Tennessee Valley Authority
Form 10-Q
May 06, 2014
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(MARK ONE)
x QUARTERLY REPORT PURSUANT TO SECTION 13, 15(d), OR 37 OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2014
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____

Commission file number 000-52313

TENNESSEE VALLEY AUTHORITY
(Exact name of registrant as specified in its charter)

A corporate agency of the United States created by an act of Congress (State or other jurisdiction of incorporation or organization)	62-0474417 (IRS Employer Identification No.)
400 W. Summit Hill Drive Knoxville, Tennessee (Address of principal executive offices)	37902 (Zip Code)

(865) 632-2101
(Registrant’s telephone number, including area code)

None
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13, 15(d), or 37 of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer o
Non-accelerated filer x Smaller reporting company o
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No x

Table of Contents

Table of Contents

Table of Contents

GLOSSARY OF COMMON ACRONYMS

Following are definitions of terms or acronyms frequently used in this Quarterly Report on Form 10-Q for the quarter ended March 31, 2014 (the "Quarterly Report"):

Term or Acronym	Definition
AFUDC	Allowance for funds used during construction
ARO	Asset retirement obligation
ART	Asset Retirement Trust
ASLB	Atomic Safety and Licensing Board
BEST	Bellefonte Efficiency and Sustainability Team
BREDL	Blue Ridge Environmental Defense League
CAA	Clean Air Act
CAIR	Clean Air Interstate Rule
CCOLA	Combined construction and operating license application
CCP	Coal combustion products
CCR	Coal combustion residual
CME	Chicago Mercantile Exchange
CO_2	Carbon dioxide
COLA	Cost-of-living adjustment
CSAPR	Cross State Air Pollution Rule
CTs	Combustion turbine unit(s)
CVA	Credit valuation adjustment
CY	Calendar year
DOE	Department of Energy
EPA	Environmental Protection Agency
FASB	Financial Accounting Standards Board
FERC	Federal Energy Regulatory Commission
FTP	Financial Trading Program
GAAP	Accounting principles generally accepted in the United States of America
GAO	Government Accountability Office
GHG	Greenhouse gas
GWh	Gigawatt hour(s)
JSCCG	John Sevier Combined Cycle Generation LLC
kWh	Kilowatt hour(s)
LIBOR	London Interbank Offered Rate
LPC	Local power company customer of TVA
MD&A	Management's Discussion and Analysis of Financial Condition and Results of Operations
MISO	Midcontinent Independent System Operator, Inc.
mmBtu	Million British thermal unit(s)
MtM	Mark-to-market
MW	Megawatt
NAV	Net asset value
NDT	Nuclear Decommissioning Trust
NEPA	National Environmental Policy Act
NERC	North American Electric Reliability Corporation
NO_x	Nitrogen oxides
NPDES	National Pollutant Discharge Elimination System
NRC	Nuclear Regulatory Commission

OCI	Other Comprehensive Income (Loss)
PM	Particulate matter

Table of Contents

QTE	Qualified technological equipment and software
REIT	Real Estate Investment Trust
SACE	Southern Alliance for Clean Energy
SCCG	Southaven Combined Cycle Generation, LLC
SCRs	Selective catalytic reduction systems
SEC	Securities and Exchange Commission
SERP	Supplemental Executive Retirement Plan
Seven States	Seven States Power Corporation
SHLLC	Southaven Holdco, LLC
SMR	Small modular reactor(s)
SO_2	Sulfur dioxide
SSSL	Seven States Southaven, LLC
TCWN	Tennessee Clean Water Network
TDEC	Tennessee Department of Environment & Conservation
TOU	Time-of-use
TVARS	Tennessee Valley Authority Retirement System
TN Board	Tennessee Water Quality, Oil, and Gas Board
USEC	United States Enrichment Corporation
VIE	Variable interest entity
XBRL	eXtensible Business Reporting Language

Table of Contents

FORWARD-LOOKING INFORMATION

This Quarterly Report contains forward-looking statements relating to future events and future performance. All statements other than those that are purely historical may be forward-looking statements. In certain cases, forward-looking statements can be identified by the use of words such as “may,” “will,” “should,” “expect,” “anticipate,” “beli “intend,” “project,” “plan,” “predict,” “assume,” “forecast,” “estimate,” “objective,” “possible,” “probably,” “likely,” “potentia other similar expressions.

Although the Tennessee Valley Authority ("TVA") believes that the assumptions underlying the forward-looking statements are reasonable, TVA does not guarantee the accuracy of these statements. Numerous factors could cause actual results to differ materially from those in the forward-looking statements. These factors include, among other things:

- New or amended laws, regulations, or administrative determinations, including those related to environmental matters, and the costs of complying with these laws, regulations, and administrative determinations;
- The requirement or decision to make additional contributions to TVA's pension or other post-retirement benefit plans or to TVA's Nuclear Decommissioning Trust ("NDT") or Asset Retirement Trust ("ART");
- Events at a TVA facility, which, among other things, could result in loss of life, damage to the environment, damage to or loss of the facility, and damage to the property of others;
- Events at a nuclear facility, whether or not operated by or licensed to TVA, which, among other things, could lead to increased regulation or restriction on the construction, ownership, operation, and decommissioning of nuclear facilities or on the storage of spent fuel, obligate TVA to pay retrospective insurance premiums, reduce the availability and affordability of insurance, increase the costs of operating TVA's existing nuclear units, negatively affect the cost and schedule for completing Watts Bar Nuclear Plant ("Watts Bar") Unit 2 and preserving Bellefonte Nuclear Plant ("Bellefonte") Unit 1 for possible completion, or cause TVA to forego future construction at these or other facilities;
- Significant delays, cost increases, or cost overruns associated with the construction of generation or transmission assets;
- Costs and liabilities that are not anticipated in TVA’s financial statements for third-party claims, natural resource damages, or fines or penalties associated with events such as the Kingston Fossil Plant ("Kingston") ash spill;
- Inability to eliminate identified deficiencies in TVA's systems, standards, controls, and corporate culture;
- Failure of TVA's cyber security program to protect TVA's assets from cyber attacks;
- The outcome of legal and administrative proceedings;
- Significant changes in demand for electricity which may result from, among other things, economic downturns, loss of customers, increased energy efficiency and conservation, and improvements in distributed generation and other alternative generation technologies;
- Addition or loss of customers;
- The failure of TVA's generation, transmission, flood control, and related assets, including coal combustion residual ("CCR") facilities, to operate as anticipated, resulting in lost revenues, damages, and other costs that are not reflected in TVA’s financial statements or projections;
- The cost of complying with known, anticipated, and new emissions reduction requirements, some of which could render continued operation of many of TVA's aging coal-fired generation units not cost-effective and result in their removal from service, perhaps permanently;
- Disruption of fuel supplies, which may result from, among other things, weather conditions, production or transportation difficulties, labor challenges, or environmental laws or regulations affecting TVA's fuel suppliers or transporters;
- Purchased power price volatility and disruption of purchased power supplies;
- Events or changes involving transmission lines, dams, and other facilities not operated by TVA, including those that affect the reliability of the interstate transmission grid of which TVA's transmission system is a part

and those that increase flows across TVA's transmission grid, as well as inadequacies in the supply of water to TVA's generation facilities;

- Inability to obtain regulatory approval for the construction or operation of assets;
- Weather conditions;
- Catastrophic events such as fires, earthquakes, solar events, floods, hurricanes, tornadoes, pandemics, wars, national emergencies, terrorist activities, and other similar events, especially if these events occur in or near TVA's service area;
- Restrictions on TVA's ability to use or manage real property currently under its control;
- Reliability and creditworthiness of counterparties;
- Changes in the market price of commodities such as coal, uranium, natural gas, fuel oil, crude oil, construction materials, reagents, electricity, and emission allowances;
- Changes in the market price of equity securities, debt securities, and other investments;
- Changes in interest rates, currency exchange rates, and inflation rates;
- Changes in the timing or amount of pension and health care costs;
- Increases in TVA's financial liability for decommissioning its nuclear facilities and retiring other assets;
- Limitations on TVA's ability to borrow money which may result from, among other things, TVA's approaching or substantially reaching the limit on bonds, notes, and other evidences of indebtedness specified in the TVA Act of 1933;

Table of Contents

- An increase in TVA's cost of capital which may result from, among other things, changes in the market for TVA's debt securities, changes in the credit rating of TVA or the U.S. government, and an increased reliance by TVA on alternative financing arrangements as TVA approaches its debt ceiling;
- Actions taken, or inaction, by the U.S. government to address the situation of approaching its debt limit;
- Changes in the economy and volatility in financial markets;
- Ineffectiveness of TVA's disclosure controls and procedures and its internal control over financial reporting;
- Problems attracting and retaining a qualified workforce;
- Changes in technology;
- Failure of TVA's assets to operate as planned;
- Differences between estimates of revenues and expenses and actual revenues earned and expenses incurred; and
- Unforeseeable events.

See also Item 1A, Risk Factors, and Item 7, Management’s Discussion and Analysis of Financial Condition and Results of Operations in TVA’s Annual Report on Form 10-K for the fiscal year ended September 30, 2013 (the “Annual Report”) and
Part I, Item 2, Management’s Discussion and Analysis of Financial Condition and Results of Operations in this Quarterly Report for a discussion of factors that could cause actual results to differ materially from those in a forward-looking statement. New factors emerge from time to time, and it is not possible for management to predict all such factors or to assess the extent to which any factor or combination of factors may impact TVA’s business or cause results to differ materially from those contained in any forward-looking statement. TVA undertakes no obligation to update any forward-looking statement to reflect developments that occur after the statement is made.

GENERAL INFORMATION

Fiscal Year

References to years (2014, 2013, etc.) in this Quarterly Report are to TVA’s fiscal years ending September 30. Years that are preceded by “CY” are references to calendar years.

Notes

References to “Notes” are to the Notes to Consolidated Financial Statements contained in Part I, Item 1, Financial Statements in this Quarterly Report.

Available Information

TVA's Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and all amendments to those reports are available on TVA's web site, free of charge, as soon as reasonably practicable after such reports are electronically filed with or furnished to the Securities and Exchange Commission ("SEC"). TVA's web site is www.tva.gov. Information contained on TVA’s web site shall not be deemed to be incorporated into, or to be a part of, this Quarterly Report. TVA's SEC reports are also available to the public without charge from the web site maintained by the SEC at www.sec.gov.

Table of Contents

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

TENNESSEE VALLEY AUTHORITY
CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)
(in millions)

	Three Months Ended March 31		Six Months Ended March 31	
	2014	2013	2014	2013
Operating revenues				
Sales of electricity	$2,901	$2,709	$5,251	$5,258
Other revenue	37	32	69	62
Total operating revenues	2,938	2,741	5,320	5,320
Operating expenses				
Fuel	663	672	1,206	1,466
Purchased power	313	288	564	533
Operating and maintenance	793	876	1,600	1,795
Depreciation and amortization	453	408	894	836
Tax equivalents	140	136	262	273
Total operating expenses	2,362	2,380	4,526	4,903
Operating income	576	361	794	417
Other income (expense), net	13	11	27	26
Interest expense				
Interest expense	336	359	675	714
Allowance for funds used during construction and nuclear fuel expenditures	(42)	(41)	(82)	(80)
Net interest expense	294	318	593	634
Net income (loss)	$295	$54	$228	$(191)

The accompanying notes are an integral part of these consolidated financial statements.

TENNESSEE VALLEY AUTHORITY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (Unaudited)
(in millions)

	Three Months Ended March 31		Six Months Ended March 31	
	2014	2013	2014	2013
Net income (loss)	$295	$54	$228	$(191)
Other comprehensive income (loss)				
Net unrealized gain (loss) on cash flow hedges	2	(49)	22	(16)
Reclassification to earnings from cash flow hedges	(7)	63	(29)	58
Total other comprehensive income (loss)	$(5)	$14	$(7)	$42
Total comprehensive income (loss)	$290	$68	$221	$(149)

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

TENNESSEE VALLEY AUTHORITY
CONSOLIDATED BALANCE SHEETS
(in millions)
ASSETS

	March 31, 2014	September 30, 2013
Current assets	(Unaudited)	
Cash and cash equivalents	$506	$1,602
Restricted cash and investments	11	33
Accounts receivable, net	1,449	1,567
Inventories, net	1,047	1,091
Regulatory assets	635	561
Other current assets	69	52
Total current assets	3,717	4,906
Property, plant, and equipment		
Completed plant	47,541	47,073
Less accumulated depreciation	(23,845)	(23,157)
Net completed plant	23,696	23,916
Construction in progress	5,245	4,704
Nuclear fuel	1,305	1,256
Capital leases	62	47
Total property, plant, and equipment, net	30,308	29,923
Investment funds	1,827	1,701
Regulatory and other long-term assets		
Regulatory assets	8,663	9,131
Other long-term assets	508	445
Total regulatory and other long-term assets	9,171	9,576
Total assets	$45,023	$46,106

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

TENNESSEE VALLEY AUTHORITY
CONSOLIDATED BALANCE SHEETS
(in millions)
LIABILITIES AND PROPRIETARY CAPITAL

	March 31, 2014	September 30, 2013
Current liabilities	(Unaudited)	
Accounts payable and accrued liabilities	$1,499	$1,627
Environmental cleanup costs - Kingston ash spill	118	102
Accrued interest	397	378
Current portion of leaseback obligations	75	69
Current portion of energy prepayment obligations	100	100
Regulatory liabilities	180	212
Short-term debt, net	1,691	2,432
Current maturities of power bonds	32	32
Current maturities of long-term debt of variable interest entities	31	30
Total current liabilities	4,123	4,982
Other liabilities		
Post-retirement and post-employment benefit obligations	5,319	5,348
Asset retirement obligations	3,535	3,472
Other long-term liabilities	1,877	1,861
Leaseback obligations	637	692
Energy prepayment obligations	360	410
Environmental cleanup costs - Kingston ash spill	—	67
Regulatory liabilities	2	1
Total other liabilities	11,730	11,851
Long-term debt, net		
Long-term power bonds, net	22,014	22,315
Long-term debt of variable interest entities	1,295	1,311
Total long-term debt, net	23,309	23,626
Total liabilities	39,162	40,459
Proprietary capital		
Power program appropriation investment	263	268
Power program retained earnings	4,997	4,767
Total power program proprietary capital	5,260	5,035
Nonpower programs appropriation investment, net	605	609
Accumulated other comprehensive income (loss)	(4)	3
Total proprietary capital	5,861	5,647
Total liabilities and proprietary capital	$45,023	$46,106

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

TENNESSEE VALLEY AUTHORITY
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
For the six months ended March 31
(in millions)

	2014		2013	
Cash flows from operating activities				
Net income (loss)	$228		$(191	)
Adjustments to reconcile net income (loss) to net cash provided by operating activities				
Depreciation and amortization (including amortization of debt issuance costs and premiums/discounts)	917		857	
Amortization of nuclear fuel cost	143		117	
Non-cash retirement benefit expense	286		311	
Prepayment credits applied to revenue	(50	)	(52	)
Fuel cost adjustment deferral	(162	)	55	
Fuel cost tax equivalents	(3	)	3	
Environmental cleanup costs – Kingston ash spill – non cash	34		36	
Changes in current assets and liabilities				
Accounts receivable, net	116		312	
Inventories and other, net	62		(54	)
Accounts payable and accrued liabilities	(96	)	(171	)
Accrued interest	19		22	
Regulatory assets costs	(39	)	(5	)
Pension contributions	(132	)	(6	)
Environmental cleanup costs – Kingston ash spill	(43	)	(51	)
Insurance recoveries	161		—	
Other, net	(15	)	(35	)
Net cash provided by operating activities	1,426		1,148	
Cash flows from investing activities				
Construction expenditures	(1,141	)	(996	)
Nuclear fuel expenditures	(239	)	(213	)
Loans and other receivables				
Advances	(1	)	(4	)
Repayments	4		5	
Other, net	3		4	
Net cash used in investing activities	(1,374	)	(1,204	)
Cash flows from financing activities				
Long-term debt				
Issues of power bonds	—		1,067	
Redemptions and repurchases of power bonds	(333	)	(1,387	)
Redemptions of variable interest entities	(15	)	(6	)
Short-term debt issues (redemptions), net	(741	)	537	
Payments on leases and leasebacks	(50	)	(55	)
Financing costs, net	—		(7	)
Payments to U.S. Treasury	(7	)	(13	)
Other, net	(2	)	(29	)
Net cash (used in) provided by financing activities	(1,148	)	107	
Net change in cash and cash equivalents	(1,096	)	51	
Cash and cash equivalents at beginning of period	1,602		868	

Cash and cash equivalents at end of period	$506	$919

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

TENNESSEE VALLEY AUTHORITY
CONSOLIDATED STATEMENTS OF CHANGES IN PROPRIETARY CAPITAL (Unaudited)
For the three months ended March 31, 2014 and 2013
(in millions)

	Power Program Appropriation Investment	Power Program Retained Earnings	Nonpower Programs Appropriation Investment, Net	Accumulated Other Comprehensive Income (Loss) from Net Gains (Losses) on Cash Flow Hedges	Total
Balance at December 31, 2012 (unaudited)	$283	$4,249	$617	$(46)	$5,103
Net income (loss)	—	55	(1)	—	54
Total other comprehensive income (loss)	—	—	—	14	14
Return on power program appropriation investment	—	(2)	—	—	(2)
Return of power program appropriation investment	(5)	$—	—	—	(5)
Balance at March 31, 2013 (unaudited)	$278	$4,302	$616	$(32)	$5,164
Balance at December 31, 2013 (unaudited)	$265	$4,701	$607	$1	$5,574
Net income (loss)	—	297	(2)	—	295
Total other comprehensive income (loss)	—	—	—	(5)	(5)
Return on power program appropriation investment	—	(1)	—	—	(1)
Return of power program appropriation investment	(2)	—	—	—	(2)
Balance at March 31, 2014 (unaudited)	$263	$4,997	$605	$(4)	$5,861

The accompanying notes are an integral part of these consolidated financial statements.

TENNESSEE VALLEY AUTHORITY
CONSOLIDATED STATEMENTS OF CHANGES IN PROPRIETARY CAPITAL (Unaudited)
For the six months ended March 31, 2014 and 2013
(in millions)

	Power Program Appropriation Investment	Power Program Retained Earnings	Nonpower Programs Appropriation Investment, Net	Accumulated Other Comprehensive Income (Loss) from Net Gains (Losses) on Cash Flow	Total

				Hedges	
Balance at September 30, 2012	$288	$4,492	$620	$(74)	$5,326
Net income (loss)	—	(187)	(4)	—	(191)
Total other comprehensive income (loss)	—	—	—	42	42
Return on power program appropriation investment	—	(3)	—	—	(3)
Return of power program appropriation investment	(10)	$—	—	—	(10)
Balance at March 31, 2013 (unaudited)	$278	$4,302	$616	$(32)	$5,164
Balance at September 30, 2013	$268	$4,767	$609	$3	$5,647
Net income (loss)	—	232	(4)	—	228
Total other comprehensive income (loss)	—	—	—	(7)	(7)
Return on power program appropriation investment	—	(2)	—	—	(2)
Return of power program appropriation investment	(5)	—	—	—	(5)
Balance at March 31, 2014 (unaudited)	$263	$4,997	$605	$(4)	$5,861

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
(Dollars in millions except where noted)

1. Summary of Significant Accounting Policies

General

The Tennessee Valley Authority ("TVA") is a corporate agency and instrumentality of the United States that was created in 1933 by legislation enacted by the United States ("U.S.") Congress in response to a request by President Franklin D. Roosevelt. TVA was created to, among other things, improve navigation on the Tennessee River, reduce the damage from destructive flood waters within the Tennessee River system and downstream on the lower Ohio and Mississippi Rivers, further the economic development of TVA's service area in the southeastern United States, and sell the electricity generated at the facilities TVA operates.

Today, TVA operates the nation's largest public power system and supplies power in most of Tennessee, northern Alabama, northeastern Mississippi, and southwestern Kentucky and in portions of northern Georgia, western North Carolina, and southwestern Virginia to a population of over nine million people.

TVA also manages the Tennessee River, its tributaries, and certain shorelines to provide, among other things, year-round navigation, flood damage reduction, and affordable and reliable electricity. Consistent with these primary purposes, TVA also manages the river system to provide recreational opportunities, adequate water supply, improved water quality, natural resource protection, and economic development.

The power program has historically been separate and distinct from the stewardship programs. It is required to be self-supporting from power revenues and proceeds from power financings, such as proceeds from the issuance of bonds, notes, or other evidences of indebtedness ("Bonds"). Although TVA does not currently receive congressional appropriations, it is required to make annual payments to the U.S. Treasury in repayment of and as a return on the government's appropriation investment in TVA's power facilities (the "Power Program Appropriation Investment"). In the 1998 Energy and Water Development Appropriations Act, Congress directed TVA to fund essential stewardship activities related to its management of the Tennessee River system and nonpower or stewardship properties with power revenues in the event that there were insufficient appropriations or other available funds to pay for such activities in any fiscal year. Congress has not provided any appropriations to TVA to fund such activities since 1999. Consequently, during 2000, TVA began paying for essential stewardship activities primarily with power revenues, with the remainder funded with user fees and other forms of revenues derived in connection with those activities. The activities related to stewardship properties do not meet the criteria of an operating segment under accounting principles generally accepted in the United States of America ("GAAP"). Accordingly, these assets and properties are included as part of the power program, TVA's only operating segment.

Power rates are established by the TVA Board of Directors (the "TVA Board") as authorized by the Tennessee Valley Authority Act of 1933, as amended, 16 U.S.C. §§ 831-831ee (as amended, the “TVA Act”). The TVA Act requires TVA to charge

12

Table of Contents

rates for power that will produce gross revenues sufficient to provide funds for operation, maintenance, and administration of its power system; payments to states and counties in lieu of taxes ("tax equivalents"); debt service on outstanding indebtedness; payments to the U.S. Treasury in repayment of and as a return on the Power Program Appropriation Investment; and such additional margin as the TVA Board may consider desirable for investment in power system assets, retirement of outstanding Bonds in advance of maturity, additional reduction of the Power Program Appropriation Investment, and other purposes connected with TVA's power business. In setting TVA's rates, the TVA Board is charged by the TVA Act to have due regard for the primary objectives of the TVA Act, including the objective that power shall be sold at rates as low as are feasible. Rates set by the TVA Board are not subject to review or approval by any state or other federal regulatory body.

Fiscal Year

TVA's fiscal year ends September 30. Years (2014, 2013, etc.) refer to TVA's fiscal years unless they are preceded by “CY,” in which case the references are to calendar years.

Cost-Based Regulation

Since the TVA Board is authorized by the TVA Act to set rates for power sold to its customers, TVA is self-regulated. Additionally, TVA's regulated rates are designed to recover its costs. In view of demand for electricity and the level of competition, TVA believes that rates, set at levels that will recover TVA's costs, can be charged and collected. As a result of these factors, TVA records certain assets and liabilities that result from the regulated ratemaking process that would not be recorded under GAAP for non-regulated entities. Regulatory assets generally represent incurred costs that have been deferred because such costs are probable of future recovery in customer rates. Regulatory liabilities generally represent obligations to make refunds to customers for previous collections for costs that are not likely to be incurred or deferral of gains that will be credited to customers in future periods. TVA assesses whether the regulatory assets are probable of future recovery by considering factors such as applicable regulatory changes, potential legislation, and changes in technology. Based on these assessments, TVA believes the existing regulatory assets are probable of future recovery. This determination reflects the current regulatory and political environment and is subject to change in the future. If future recovery of regulatory assets ceases to be probable, or any of the other factors described above cease to be applicable, TVA would no longer be considered to be a regulated entity and would be required to write off these costs. Most regulatory asset write offs would be required to be recognized in earnings in the period in which future recovery ceases to be probable.

Basis of Presentation

TVA prepares its consolidated interim financial statements in conformity with GAAP for consolidated interim financial information. Accordingly, TVA's consolidated interim financial statements do not include all of the information and notes required by GAAP for annual financial statements. As such, they should be read in conjunction with the audited financial statements for the year ended September 30, 2013, and the notes thereto, which are contained in TVA's Annual Report on Form 10-K for the year ended September 30, 2013 (the “Annual Report”). In the opinion of management, all adjustments (consisting of items of a normal recurring nature) considered necessary for fair presentation are included in the interim financial statements.

The accompanying consolidated interim financial statements include the accounts of TVA and three variable interest entities ("VIEs"), of which TVA is the primary beneficiary. See Note 8. Intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements requires TVA to estimate the effects of various matters that are inherently uncertain as of the date of the consolidated financial statements. Although the consolidated financial statements are prepared in conformity with GAAP, TVA is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the amounts of revenues and expenses reported during the reporting period. Each of these estimates varies in regard to the level of judgment involved and its potential impact on TVA's financial results. Estimates are deemed critical either when a different estimate could have reasonably been used or where changes in the estimate are reasonably likely to occur from period to period and such use or change would materially impact TVA's financial condition, results of operations, or cash flows.

Reclassifications

Certain reclassifications have been made to the Consolidated Statement of Cash Flows for the six months ended March 31, 2014 in the Cash flows from operating activities section as $(11) million previously reported as Other, net for the six months ended March 31, 2013, was reclassified to $(5) million Regulatory assets costs and $(6) million Pension contributions.

Table of Contents

Allowance for Uncollectible Accounts

The allowance for uncollectible accounts reflects TVA's estimate of probable losses inherent in its accounts and loans receivable balances. TVA determines the allowance based on known accounts, historical experience, and other currently available information including events such as customer bankruptcy and/or a customer failing to fulfill payment arrangements after 90 days. It also reflects TVA's corporate credit department's assessment of the financial condition of customers and the credit quality of the receivables.

The allowance for uncollectible accounts was $1 million at both March 31, 2014 and September 30, 2013 for accounts receivable. Additionally, loans receivable of $92 million and $73 million at March 31, 2014 and September 30, 2013, respectively, are included in Other long-term assets and reported net of allowances for uncollectible accounts of $10 million.

Depreciation

Depreciation expense was $382 million and $337 million for the three months ended March 31, 2014, and 2013, and $750 million and $694 million for the six months ended March 31, 2014, and 2013, respectively. On November 14, 2013, TVA determined that Paradise Fossil Plant ("Paradise") Units 1 and 2 will be idled on March 31, 2017, and depreciation expense is being accelerated over the remaining useful life. This resulted in additional depreciation expense of $13 million during the three and six months ended March 31, 2014. It is expected that the decision to idle Paradise Units 1 and 2 on March 31, 2017, will increase depreciation expense by approximately $40 million for the remainder of 2014.

Blended Low-Enriched Uranium Program

Under the blended low-enriched uranium ("BLEU") program, TVA, the Department of Energy ("DOE"), and certain nuclear fuel contractors have entered into agreements providing for the DOE's surplus of enriched uranium to be blended with other uranium down to a level that allows the blended uranium to be fabricated into fuel that can be used in nuclear power plants. Under the terms of an interagency agreement between TVA and the DOE, in exchange for supplying highly enriched uranium materials to the appropriate third-party fuel processors for processing into usable BLEU fuel for TVA, the DOE participates to a degree in the savings generated by TVA’s use of this blended nuclear fuel. Over the life of the program, TVA projects that the DOE’s share of savings generated by TVA’s use of this blended nuclear fuel could result in payments to the DOE of as much as $175 million. TVA accrues an obligation with each BLEU reload batch related to the portion of the ultimate future payments estimated to be attributable to the BLEU fuel currently in use. At March 31, 2014, TVA had paid out approximately $101 million for this program, and the obligation recorded was $16 million.

2. Impact of New Accounting Standards and Interpretations

The following accounting standards became effective for TVA on October 1, 2013.

Balance Sheet. In December 2011, Financial Accounting Standards Board ("FASB") issued guidance that requires additional disclosures relating to the rights of offset or other netting arrangements of assets and liabilities that are presented on a net or gross basis in the consolidated balance sheets. In January 2013, FASB issued additional guidance to limit the scope of the new offsetting disclosure requirements to derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and lending transactions. The guidance requires the disclosure of the gross amounts subject to offset, actual amounts offset in accordance with GAAP, and the related net exposure. These changes became effective for TVA on October 1, 2013, and have been applied on a retrospective basis. This guidance relates solely to enhanced disclosures in the notes to the consolidated financial statements and did not have an impact on TVA's financial condition, results of operations, or cash flows.

Comprehensive Income. In February 2013, FASB issued guidance that requires public reporting companies under the Securities Act of 1933 to present information about reclassification adjustments from accumulated other comprehensive income (loss) ("AOCI") in their annual and interim financial statements in a single location. The guidance requires that companies present the effect of significant amounts reclassified from each component of AOCI based on its source and the income statement line items affected by the reclassification. This information may be disclosed either in a single note or parenthetically on the face of the financial statements. If a component is not required to be reclassified to net income in its entirety, companies must cross reference to the related footnote for additional information. These changes became effective for TVA on October 1, 2013, and have been applied on a prospective basis. TVA has chosen to disclose the required information in a single note. This guidance relates solely to enhanced disclosures and did not have an impact on TVA's financial condition, results of operations, or cash flows.

There are no FASB Accounting Standards Updates that have been issued but not yet adopted as March 31, 2014, that are expected to significantly impact TVA's financial condition, results of operations, or cash flows.

Table of Contents

3. Restructuring

TVA is undertaking cost reduction initiatives with the goal of keeping rates low, keeping reliability high, and continuing to fulfill its broader mission of environmental stewardship and economic development. TVA's current focus is on reducing operating and maintenance costs through further efficiency gains and streamlining the organization. TVA's goal is to reduce operating and maintenance costs by $500 million by 2015 as compared to its 2013 budget. Certain employees will be eligible for severance payments as a result of these cost reduction initiatives. These amounts are included in Accounts payable and accrued liabilities on the Consolidated Balance Sheets. The table below summarizes the activity related to severance costs:

Severance Cost Liability Activity

	Three Months Ended March 31, 2014	Six Months Ended March 31, 2014
Severance cost liability at beginning of period	$12	$—
Liabilities incurred during the period	17	29
Actual costs paid during the period	(4)	(4)
Severance cost liability at end of period	$25	$25

4. Accounts Receivable, Net

Accounts receivable primarily consist of amounts due from customers for power sales. The table below summarizes the types and amounts of TVA's accounts receivable:

Accounts Receivable, Net

	At March 31, 2014	At September 30, 2013
Power receivables	$1,385	$1,495
Other receivables	65	73
Allowance for uncollectible accounts	(1)	(1)
Accounts receivable, net	$1,449	$1,567

5. Inventories, Net

The table below summarizes the types and amounts of TVA's inventories:

Inventories, Net

	At March 31, 2014	At September 30, 2013
Materials and supplies inventory	$619	$620
Fuel inventory	451	494
Emission allowance inventory	17	14
Allowance for inventory obsolescence	(40)	(37)
Inventories, net	$1,047	$1,091

6. Other Long-Term Assets

The table below summarizes the types and amounts of TVA's other long-term assets:

Other Long-Term Assets

	At March 31, 2014	At September 30, 2013
EnergyRight® receivables	$118	$117
Unamortized debt issue cost of power bonds	66	75
Loans and other long-term receivables, net	92	73
Prepaid capacity payments	58	62
Restricted cash	74	—

Currency swap asset, net	—	28
Coal contract derivative assets	2	1
Other	98	89
Other long-term assets	$508	$445

Table of Contents

In association with the EnergyRight® Solutions program, local power company customers of TVA ("LPCs") offer financing to end-use customers for the purchase of energy-efficient equipment. TVA purchases the resulting loans receivable from its LPCs. The loans receivable are then transferred to a third-party bank with which TVA has agreed to repay in full any loan receivable that has been in default for 180 days or more or that TVA has determined is uncollectible. Given this continuing involvement, TVA accounts for the transfer of the loans receivable as secured borrowings. The current and long-term portions of the loans receivable are reported in Accounts receivable, net and Other long-term assets, respectively, on TVA's Consolidated Balance Sheets. As of March 31, 2014 and September 30, 2013, the carrying amount of the loans receivable, net of discount, reported in Accounts receivable, net was approximately $33 million. See Note 10 for information regarding the associated financing obligation.

7. Regulatory Assets and Liabilities

Regulatory assets generally represent incurred costs that have been deferred because such costs are probable of future recovery in customer rates. Regulatory liabilities generally represent obligations to make refunds to customers for previous collections for costs that are not likely to be incurred or deferrals of gains that will be credited to customers in future periods. Components of regulatory assets and regulatory liabilities are summarized in the table below:

Regulatory Assets and Liabilities

	At March 31, 2014	At September 30, 2013
Current regulatory assets		
Deferred nuclear generating units	$237	$237
Unrealized losses on commodity derivatives	122	183
Environmental agreements	83	73
Environmental cleanup costs - Kingston ash spill	60	68
Fuel cost adjustment receivable	133	—
Total current regulatory assets	635	561
Non-current regulatory assets		
Deferred pension costs and other post-retirement benefits costs	3,942	4,076
Unrealized losses on interest rate derivatives	833	808
Nuclear decommissioning costs	856	893
Environmental cleanup costs - Kingston ash spill	487	681
Non-nuclear decommissioning costs	582	571
Deferred nuclear generating units	1,358	1,438
Environmental agreements	153	189
Unrealized losses on commodity derivatives	127	139
Other non-current regulatory assets	325	336
Total non-current regulatory assets	8,663	9,131
Total regulatory assets	$9,298	$9,692
Current regulatory liabilities		
Fuel cost adjustment tax equivalents	$173	$176
Fuel cost adjustment liability	—	29
Unrealized gains on commodity derivatives	7	7
Total current regulatory liabilities	180	212
Non-current regulatory liabilities		
Unrealized gains on commodity derivatives	2	1
Total non-current regulatory liabilities	2	1
Total regulatory liabilities	$182	$213

16

Table of Contents

8. Variable Interest Entities

A VIE is an entity that either (i) has insufficient equity to permit the entity to finance its activities without additional subordinated financial support or (ii) has equity investors who lack the characteristics of owning a controlling financial interest. The analysis to determine whether an entity is a VIE considers factors such as contracts with an entity, credit support for an entity, the adequacy of the equity investment of an entity, the extent of an entity's activities that either involve or are conducted on behalf of an investor with disproportionate voting rights, and the relationship of voting power to the amount of equity invested in an entity. A VIE is consolidated by its primary beneficiary. The primary beneficiary has both (i) the power to direct the activities that most significantly impact the entity's economic performance and (ii) the obligation to absorb losses or the right to receive benefits from the entity that could potentially be significant to the VIE. The determination of the primary beneficiary requires continual reassessment.

When TVA determines that it has a variable interest in a variable interest entity, a qualitative evaluation is performed to assess which interest holders have the power to direct the activities that most significantly impact the economic performance of the entity and have the obligation to absorb losses or receive benefits that could be significant to the entity. The evaluation considers the purpose and design of the business, the risks that the business was designed to create and pass along to other entities, the activities of the business that can be directed and which party can direct them, and the expected relative impact of those activities on the economic performance of the business through its life. TVA has the power to direct the activities of an entity when it has the ability to make key operating and financing decisions, including, but not limited to, capital investment and the issuance of debt.

Southaven

On August 9, 2013, TVA entered into a lease financing arrangement with Southaven Combined Cycle Generation, LLC ("SCCG") for the lease by TVA of the Southaven Combined Cycle Facility ("Southaven CCF"). SCCG is a special single-purpose limited liability company formed in June 2013 to finance the Southaven CCF through a $360 million secured notes issuance (the “SCCG notes”) and the issuance of $40 million of membership interests subject to mandatory redemption. The membership interests were purchased by Southaven Holdco, LLC ("SHLLC"). SHLLC is a special single-purpose entity, also formed in June 2013, established to acquire and hold the membership interests of SCCG. A non-controlling interest in SHLLC is held by a third party through nominal membership interests, to which none of the income, expenses, and cash flows of SHLLC are allocated.

The membership interests held by SHLLC were purchased with proceeds from the issuance of $40 million of secured notes (the “SHLLC notes”) and are subject to mandatory redemption pursuant to scheduled amortizing, semi-annual payments due each August 15 and February 15, with a final payment due on August 15, 2033. The payment dates for the mandatorily redeemable membership interests are the same as those of the SHLLC notes. The sale of the SCCG notes, the membership interests in SCCG, and the SHLLC notes all closed on August 9, 2013. The SCCG notes are secured by TVA’s lease payments, and the SHLLC notes are secured by SHLLC’s investment in, and amounts receivable from, SCCG. TVA’s lease payments to SCCG are payable on the same dates as SCCG’s and SHLLC’s semi-annual debt service payments and are equal to the sum of (i) the amount of SCCG’s semi-annual debt service payments, (ii) the amount of SHLLC’s semi-annual debt service payments, and (iii) the amount of scheduled pre-determined payments to be made to Seven States Southaven, LLC on each lease payment date by SHLLC as agreed in SHLLC’s formation documents. In addition to the lease payments, TVA pays administrative and miscellaneous expenses incurred by SCCG and SHLLC. Certain agreements related to this transaction contain default and acceleration provisions.

TVA participated in the design, business conduct, and financial support of SCCG and has determined that it has a direct variable interest in SCCG resulting from risk associated with the value of the Southaven CCF at the end of the lease term. Based on its analysis, TVA has determined that it is the primary beneficiary of SCCG and, as such, is required to account for the VIE on a consolidated basis.

John Sevier

On January 17, 2012, TVA entered into a $1.0 billion construction management agreement and lease financing arrangement with John Sevier Combined Cycle Generation LLC ("JSCCG") for the completion and lease by TVA of the John Sevier Combined Cycle Facility ("John Sevier CCF"). JSCCG is a special single-purpose limited liability company formed in January 2012 to finance the John Sevier CCF through a $900 million secured note issuance (the “JSCCG notes”) and the issuance of $100 million of membership interests subject to mandatory redemption. The membership interests were purchased by John Sevier Holdco LLC ("Holdco"). Holdco is a special single-purpose entity, also formed in January 2012, established to acquire and hold the membership interests in JSCCG. A non-controlling interest in Holdco is held by a third party through nominal membership interests, to which none of the income, expenses, and cash flows are allocated.

The membership interests held by Holdco in JSCCG were purchased with proceeds from the issuance of $100 million of secured notes (the “Holdco notes") and are subject to mandatory redemption pursuant to scheduled amortizing, semi-annual payments due each January 15 and July 15, with a final payment due on January 15, 2042. The payment dates for the mandatorily redeemable membership interests are the same as those of the Holdco notes. The sale of the JSCCG notes, the membership interests in JSCCG, and the Holdco notes all closed on January 17, 2012. The JSCCG notes are secured by TVA’s

Table of Contents

lease payments, and the Holdco notes are secured by Holdco's investment in, and amounts receivable from, JSCCG. TVA's lease payments to JSCCG are equal to and payable on the same dates as JSCCG's and Holdco's semi-annual debt service payments. In addition to the lease payments, TVA pays administrative and miscellaneous expenses incurred by JSCCG and Holdco. Certain agreements related to this transaction contain default and acceleration provisions.

Due to its participation in the design, business conduct, and credit and financial support of JSCCG and Holdco, TVA has determined that it has a variable interest in both of these entities. Based on its analysis, TVA has concluded that it is the primary beneficiary of JSCCG and Holdco and, as such, is required to account for the VIEs on a consolidated basis. Holdco's membership interests in JSCCG are eliminated in consolidation.

The financial statement items attributable to carrying amounts and classifications of JSCCG, Holdco, and SCCG as of March 31, 2014 and September 30, 2013, as reflected in the Consolidated Balance Sheets are as follows:

Summary of Impact of VIEs on Consolidated Balance Sheets

	At March 31, 2014	At September 30, 2013
Current liabilities of VIE		
Accrued interest of VIE	$12	$12
Current portion of membership interests of VIE subject to mandatory redemption	2	2
Current maturities of long-term debt of VIE	31	30
Total current liabilities of VIE	45	44
Other liabilities of VIE		
Membership interests of VIE subject to mandatory redemption	37	38
Long-term debt of VIE, net		
Long-term debt of VIE	1,295	1,311
Total liabilities of VIE	$1,377	$1,393

Creditors of the VIEs do not have any recourse to the general credit of TVA. TVA does not have any obligations to provide financial support to the VIEs other than as prescribed in the terms of the agreements related to these transactions.

9. Kingston Fossil Plant Ash Spill

The Event

In December 2008, one of the dredge cells at the Kingston Fossil Plant ("Kingston") failed, and over five million cubic yards of water and coal fly ash flowed out of the cell. TVA is continuing cleanup and recovery efforts in conjunction with federal and state agencies. TVA completed the removal of time-critical ash from the river during the third quarter of 2010. In November 2012, the Environmental Protection Agency ("EPA") and the Tennessee Department of Environment and Conservation ("TDEC") approved a plan to allow the Emory River's natural processes to remediate the remaining ash in the river, and to conduct a long-term monitoring program. TVA estimates that the physical cleanup work (final cleanup work and closure) will be completed in the spring of 2015. A final assessment, issuance of a completion report, and approval by the State of Tennessee and the EPA are expected to occur by the third quarter of 2015.

Claims and Litigation

See Note 18 — Legal Proceedings —