



Memorandum from the Office of the Inspector General

May 15, 2024

Michael J. McCall

**REQUEST FOR MANAGEMENT DECISION – AUDIT 2023-17447 – COMMERCIAL
RESERVOIR LAND USE AGREEMENTS**

Attached is the subject final report for your review and management decision. You are responsible for determining the necessary actions to take in response to our findings. Please advise us of your management decision within 60 days from the date of this report. In accordance with the Inspector General Act of 1978, as amended, the Office of the Inspector General is required to report to Congress semiannually regarding audits that remain unresolved after 6 months from the date of report issuance.

If you have any questions or wish to discuss our findings, please contact Stephanie L. Simmons, Senior Auditor, at (423) 785-4820 or Rick C. Underwood, Director, Financial and Operational Audits, at (423) 785-4824. We appreciate the courtesy and cooperation received from your staff during the audit.

David P. Wheeler
Assistant Inspector General
(Audits and Evaluations)

SLS:FAJ

Attachment

cc (Attachment):

TVA Board of Directors
Janda E. Brown
Samuel P. Delk
Buddy Eller
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OIG File No. 2023-17447



Office of the Inspector General

Audit Report

To the Vice President,
Environment and
Sustainability

COMMERCIAL RESERVOIR LAND USE AGREEMENTS

Audit Team
Stephanie L. Simmons
Andrew A. Bailey

Audit 2023-17447
May 15, 2024

ABBREVIATIONS

CPA	Certified Public Accountant
NR	Natural Resources
SPP	Standard Programs and Processes
TVA	Tennessee Valley Authority

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MEMORANDUM DATED MAY 13, 2024, FROM MICHAEL MCCALL TO
DAVID P. WHEELER



Audit 2023-17447 – Commercial Reservoir Land Use Agreements

EXECUTIVE SUMMARY

Why the OIG Did This Audit

Land use agreements are contracts that permit operators to use specific Tennessee Valley Authority (TVA) reservoir property for a specific purpose and for a limited amount of time, subject to management and control retained by TVA. Reservoir land use agreements are typically for commercial recreational operations such as campgrounds and marinas.

We performed an audit of TVA's commercial reservoir land use agreements due to reputational risks associated with the potential inconsistent treatment of operators within the program. Our audit objective was to determine if TVA is managing commercial reservoir land use agreements appropriately and in accordance with applicable regulations, policies, and procedures. Our audit scope included commercial reservoir land use agreements (1) in place as of October 1, 2023, and (2) invoiced from October 1, 2021, through September 30, 2023. During this period, TVA had 169 reservoir land use agreements with total billings of approximately \$3.6 million.

What the OIG Found

We determined TVA had (1) accurately invoiced most periodic and all minimum rental payments according to payment terms and (2) obtained required certificates of insurance from operators. However, TVA could improve its management of commercial land use agreements by enforcing requirements for (1) operators to submit documentation of gross revenues, which is necessary for verification of rental payments due to TVA; (2) Natural Resources personnel to confirm all security assurances;ⁱ and (3) campground operators to submit updated annual operating plans.

What the OIG Recommends

We recommend the Vice President, Environment and Sustainability, take actions to (1) provide personnel with additional guidance related to the enforcement of agreement provisions for gross revenues documentation and adequacy of security assurances; (2) confirm and obtain, if needed, the appropriate amount of security assurance for all active commercial reservoir land use agreements; and (3) determine what information is needed in annual campground operating plans, if any, and enforce the requirement.

ⁱ Security assurances are deposits or letters of credit held by TVA to ensure operators fulfill rental payment and premises condition obligations.



Audit 2023-17447 – Commercial Reservoir Land Use Agreements

EXECUTIVE SUMMARY

TVA Management Comments

In response to our draft audit report, TVA management agreed with the recommendations. See the Appendix for TVA management's complete response.

BACKGROUND

The Tennessee Valley Authority Act of 1933 grants the Tennessee Valley Authority (TVA) the power to dispose of interests in real property and approve construction along, across, or in the Tennessee River and its tributaries. Land use agreements are contracts that permit operators to use specific TVA reservoir property for a specific purpose and for a limited amount of time, subject to management and control retained by TVA. Reservoir land use agreements are typically for commercial recreational operations such as campgrounds and marinas. Under most agreements, operators are required to pay TVA rental payments on a periodic basis for the duration of the agreement.¹ Rental payments are calculated by TVA according to either the (1) fair market value of the land, where payments are based on a set percentage of the appraised value of the licensed area or (2) percent of gross revenues, where payments are based on set percentages of revenues from activities on the licensed premises. From October 1, 2021, through September 30, 2023, TVA had 169 commercial reservoir land use agreements with total billings of approximately \$3.6 million.

TVA Standard Programs and Processes (SPP), TVA-SPP-37.202, *Reservoir Land Use and Disposal*, assigns responsibility for managing TVA reservoir property to Natural Resources (NR) and authorizes NR to administer and execute all land use and disposal actions on TVA reservoir property. TVA-SPP-37.202 states that land use requests are approved in accordance with TVA's objectives to promote growth, enable appropriate use and enjoyment of public lands, and uphold TVA's stewardship responsibilities.

NR guidelines provide instruction for the ongoing management of reservoir land use agreements. NR Guideline 7.3.4, *Contract Compliance*, states that, in general, contract compliance focuses on ensuring that lands allocated for commercial recreation development remain available to the general public and are maintained and operated in a manner consistent with the terms and conditions of the agreements. NR representatives are instructed to review the agreements against a list of standard review items when completing compliance inspections. According to NR management, these compliance inspections are performed annually and include confirming compliance with the following four agreement provisions:

- **Security Assurance** – Security assurance is a cash deposit held by TVA or a letter of credit from an institution, satisfactory to TVA, to ensure licensee fulfills rental payment and premises condition obligations. The initial required amount is documented in the agreement and then reviewed annually to assess the appropriate amount based on current site conditions.²

¹ The rent structure for commercial reservoir land use agreements was put in place in 2012. Agreements executed prior to this may not contain payment provisions and are referred to as "no charge" agreements.

² Requiring security assurance became standard practice in 2012. Agreements that predate 2012 may not include a required security assurance amount.

- **Certificate of Insurance** – Proof of continuous general liability insurance coverage for the minimum amount as determined by TVA and documented in the agreement is to be provided to TVA.
- **Rental Payments** – If rental payments are based on the fair market value approach, operators are required to make periodic rental payments based on the value of the licensed area. If rental payments are based on the percent of gross revenues approach, operators are required to make periodic payments based on the minimum rent rate established in the agreement. The operators are also required to pay any additional rent amount due based on the annual gross revenues generated during the preceding calendar year. To support the reported gross revenues, the operator is required to submit an annual gross revenue summary sheet and accompanying financial statements compiled/reviewed by a certified public accountant (CPA) or copies of tax documents prepared and signed by a CPA.³
- **Operating Plan** – An annual operating plan is required by the agreement for campground operations only.⁴ Operating plans are required to include information such as campsite occupancy rates for the previous calendar year, written report of the operator's personal compliance inspection of the campground for the previous calendar year, accurate map showing campground amenities, fees for services, and flood awareness/evacuation plan confirmed to have been shared with local emergency management agencies.

We performed an audit of commercial reservoir land use agreements due to reputational risks associated with the potential inconsistent treatment of operators within the program. When we initiated the audit, TVA informed us they were in the process of updating their guidelines and processes, including those related to management of land use agreements. However, these updates had not been finalized at the time of our audit.

OBJECTIVE, SCOPE, AND METHODOLOGY

Our audit objective was to determine if TVA is managing commercial reservoir land use agreements appropriately and in accordance with applicable regulations, policies, and procedures. Our audit scope included commercial reservoir land use agreements (1) in place as of October 1, 2023, and (2) invoiced from October 1, 2021, through September 30, 2023. During this period, TVA had 169 reservoir land use agreements with total billings of approximately \$3.6 million. To achieve our objective, we:

- Reviewed the Tennessee Valley Authority Act of 1933, Title 40, United States Code § 1314, Title 18 Code of Federal Regulations §§ 1310.1-1310.3, and other regulations to identify requirements for management of commercial

³ Operators are still required to submit gross revenues documentation even if the amount owed is zero.

⁴ Requiring annual campground operating plans became standard practice in 2012. Agreements that predate 2012 may not include this requirement.

reservoir land use agreements. TVA-SPP-37.202, *Reservoir Land Use and Disposal*, implements the requirements of these regulations.

- Reviewed TVA-SPP-37.202, *Reservoir Land Use and Disposal*, and other TVA SPPs to identify roles and responsibilities for the management of commercial reservoir land use agreements.
- Reviewed NR Guideline 7.3.4, *Contract Compliance*, and other NR guidelines, to identify key requirements for managing commercial reservoir land use agreements.
- Obtained an understanding of internal controls, including information system controls, associated with reservoir land use management. We did not identify any internal controls that were significant to the audit objective.
- Interviewed NR, Financial Services, and Corporate Risk personnel to gain an understanding of the roles, responsibilities, and activities for ongoing management of commercial reservoir land use agreements.
- Obtained a listing of active commercial reservoir land use agreements as of October 1, 2023, from NR. There were 166 active agreements.
- Obtained invoicing data for the period of October 1, 2021, through September 30, 2023, from Financial Services. There were 987 invoices associated with 156 agreements⁵ totaling \$3,614,971 during the period.
- Compared the listing of active agreements received from NR to the invoices received from Financial Services to test the accuracy of the data recorded in both systems.
- Judgmentally selected a sample of 5 agreements from the 13 classified by NR as “no-charge” agreements and verified the corresponding agreements did not contain payment terms. Our selection was based on the age and type of the agreements. Since we did not use statistical sampling, results of the sample cannot be projected to the population.
- Judgmentally selected a sample of 15 agreements, shown in Table 1, from the 156 agreements invoiced during the audit period, representing \$1,065,015 (29 percent) of the total invoiced amount during the audit period. Our selection was based on the highest total invoiced dollars, age of agreements, and number of invoices issued. Since we did not use statistical sampling, the results of the sample cannot be projected to the population.

⁵ These 156 agreements represent all agreements billed during the period and do not include “no charge” agreements. When a property is sold, the corresponding agreement is terminated and a new agreement is put in place with the new owner.

Sample of Land Reservoir Agreements		
Type	Judgmental Sample	Sample Amount
Marina	7	\$563,276
Marina & Campground	4	288,538
Campground	<u>4</u>	<u>213,202</u>
Total	15	\$1,065,016

Table 1

To determine if TVA was appropriately managing each agreement in our sample, we:

- Obtained copies of each agreement and reviewed all provisions within, which require ongoing, active management of the agreement by TVA.
- Tested the accuracy of the invoicing.
- Requested documentation of insurance, security assurance assessments, gross revenues documentation for percent of gross revenues agreements, and campground operating plans.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

FINDINGS

We determined TVA had (1) accurately invoiced most periodic and all minimum rental payments according to payment terms⁶ and (2) obtained required certificates of insurance from operators. However, TVA could improve its management of commercial reservoir land use agreements. Specifically, TVA was not enforcing requirements for (1) operators to submit documentation of gross revenues, which is necessary for verification of rental payments due to TVA; (2) NR personnel to confirm all security assurances; and (3) campground operators to submit updated annual operating plans.

TVA WAS NOT ENFORCING REVENUES DOCUMENTATION REQUIREMENT

Operators whose agreements are based on a percentage of gross revenue are required to submit financial documentation necessary for TVA to verify the accuracy of the amounts paid annually to TVA. However, we determined TVA was not enforcing the requirement for some operators to submit necessary documentation.

⁶ All agreements tested were accurate except for one that resulted in a \$1,352 overbilling over a 3-year period. TVA credited the overbilled amount back to the operator after this audit identified the error.

We selected a judgmental sample of 15 agreements, consisting of 11 agreements based on the percentage of gross revenues and 4 agreements based on the fair market value. For 10 of the 11 agreements based on the percentage of gross revenues, operators had not provided sufficient supporting financial documentation and/or the financial statements did not contain indication of being compiled or prepared by a CPA as required. Without this documentation, TVA cannot confirm the accuracy of amounts due from operators. According to NR management, when an operator does not provide the required documentation, the NR representative will contact the operator and request the information. However, NR management stated they have limited resources to continue to pursue documentation when operators are not complying with representatives' requests and primarily have to rely on the operators' voluntary compliance.

According to the agreements, TVA's options for recourse for an operator's noncompliance include assessing fees on late payments, conducting a full audit of the operation, and potentially terminating the agreement. However, we noted NR guidelines did not include specific guidance on how and when NR representatives should contact operators who are not providing required revenues documentation. Additionally, there were no standardized templates for communicating with operators who are not in compliance.

Providing more specific guidance and creating standardized communications citing the potential consequences of noncompliance, may help ensure operators are treated consistently and may increase voluntary compliance. If TVA continues not to enforce this requirement, it could create a perception of favoritism or a culture of noncompliance among operators.

TVA WAS NOT CONFIRMING THAT ALL SECURITY ASSURANCES WERE APPROPRIATE

Commercial land use agreements include the amounts operators are required to provide TVA as security assurance. As stated above, security assurances are required to be reviewed annually during compliance inspections to assess the appropriate amount of security assurance based on current site conditions. Additionally, NR guidelines state TVA should confirm security assurance amounts during compliance inspections. However, we identified an agreement for which TVA did not hold the appropriate amount of security assurance.

We requested documentation of security assurance assessments and confirmation of the amounts held by TVA for the 15 sampled agreements. For 1 of 15 agreements, TVA did not hold the appropriate amount of security assurance. TVA held \$3,200 in security assurance as of February 21, 2024. However, the agreement executed in 2012 required a \$10,000 security assurance. The most recent security assurance assessment estimates the appropriate amount would be \$12,400. At the time of the audit, TVA had not requested the operator provide the required additional security assurance.

TVA may request operators to increase the required amount of security assurance previously provided to take into account higher anticipated costs of cleanup and restoration due to economic growth, additional development, or other factors.⁷ However, NR guidelines do not specify the threshold at which TVA should request additional security assurance from operators. Maintaining the appropriate amount of security assurance from operators is important to ensure TVA is protected in the event operators do not fulfill rental payment and premises condition obligations.

TVA WAS NOT ENFORCING ANNUAL CAMPGROUND OPERATING PLANS REQUIREMENT

Campground agreements require an operating plan to be submitted to TVA annually. While the majority of information required in the operating plans may not typically change from year to year, operators are to provide (1) campsite occupancy rates for the previous calendar year and (2) a written report of the operator's personal compliance inspection of the campground for the previous calendar year. However, TVA is not enforcing the requirement for campground operators to submit updated annual operating plans.

Seven of fifteen agreements sampled were for campground operations with provisions requiring annual operating plan submissions. However, none of the 7 campgrounds had submitted operating plans that met the standards as outlined in the agreements. NR personnel informed us, that to save time and resources, they allow operators to resubmit the same operating plan annually. NR personnel also indicated they (1) have limited use for the previous calendar year information requested as part of the agreement requirement and (2) perform their own compliance inspections.

RECOMMENDATIONS

We recommend the Vice President, Environment and Sustainability:

1. Develop specific guidance for NR representatives that includes a timeline and specific steps representatives should follow when an operator is not providing required gross revenues documentation. Consider developing standardized letters or notifications that can be sent to the operators that include the contract language and ramifications of noncompliance.
2. Develop specific guidance for the threshold at which TVA should request additional security assurance amounts from operators.
3. Take action to obtain the appropriate amount of security assurance for the one exception noted and confirm TVA holds the appropriate amount of

⁷ According to Corporate Credit personnel, the informal threshold for requesting additional security assurance would be an increase of greater than 20 percent of the assessment.

security assurance for all other active commercial reservoir land use agreements.

4. Determine what information is needed to be submitted in the campgrounds' annual operating plans, if any, and enforce the requirement. If TVA determines annual operating plans are not necessary, then instead require one submission at the onset of the agreement and only require a new submission to reflect relevant changes, as needed. If this requirement is removed, add a "no change" confirmation to the standard review items to be completed during NR representatives' compliance inspections.

TVA Management's Comments – In response to our draft report, TVA management agreed with the recommendations. See the Appendix for TVA management's complete response.

May 13, 2024

David P. Wheeler, WT 2C-K

**RESPONSE TO REQUEST FOR COMMENTS – AUDIT 2023-17447 – COMMERCIAL
RESERVOIR LAND USE AGREEMENTS**

Natural Resources appreciates the opportunity to provide comments to the subject draft report. Our responses to the recommendations made by your staff are below.

1. Develop specific guidance for Natural Resources representatives that includes a timeline and specific steps representatives should follow when an operator is not providing required gross revenues documentation. Consider developing standardized letters or notifications that can be sent to the operators that include the contract language and ramifications of noncompliance.

Response – Natural Resources agrees with the recommendation.

2. Develop specific guidance for the threshold at which TVA should request additional security assurance amounts from operators.

Response – Natural Resources agrees with the recommendation.

3. Take action to obtain the appropriate amount of security assurance for the one exception noted and confirm TVA holds the appropriate amount of security assurance for all other active commercial reservoir land use agreements.

Response – Natural Resources agrees with the recommendation.

4. Determine what information is needed to be submitted in the campgrounds' annual operating plans, if any, and enforce the requirement. If TVA determines annual operating plans are not necessary, then instead require one submission at the onset of the agreement and only require a new submission to reflect relevant changes, as needed. If this requirement is removed, add a "no change" confirmation to the standard review items to be completed during Natural Resources representatives' compliance inspections.

Response – Natural Resources agrees with the recommendation

David P. Wheeler
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If you have any questions or concerns, please contact Rebecca Hayden, Director, Natural Resources, at 423-467-3804. We appreciate the courtesy and professionalism of your staff while conducting the audit.



Michael McCall
Vice President
Environment & Sustainability
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