION

Personal expenses should not be charged to NES procurement credit cards as noted in the purchasing credit card agreement. Management should review documentation prior to reimbursement to ensure only authorized expenses are allowed.

MANAGEMENT'S RESPONSE

Personal expenses are not to be charged to the NES procurement card. When this occurs, Management requires that those items be corrected promptly. The items mentioned had been properly reimbursed prior to the start of this review. Training has been developed for credit card holders to advise/remind them of credit card use guidelines and changes that occur.

FINDING 12.10 **TRAVEL CLAIM DEFICIENCIES WERE NOTED**

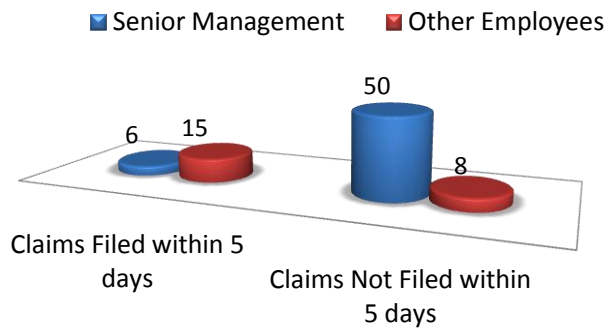
We noted the following deficiencies that were pervasive throughout our review of travel claims:

- A. Numerous travel claims did not have receipts to support the expense. The NES travel policy requires receipts for all expenses of \$25 or more. Without receipts, auditors could not ascertain the validity of the expenses that were subsequently reimbursed. The failure to attach receipts that support the travel expense could lead to a loss or abuse of funds by utility employees.
- B. Although receipts were attached to a few travel claims, in many instances these receipts were in aggregate amounts and were not itemized. For example, we could not determine how many meals were purchased by an individual that submitted a travel claim when the receipt included a total amount. The failure to include itemized receipts with travel claims could lead to a loss or abuse of funds by utility employees.
- C. We noted numerous instances where travel claims were not submitted within five working days upon return from trips, were not verified by the accounting department, and were not approved by a supervisor before reimbursement was made as required by the travel policy. Several travel claims were filed more than a year late. Of the 56 travel claims submitted by top management, 50 of these claims were not submitted within five working days

upon return. Of the 23 travel claims submitted by other employees, eight of these claims were not submitted within five working days upon return.

Timely Filing of Travel Claims

January 1, 2010 to December 31, 2011



RECOMMENDATION

Itemized receipts should be filed with all travel claims to support expenses claimed for reimbursement. Claims for reimbursement should be submitted within the five-day time frame, verified by the accounting department, and approved by a supervisor as required by the travel policy.

MANAGEMENT'S RESPONSE

Itemized receipts are required where appropriate under the new policy adopted January 25, 2012. The Operating Memorandum issued requires travel expense statements to be submitted within 30 days after returning from travel, approved by appropriate supervision, and verified by Accounting before the settlement can be completed. We will adopt the same timeframe for submitting travel expense statements for all employees and board members.

FINDING 12.11 **NES REIMBURSED TRAVEL EXPENSES IN EXCESS OF CONUS PER DIEM RATES BY \$12,127.91**

The Nashville and Davidson County Metropolitan Council requested the Office of Internal Audit conduct a review of NES' travel reimbursement rates and their use of per diem rates similar to continental United States (CONUS) guidelines. In lieu of the Office of Internal Audit performing the review, the Comptroller of the Treasury directed the Division of Local Government Audit to address the Council's request. For the period of our review, NES reimbursed employees for travel expenses in excess of CONUS per diem rates by \$12,127.91. We reviewed \$72,849.32 paid on 56 travel claims submitted by five NES board members, three members of executive management, and eight vice-presidents. Of this

amount, NES reimbursed \$10,795.67 in excess of CONUS per diem rates for various conferences and NES business. We reviewed 23 travel claims of non-management employees totaling \$20,535.34. Of this amount, NES reimbursed \$1,332.24 in excess of CONUS per diem rates for NES business. As previously noted in this report, NES policy provides for employees to be reimbursed for actual cost without limitation. However, the federal government has stated that CONUS guidelines are fair and reasonable for governmental entities. In addition, the Internal Revenue Service, Revenue Ruling 2006-56, provides that if an employer routinely pays expense allowances that exceed CONUS per diem rates, the excess amounts may be subject to personal income and employment taxes.

RECOMMENDATION

NES should adopt a travel policy that establishes maximum reimbursement levels for out-of-town business for related mileage, lodging, meals, and other travel expenses. NES should consider whether CONUS rates and guidelines should be adopted, and have procedures in place for explaining reimbursements that vary from these general guidelines. If NES chooses to continue to reimburse travel expenses in excess of CONUS rates, Internal Revenue Service requirements should be considered.

MANAGEMENT'S RESPONSE

All of the referenced travel reimbursements were consistent with approved NES policy. We are not aware that the board-approved policy in effect at that time did not comply with all applicable local, State and Federal requirements. NES has been and continues to be in compliance with our policy. When establishing the NES travel policy, NES reviewed policies of other municipal utilities and government entities, as well as CONUS, to establish our travel reimbursement guidelines. NES will adopt more comprehensive travel guidelines to require CONUS per diems where appropriate. Since the vast majority of travel is to industry-related training and conferences, the policy will continue to encourage employees to stay at the hotel where the training/conference is being held, at discounted rates, in order to avoid additional transportation time and costs.

FINDING 12.12 **NES ADOPTED TWO TRAVEL POLICIES**

NES adopted a detailed travel policy exclusively for the board and senior management on January 25, 2012, effective February 1, 2012. Also, the board approved travel guidelines effective January 1, 2012, for all other NES employees below the vice-president level as outlined in an "Operating Memorandum" that is updated from time-to-time by the president.

We noted the following areas with regard to the two policies:

- A. The travel policies do not have a maximum reimbursement level for lodging while out-of-town on official business.
- B. The board's travel policy allows per diem rates for meal reimbursements to be set at \$70 per day, with the exception of travel to New York, NY or

Washington, DC, which are approved for \$85 per day. These rates exceed the U.S. General Services Administration's CONUS per diem rates.

- C. The board's travel policy permits a single individual to pay for all diners in the party in-lieu-of having each diner file his own claim.
- D. The board's travel policy allows for alcohol purchases to be reimbursed with the pre-approval of a majority vote of the board.
- E. The travel policies only require receipts for expenses above \$25, with the exception of per diem for meal reimbursements.
- F. Per diem reimbursements for meals are allowed for non-overnight stay.

RECOMMENDATION

NES travel policies should be reasonable and promote transparency, accountability, and fairness to both employees and NES ratepayers with consideration given to the items noted.

MANAGEMENT'S RESPONSE

In developing the above referenced policy, we conducted a review of municipal and government entities within Tennessee, as well as CONUS, and crafted a policy that is consistent with other Tennessee municipal entities and, in our view, is transparent and fair to both employees and NES ratepayers. The policy allows for per diem rates for meals. The policy addresses travel for Vice Presidents and above. All employees below the Vice President level are covered by the Operating Memorandum. NES revises its policies on an annual basis. We plan to include a Travel Expense Reimbursement Policy that addresses reimbursement of travel related expenses for those below the level of Vice President. We expect that policy to adopt CONUS rates for per diem meals and CONUS lodging rates for field travel. We plan to continue the practice of paying the discounted hotel rate for employees traveling to conferences and seminars. This practice is consistent with the State of Tennessee travel guidelines and with other State of Tennessee municipal entities. The proposed comprehensive revised travel policy prohibits the purchase of alcohol.

INTERNAL AUDIT FUNCTION

The stated mission of the NES Internal Audit Department is "to provide independent, objective assurance and consulting services designed to add value and improve the organization's operations. Internal Audit assists the organization in accomplishing its objectives by bringing a systematic disciplined approach to evaluating and improving the effectiveness of risk management, control, and governance processes." The stated scope of the Internal Auditor at NES "ensures risks are appropriately identified and managed, significant financial, managerial and operating information is accurate, reliable, and timely, actions comply with policies, procedures, and applicable laws and regulations, and assets are acquired economically, used efficiently, and adequately protected."

The Vice-President of Internal Audit reports administratively to the President and CEO and functionally to the Audit and Ethics Committee of the board. NES Vice-President Internal Audit, has been at NES for five years and has a staff of three internal auditors. She advised us that at least twice a year a report is made to the board. She also advised the board provides approval for all internal audit reviews that are conducted.

FINDING 12.13 NES HAD NOT HAD A QUALITY ASSURANCE REVIEW OF THE INTERNAL AUDIT FUNCTION SINCE 2005

At the time of our review, NES had not had a quality assurance review of its internal audit function since 2005. The Institute of Internal Auditors, the standards setter for the professional practice of internal auditing, requires an external quality assurance review of the internal audit activity every five years. These reviews are designed to assess the internal audit department's reporting structure, conformance with the standards of the internal audit profession, and its effectiveness in providing adequate internal audit services. We were advised NES Internal Audit does follow the Institute of Internal Auditors standards.

During October 2012, a quality control review of NES Internal Audit was conducted by representatives of the Association of Local Government Auditors. The reviewers concluded that NES internal audits are conducted in accordance with Government Auditing Standards.

OTHER FINDING AND RECOMMENDATION

FINDING 12.14 EMPLOYEES IMPROPERLY FILED REIMBURSEMENT CLAIMS FOR EDUCATIONAL BENEFITS

Nashville Electric Service (NES) performed an internal audit of its Aid to Education Program. The audit disclosed that six employees received reimbursements under this program based on altered documents. Subsequently, due process meetings were held for each of the employees, and disciplinary suspensions were levied against two employees. NES recommended that the remaining four employees be brought before an administration law judge for a hearing for terminating their employment. One of the remaining four employees resigned rather than face charges. The administrative law judge recommended that the final three employees' jobs be terminated. These three employees' jobs were eventually terminated by the Civil Service and Pension Board. NES demanded repayment of all monies based on altered documents from these employees. Records provided by NES disclosed that these employees had been reimbursed a total of \$12,968 based upon the altered documents. NES demanded and received restitution payments of \$5,954 from these former employees leaving an outstanding balance of \$7,014 due to NES as of May 2012.

RECOMMENDATION

NES should continue to seek full restitution.

MANAGEMENT'S RESPONSE

No inappropriate conduct by NES employees is acceptable. NES is dedicated to ensuring that its employees act in an appropriate manner legally and ethically. Despite training and oversight, there are occasional situations where NES policy is not followed. In regard to the situation noted, we are doing what is necessary to recover funds that were inappropriately reimbursed. NES has secured full restitution from four of the six referenced individuals. One additional person has signed a promissory note and continues to make payments toward a full restitution. NES is exploring recovery options against the final individual.