



**METROPOLITAN GOVERNMENT OF
NASHVILLE AND DAVIDSON COUNTY**

OFFICE OF INTERNAL AUDIT

Professional Audit and Advisory Service

Final Report



**Audit of Payments From and To
Nashville Electric Services
(In-Lieu of Taxes and Other Billings)
July 1, 2008 through June 30, 2012**

Date Issued: January 17, 2013

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*The Office of Internal Audit is an independent audit agency reporting directly to the
Metropolitan Nashville Audit Committee*

EXECUTIVE SUMMARY

January 17, 2013

Results in Brief	Background and Recommendations																									
<p>This audit was initiated due to the magnitude of payments between the Metropolitan Nashville Government and Nashville Electric Services. For fiscal year 2012 Metropolitan Nashville Government paid Nashville Electric Services \$58 million for electric services and received \$26.7 million for payment in-lieu of property taxes and reimbursement for shared use of the Metro Nashville 800 MHz trunked radio system.</p> <p style="text-align: center;">Audit Objectives</p> <ul style="list-style-type: none"> • <i>Were payments in-lieu of taxes from Nashville Electric Services calculated in accordance with Tennessee Code Annotated Title 7 Chapter 52 Part 3?</i> <p>Yes. Independent verification confirmed the accuracy of the formula for calculation and actual payments made for fiscal years 2009, 2010, and 2011.</p> <ul style="list-style-type: none"> • <i>Did Nashville Electric Services pay for services rendered by Metro Nashville in accordance with agreed upon terms?</i> <p>Generally yes. The total invoiced amount calculated by Metro Radio Communications for the four fiscal years reviewed, including year-end adjustments, was \$67,537 under-billed based on actual costs recorded in EnterpriseOne (See Observation A.)</p> <ul style="list-style-type: none"> • <i>Were Nashville Electric Services invoices paid for Metro Nashville properties?</i> <p>Yes. Nashville Electric Services electric bill addresses for 39 sample locations were verified to be for Metro Nashville Government use.</p>	<p style="text-align: center;">Payments Summary July 1, 2008 through June 30, 2012</p> <p style="text-align: center;">Nashville Electric Services Paying Metropolitan Nashville</p> <table border="1" style="width: 100%; border-collapse: collapse; margin-bottom: 20px;"> <thead> <tr style="background-color: #e1ecf4;"> <th style="text-align: center;">Fiscal Year</th> <th style="text-align: center;">Payments In-Lieu Of Taxes</th> <th style="text-align: center;">Radio Shop Services</th> </tr> </thead> <tbody> <tr> <td style="text-align: center;">2009</td> <td style="text-align: right;">\$24,333,795</td> <td style="text-align: right;">\$257,869</td> </tr> <tr> <td style="text-align: center;">2010</td> <td style="text-align: right;">25,005,703</td> <td style="text-align: right;">265,816</td> </tr> <tr> <td style="text-align: center;">2011</td> <td style="text-align: right;">25,646,906</td> <td style="text-align: right;">219,193</td> </tr> <tr> <td style="text-align: center;">2012</td> <td style="text-align: right;">26,561,644</td> <td style="text-align: right;">182,802</td> </tr> </tbody> </table> <p style="text-align: center;">Metropolitan Nashville Paying Nashville Electric Services</p> <table border="1" style="width: 100%; border-collapse: collapse; margin-bottom: 20px;"> <thead> <tr style="background-color: #e1ecf4;"> <th style="text-align: center;">Fiscal Year</th> <th style="text-align: center;">Electric Bills</th> </tr> </thead> <tbody> <tr> <td style="text-align: center;">2009</td> <td style="text-align: right;">\$55,764,416</td> </tr> <tr> <td style="text-align: center;">2010</td> <td style="text-align: right;">52,457,831</td> </tr> <tr> <td style="text-align: center;">2011</td> <td style="text-align: right;">57,368,636</td> </tr> <tr> <td style="text-align: center;">2012</td> <td style="text-align: right;">58,178,399</td> </tr> </tbody> </table> <p style="text-align: center;">Recommendation</p> <p>The Metropolitan Government Emergency Management Committee should establish a formal process to determine the cost structure for the maintenance and operation of the 800 MHz trunked radio system infrastructure before allocating the total costs to internal users and external agencies such as Nashville Electric Services.</p>	Fiscal Year	Payments In-Lieu Of Taxes	Radio Shop Services	2009	\$24,333,795	\$257,869	2010	25,005,703	265,816	2011	25,646,906	219,193	2012	26,561,644	182,802	Fiscal Year	Electric Bills	2009	\$55,764,416	2010	52,457,831	2011	57,368,636	2012	58,178,399
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INTRODUCTION

Audit Initiation

The audit was initiated due to the magnitude of payments between both entities. For fiscal year 2012 Metropolitan Nashville Government paid Nashville Electric Services \$58 million for electric services and received \$26.7 million for payment in-lieu of property taxes and reimbursement for shared use of the Metro Nashville 800 megahertz radio system.

This audit was initially approved by the Metropolitan Nashville Audit Committee in 2010 and was carry-forward to the 2012 Internal Audit Work Plan due to other internal audit priorities.

Background

Nashville Electric Services is the official operating entity for the Electric Power Board. Although Nashville Electric Services is a component unit of the Metropolitan Nashville Government; it maintains its own funds separately from all other funds of the Metropolitan Nashville Government. Its business relationships with the rest of the Metropolitan Nashville Government are established through normal business transactions and interlocal agreements. Tennessee State Law authorizes municipalities to accept payments in-lieu of taxes (PILOT) from public utilities. Nashville Electric Services makes such payments quarterly which are allocated into three different Metro funds.

The source of electric power is solely purchasing from the Tennessee Valley Authority. Nashville Electric Services serves all industrial, commercial and residential electric power needs in Davidson County and small portions of several neighbor counties.

Organizational Structure

Although the Electric Power Board members are appointed by Metropolitan Mayor and approved by Metropolitan Nashville Council, the Charter states:

“...said electric power board of the metropolitan government shall have exclusive management and control of the operation of said electric power plant and/or distribution system”.

The existing management under the Board comprises a president chief executive officer, an executive vice president chief operating officer, a vice president chief financial officer, and a vice president general counsel.

Financial Information

Key Nashville Electric Services financial results which impact the payment in-lieu of property taxes are described in Exhibit A on the next page.

Exhibit A - Nashville Electric Services Key Financials for Payment In-Lieu of Taxes Calculation

(\$000 omitted)	2011	2010	2009
Net Assets	\$ 530,696	\$ 501,809	\$ 488,104
Operating Revenues	1,199,609	1,063,155	1,146,747
Purchased Power	927,065	816,152	915,005
Operating Expenses	217,304	206,154	198,284
Utility Plant	1,366,207	1,322,130	1,267,244
Construction Work-in-progress	67,286	69,326	54,211
Utility Plant Accumulated Depreciation	523,823	502,795	468,839
Materials and Supplies	19,884	20,015	18,379

Source: Nashville Electric Services Annual Financial Reports

Payments between Nashville Electric Services and the Metropolitan Nashville Government are shown in Exhibit B and Exhibit C below:

Exhibit B - Nashville Electric Services Paying Metropolitan Nashville Government

Fiscal Year	Payments In-Lieu Of Taxes	Radio Shop Services	Total
2009	\$24,333,795	\$257,869	\$24,591,664
2010	25,005,703	265,816	25,271,519
2011	25,646,906	219,193	25,866,099
2012	26,561,644	182,802	26,744,446

Sources: Metropolitan Nashville Enterprise One Accounting System

Exhibit C - Metropolitan Nashville Government Paying Nashville Electric Services

Fiscal Year	Electric Bills
2009	\$55,764,416
2010	52,457,831
2011	57,368,636
2012	58,178,399

Sources: Metro Enterprise One Accounting System

Additionally, the Metropolitan Nashville Convention Center Authority incurred \$28.8 million in cost for the relocation of the Demonbreun Substation, completed in 2011, to make way for the new Music City Convention Center.

OBJECTIVES AND CONCLUSIONS

1. *Were payments in-lieu of taxes from Nashville Electric Services calculated in accordance with Tennessee Code Annotated Title 7 Chapter 52 Part 3?*

Yes. At the end of each fiscal year, Nashville Electric Services calculates its payment in-lieu of tax amount using the formula stipulated by Tennessee statutes, and submits the calculation to the Metropolitan Nashville Department of Finance for review. The total amount due is then paid quarterly. Independent verification confirmed the accuracy of the formula for calculation and actual payments made for fiscal years 2009, 2010, and 2011.

2. *Did Nashville Electric Services pay for services rendered by Metro Nashville in accordance with agreed upon terms?*

Generally yes. Nashville Electric Services has paid all invoiced amounts for the 800 MHz radio services provided by Metro Radio Communications for the period from July 1, 2008, to June 30, 2012. However, the total invoiced amount calculated by Metro Radio Communications for the same period, including year-end adjustments, was \$67,537 under billed based on actual costs recorded in EnterpriseOne (See Observation A.)

3. *Were Nashville Electric Services invoices paid for Metro Nashville properties?*

Yes. Nashville Electric Services electric bill addresses for 39 sample locations were verified to be for Metro Nashville Government use.

OBSERVATIONS AND RECOMMENDATIONS

A – Radio Shop Maintenance and Operation Cost Determination

The Metro Radio Communications staff was unable to locate documentation supporting the account classifications and/or percentage used to segregate 800 MHz trunked radio infrastructure expenses used as a basis to calculate the 25 percent of infrastructure expenses billed to Nashville Electric Services. The memorandum of understanding (contract 97-16-322) between the Metropolitan Nashville Government and Nashville Electric Services states that 25 percent of the costs directly traceable to the operation and maintenance of the 800 MHz trunked radio infrastructure will be reimbursed by Nashville Electric Services. Historically, Metro Radio Communications has included various percentages of expense classifications (object accounts) ranging between zero and 100 percent to segregate 800 MHz trunked radio infrastructure from the total cost for running the Metro Radio Communications shop. Documentation supporting how this portion was determined was not available.

Details about Radio Shop expenses and cost basis used for charging Nashville Electric Services are shown in the table below:

	FY 2009	FY 2010	FY 2011	FY 2012
Radio Shop total expenditure	\$ 3,509,741	\$ 3,514,424	\$ 3,043,194	\$ 2,933,778
Expenditure included in cost basis (before percentages applied)	2,070,353	2,335,244	2,053,838	1,773,793
Cost basis for infrastructure (after percentages applied)	1,021,548	969,307	851,744	759,249

Sources: EnterpriseOne, Metro Radio Shop

Additionally, when comparing amounts after annual true-up invoiced to Nashville Electric Services to actual costs recorded in Metro Nashville's EnterpriseOne accounting system, using existing calculation method, it was determined that Nashville Electric Services was over-billed \$55,247 for fiscal year 2009, and under-billed \$47,552, \$36,039, and \$39,193 respectively for fiscal years 2010, 2011, and 2012. The total amount invoiced to Nashville Electric Services for the four-year period was under-billed \$67,537. Invoices to other external agencies were not reviewed to determine whether those agencies were also under-billed.

Every mayoral administration since 1999 had an Executive Order requiring a reserve fund to cover unanticipated expenses and improvements to the radio system. Metro Nashville Department of Finance confirmed that a minimum reserve balance percentage or separate reserve fund does not exist for the radio fund.

Criteria:

Mayor Dean Executive Order 29 states that:

“5. The mission of the Metropolitan Government Emergency Management Committee is as follows...b. Determine the accurate maintenance and operating costs for the System and then recommend a plan to assess each user a fair and proportionate share to recover these costs.

c. Develop and recommend guidelines to the Director of Finance and N.E.S. for the creation and maintenance of a reserve fund to cover unanticipated expenses and improvements to the System.”

Memorandum of Understanding (contract number 97-16-323) between Metropolitan Nashville Government and Nashville Electric Services states:

“5. ...For no-specific matters, such as procurement and maintenance of the to be purchased and jointly used infrastructure, consulting fees, etc., NES shall pay twenty-five percent (25%) of the total costs for its portion. If after conclusion of the procurement it is determined that this percentage is inaccurate then allocations will be developed that are mutually agreeable to both parties. During and subsequent to the procurement, any ongoing personnel costs incurred by either party that mutually benefits both parties will be shared on similar basis and this provision applies only to direct costs that are traceable the operation and maintenance of the jointly purchased infrastructure.”

Risk:

- Actual costs of the 800 MHz trunked radio system may not be fully shared by each user as management intended.

- Funds may not be available to cover unanticipated expenses and improvements to the System.

Recommendation:

The management of the Department of General Services Metro Radio Communications should:

1. Review the methodology for billing Nashville Electric Services for the ongoing maintenance and improvement costs associated with the 800 MHz trunked radio system infrastructure to determine if it is fair and proportionate for Nashville Electric Services and the Metropolitan Nashville Government. This methodology should be approved, documented and reviewed periodically as the cost for radio service operation might change over time.
2. Review the accuracy of billings after annual true-up for fiscal years between 2009 and 2012 to determine if all costs associated with the 800 MHz trunked radio system infrastructure have been accurately billed to Nashville Electric Services.
3. Work with the Metropolitan Government Emergency Radio Management Committee and Metropolitan Nashville Office of Finance to evaluate the necessity of a minimum reserve balance percentage or separate reserve fund and document the decision made thereafter.

GENERAL AUDIT INFORMATION

Statement of Compliance with GAGAS

This audit was completed in October 2012, 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 observations and conclusions based on our audit objectives.

We believe that the evidence obtained provides a reasonable basis for our observations and conclusions based on our audit objectives.

Scope and Methodology

The audit period focused primarily on the period July 1, 2008, through June 30, 2012. The methodology employed throughout this audit was one of objectively reviewing various forms of documentation, conducting interviews, observations, performing substantive tests and review of worksheet formulas, written policies and procedures, contracts and other relevant data

Criteria

In conducting this audit, the existing processes were evaluated for compliance with:

- Tennessee Code Annotated Title 7, Chapter 52, Parts 303 to 304
- Metropolitan Charter Appendix III, Articles 42 and 43
- Metropolitan Executive Order 29 (year 2008)
- Metropolitan Executive Order 18 (year 2002)
- Metropolitan Executive Order 99-06 (year 1999)
- Memorandum Of Understanding 97-16-323

Audit Project Staff

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Bill Walker, CPA, CIA, Staff Auditor
Qian Yuan, CISA, Staff Auditor

MANAGEMENT RESPONSE

- Management's Responses Starts on Next Page -

METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY



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MAYOR

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January 16, 2013

Mr. Mark Swann
Metropolitan Auditor
Office of Internal Audit
222 3rd Avenue North, Suite 401
Nashville, TN 37201

Re: Audit of Payments From and To Nashville Electric Service

Dear Mark:

We are in receipt and have reviewed the "Audit of Payments From and To Nashville Electric Service" resulting from your audit of the subject billings. The Department of Finance concurs with the findings of the report related to the in-lieu of tax payments made by Nashville Electric Service.

Sincerely,

A handwritten signature in black ink, appearing to read "Richard M. Riebeling".

Richard M. Riebeling
Director of Finance

Metropolitan Government
of Nashville and Davidson County

Karl F. Dean, Mayor
Nancy Whittemore, Director



Department of General Services

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November 26, 2012

Mark Swann
Metropolitan Auditor
Office of Internal Audit
222 3rd Avenue North, Suite 401
Nashville, Tennessee 37201
Mark.Swann@nashville.gov

RE: 800 MHz Radio Charges to NES

Mr. Swann:

We are in receipt of and have reviewed the *Observations and Recommendations* resulting from your audit of the subject billings. The Department of General Services will implement related recommendations and improvements as appropriate and within the department's purview.

Please find attached specific responses to recommendations detailed in the Management Response format provided by your office.

We appreciate the help of your office and your support in improving our processes relating to 800 MHz Radio Charges to NES.

Sincerely,

A handwritten signature in blue ink, appearing to read "Nancy Whittemore".

Nancy Whittemore, Director
Department of General Services

Attachment

Audit of Payments From and To Nashville Electric Services

Audit Recommendation	Response to Recommendation / Action Plan	Assigned Responsibility	Estimated Completion
<p>A. Department of General Services Metro Radio Communications should review the methodology for billing Nashville Electric Services for the ongoing maintenance and improvement costs associated with the 800 MHz trunked radio system infrastructure to determine if it is fair and proportionate for Nashville Electric Services and the Metropolitan Nashville Government. This methodology should be approved, documented and reviewed periodically as the cost for radio service operation might change over time.</p>	<p>Accept. We concur with the recommendation that General Services review and formalize the methodology used to determine 800 MHz Radio infrastructure costs which are used to calculate the twenty-five percent portion for which NES is responsible.</p>	<p>General Services Financial Manager</p>	<p>April 1, 2013</p>
<p>B. Department of General Services Metro Radio Communications should review the accuracy of billings after annual true-up for fiscal years between 2009 and 2012 to determine if all costs associated with the 800 MHz trunked radio system infrastructure have been accurately billed to Nashville Electric Services.</p>	<p>Accept. We accept the recommendation. General Services will conduct reviews of annual true-up figures to determine the impact of those amounts on 800 MHz Radio infrastructure cost calculations and ensure all that all cost are billed to NES as appropriate.</p>	<p>General Services Financial Manager</p>	<p>On-Going</p>
<p>C. Department of General Services Metro Radio Communications should work with the Metropolitan Government Emergency Radio Management Committee and Metropolitan Nashville Office of Finance to evaluate the necessity of a minimum reserve balance percentage or separate reserve fund and document the decision made thereafter.</p>	<p>Partially Accept. We partially accept the recommendation. The Executive Order provisions pertaining to a reserve fund mandate only that the MRAM “Develop and recommend guidelines to the Director of Finance and N.E.S. for the creation and maintenance of a reserve fund to cover unanticipated expenses and improvement to the System.” In response, the Finance Department made the determination not to create a separate reserve fund. We hold that the stated responsibility does not require some explicit action or formal MRAM decision. Notwithstanding the foregoing, we concur with the prudence of evaluating a minimum reserve balance for purposes of funding necessary, 800 MHz Radio System expenses and improvements. The Department of General Services will continue to consult with both MRAM and the Finance Department toward that end.</p>	<p>General Services Financial Manager</p>	<p>On-Going</p>