

INSPECTOR



GENERAL

SEMIANNUAL REPORT

October 1, 1986 to March 31, 1987

TENNESSEE VALLEY AUTHORITY

KNOXVILLE, TENNESSEE 37902

OFFICE OF THE BOARD OF DIRECTORS

May 26, 1987

(THE FOLLOWING LETTER WAS SENT TO THE TENNESSEE VALLEY DELEGATION OF CONGRESS AND APPROPRIATE COMMITTEES OF CONGRESS AND OTHER INTERESTED PARTIES.)

Dear :

We are enclosing a copy of the TVA Inspector General's second "Semiannual Report" which highlights significant activities of the Office of the Inspector General (OIG) during the period October 1, 1986 to March 31, 1987. The report demonstrates the independence of the Inspector General and the capability of this organization to serve the needs of TVA.

When the Board of Directors established the OIG, it was our intention that the Inspector General would be a positive force for improvements within TVA. We believe that the activities described in this report clearly demonstrate that this plan has been successfully implemented.

The Board has delegated broad powers to the Inspector General and directed that his office would, to the maximum extent possible, function just like a statutory Inspector General's office. We remain firmly committed to this policy.

We believe the OIG report clearly demonstrates our resolve to remove uncertainties which affect the nuclear program and to make TVA a standard in the nuclear energy field. Nuclear safety and employee concerns are receiving our best efforts. The Inspector General's findings and our employee concerns programs are resolving the causes of concerns, and employees have been restored where unfair treatment has occurred. We are encouraged by recent progress with the Nuclear Regulatory Commission.

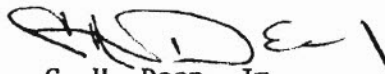
Both the Board of Directors and the OIG have acted upon the recommendations of the Office of Government Ethics to prevent and detect the existence or appearance of conflicts of interest in contracts for nuclear managers and consultants.

As the report indicates, the OIG's review of large claims has saved millions of dollars and will continue to be an area of major emphasis for his office.

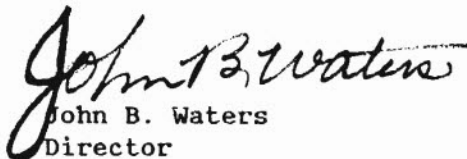
One significant issue remains from the last "Semiannual Report." The TVA Retirement Board of Directors believes that TVA's audit authority does not extend to the Retirement System and therefore refuses to permit the OIG to perform an unrestricted audit of its records. The TVA Board has requested legal opinions to seek a resolution of this matter which will assure that the Retirement System's operations are properly monitored.

As we stated in our comments on the OIG's first "Semiannual Report," we believe that TVA has an active and independent Inspector General. We support this independence and will work to assure that it is not impaired.

Sincerely,



C. H. Dean, Jr.
Chairman



John B. Waters
Director

INSPECTOR GENERAL



TENNESSEE VALLEY AUTHORITY

400 West Summit Hill Drive, E4 A14
Knoxville, Tennessee 37902

March 31, 1987

TO THE TVA BOARD OF DIRECTORS AND THE UNITED STATES CONGRESS:

This is the second "Semiannual Report" of the Tennessee Valley Authority Inspector General. It describes the significant audit and investigatory activities of the office during the reporting period from October 1, 1986 to March 31, 1987.

During this period, the Office of the Inspector General (OIG) has audited and investigated matters of critical importance to TVA, its employees, the public, and other Governmental officials. The OIG has investigated a number of employee concerns, nearly half of which involved issues raised by employees about TVA's nuclear program. The OIG has investigated and reported on allegations of harassment, misconduct, and management deficiency. At the request of the Office of Government Ethics, the OIG has also been monitoring the guidelines TVA adopted to help prevent conflicts of interest from occurring in the management of its nuclear program.

Our auditors have also evaluated TVA's program for handling employee concerns. They have audited contested claims by contractors seeking millions of dollars from TVA. They are currently reviewing TVA's policy formulation, nuclear quality assurance, and financial processes. However, one audit remains impaired. The TVA Retirement System (TVARS) Board of Directors continues to object to the OIG conducting a full scope review of the economy, efficiency, and effectiveness of TVARS.

The last six months have been a period of learning and growth. OIG managers and employees--many of whom came to TVA from other Federal agencies--have been challenged to learn and appreciate the diversity and scope of TVA's activities and operations. Other TVA managers and employees have also had an opportunity to learn about the OIG and witness firsthand our effort to make a positive contribution as an independent and objective audit and investigatory organization within TVA.

Since the OIG's inception, we have been supported by the TVA Board of Directors, senior TVA managers, TVA employees, members of the Congress, and the public. We draw strength from this continued support and will continue to work to justify the confidence that has been placed in us.

Sincerely,

A handwritten signature in black ink, appearing to read "Norman A. Zigrossi". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Norman A. Zigrossi
Inspector General

SEMIANNUAL REPORT

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EXECUTIVE SUMMARY

This report describes the significant audit and investigative activities of the office during this reporting period from October 1, 1986 to March 31, 1987.

During the past six months, the OIG's investigations and audits covered a wide range of activities with the highest priority being placed on nuclear program issues.

Nuclear Program Issues

- ° The OIG identified 794 employee concerns which were within the OIG's investigative mandate.
 - There were 131 concerns resolved and 28 substantiated. As a result of OIG investigations and TVA management actions, 31 unfair penalties against Watts Bar Nuclear Plant craft workers were rescinded. Ten actions were rescinded with complete restoration of wages.
 - Due to confidentiality pledges or anonymity of concerned individuals, 373 concerns could not be pursued. The OIG and the Nuclear Regulatory Commission are attempting to overcome these barriers.
 - Currently, there are 290 concerns under investigation.
- ° TVA's program for handling employee concerns was meeting its objectives, although opportunities exist for making the program more efficient. TVA management is taking appropriate actions.
- ° The OIG has begun an audit of TVA's nuclear quality assurance program to determine if the program is providing reasonable assurance that safety and quality issues are systematically identified and promptly resolved.
- ° At the request of the Office of Government Ethics, TVA has developed and implemented guidelines for preventing the existence or appearance of conflicts of interest in contracts for nuclear managers and consultants. The OIG is monitoring the application of these guidelines.

Other Investigative Activities

- ° Work was completed on over 200 nonnuclear investigations. Major categories of completed cases included personnel matters, discrimination or harassment, and suitability of OIG staff employees. The majority of our 120 auditors and investigators were hired in the last half of 1986 and their backgrounds are being examined.
- ° Misuse of inside information in TVA's Retirement System has led to the resignation of a senior TVA official and reprimands of two others. Other abuses have led to the retirement of another Retirement System official.

Other Audit Activities

- Three OIG audits reported that of \$42 million of contested claims, \$33 million should not be paid.
- An audit of TVA's policy formulation process is in progress. Audit objectives are to determine whether the TVA Board can be reasonably assured that its decisions are (1) based on sound information and analyses, (2) communicated properly by management, and (3) tracked to ensure proper implementation.
- A review of TVA's internal financial systems has complemented the audit work by the independent public accountant under contract to TVA in determining the fairness of TVA's year-end financial statements. OIG's review did not identify any major internal control problems.
- One issue remains from the last "Semiannual Report." The TVA Retirement System Board of Directors is still denying complete access to its records by the TVA Board and the OIG. The OIG has been prevented from conducting a full scope review of the economy, efficiency, and effectiveness of the retirement system. There is no other Government oversight of that system. The TVA Board has requested legal opinions to seek a resolution of this matter which will assure that the Retirement System's operations are properly monitored.

FOREWORD

During the past six months, TVA management has taken initiatives and implemented changes designed to improve TVA operations. These actions, if successful, hold promise for the future. The OIG has selected audits and investigations to supplement TVA's recent initiatives and organizational improvements and to assist TVA management in assuring that operations are effective, efficient, and free from fraud and abuse.

Most importantly, TVA management has (1) presented to the Nuclear Regulatory Commission a formal plan for reactivating TVA's nuclear plants; (2) modified programs to resolve employee concerns; (3) redefined the roles of several top managers, including the General Manager's role; and (4) developed a program to detect and prevent conflicts of interest in contracts for nuclear managers and advisors.

Most of the OIG's work had previously been planned to assist TVA management in overcoming nuclear issues. Other work resulted from emerging needs. The OIG emphasized six primary areas during the past six months: (1) employee concerns about the nuclear program, (2) implementation of new guidelines for avoiding conflicts of interest, (3) policy formulation processes, (4) internal financial systems, (5) major contested claims by contractors, and (6) TVA Retirement System operations.

During the next six months, work will continue in the same six areas. The OIG will also continue to be responsive to TVA's changing needs.

The TVA nuclear program has been the OIG's highest priority for the past year because of its significance to TVA's overall operations. Four primary OIG efforts have been to: (1) resolve certain kinds of employee concerns, (2) determine if TVA's employee concerns programs are meeting their objectives, (3) determine if TVA's nuclear quality assurance program is identifying and resolving safety and quality issues, and (4) assure that TVA's conflict-of-interest guidelines are followed when hiring contract employees.

I. INVESTIGATIONS OF EMPLOYEE CONCERNS

TVA's nuclear plants are not operational largely because of the safety and employee concerns which were brought to the attention of the Nuclear Regulatory Commission (NRC). TVA needed to resolve these concerns and address allegations that TVA managers were guilty of harassment and intimidation. The agency contracted with the Quality Technology Company (QTC) in April 1985 to investigate and report on employee concerns.

QTC conducted more than 6,000 interviews and identified 5,081 concerns from more than 2,000 TVA employees. After four increases, QTC proposed a fifth revision to the contract for significantly more costs and an extension of time. TVA rejected the revision, allowed the contract to expire, and then established an in-house employee concerns program.

Because QTC guaranteed confidentiality to employees who expressed their concerns, the NRC assumed control of the QTC case files. The NRC asked TVA to investigate these confidential concerns. The OIG selected 685 of the concerns which related to allegations of harassment, intimidation, and other areas within its investigative mandate. TVA program offices are investigating the remaining concerns.

During the NRC's analysis of TVA employee concerns, it identified 53 TVA managers against whom 118 allegations of harassment, intimidation, or other wrongdoing were made. The NRC asked the OIG to give priority to these 118 concerns; all of which were included in the 685 the OIG had previously selected. The OIG has resolved concerns related to 7 of the 53 managers. All seven managers were absolved of allegations of harassment, intimidation, or other wrongdoing; two, however, had ineffectively managed their employees.

In addition to the 685 former QTC cases, the OIG received 66 employee concerns from TVA's Office of Nuclear Power (ONP) and 43 concerns directly from individuals. This resulted in a total of 794 employee concerns identified.

A common concern related to alleged violations of Section 210 of the Energy Reorganization Act of 1974. Section 210 prohibits nuclear licensees from taking reprisals against employees who report violations of nuclear safety rules.

About five years ago, a policy was created that in effect resulted in automatic penalties for TVA craft employees involved in safety violations at Watts Bar Nuclear Plant. The policy did not penalize supervisors or managers of the employees who violated the rules.

- In 1982 a TVA manager issued a memorandum to trades and labor employees prescribing disciplinary action for quality assurance (QA) violations. Employees would be suspended for the first QA violation and fired for a second violation. Even employees who reported their own inadvertent violations were subject to disciplinary action. This policy tended to suppress self-reporting of safety problems and may have been in conflict with Section 210 of the Energy Reorganization Act of 1974.
- In 1984 the same manager established disciplinary action for expired welding certifications. Disciplinary action ranged from warnings to terminations depending on the number of offenses. This policy contradicted the TVA Board's stated policy to encourage "awareness and voluntary expression of safety considerations . . . without fear of recrimination or reprisal."

Forty OIG agents, including 19 temporarily hired under contracts, have investigated over half of the 794 concerns identified by the OIG. Investigations of 131 concerns are complete; investigations have not begun on 373 concerns because of insufficient information; and investigations of 290 concerns are in progress.

A. Concerns Resolved

The 131 completed or resolved concerns include 28 concerns that were substantiated, 56 that have been determined to be unsubstantiated, and 47 that were administratively closed.

The investigations of 78 of these concerns were completed by TVA's Office of the General Counsel (OGC) prior to the creation of the OIG. The OIG has reviewed these investigations in cooperation with the OGC.

1. Concerns Substantiated

Twenty-eight of the 794 concerns have been substantiated.

- (a) Three concerns related to an employee terminated on the basis of a Section 210 Energy Reorganization Act violation. The manager involved was terminated. (This action was contested and is pending administrative appeal.)

- (b) One concern related to a manager who tried to prevent an employee from talking to the NRC; the manager has received a warning letter.
- (c) One concern related to falsification of records by two employees; the two employees have received warning letters.
- (d) One concern related to an employee who harassed an NRC inspector; the employee has received a warning letter.
- (e) Twenty-two concerns were substantiated in that a perception existed among employees that they would receive an adverse action if they expressed concerns. The 22 concerned individuals were affected by the policy of assessing automatic penalties against craft employees who were involved in safety violations at Watts Bar Nuclear Plant.

After reviewing these cases, the OIG recommended that ONP identify all employees disciplined under this policy and determine if management actions were fair.

ONP has rescinded the policy for automatic disciplinary actions and has reviewed all 78 disciplinary actions which resulted from this policy. ONP rescinded 10 actions with complete restoration of lost wages, reduced 31 penalties, and determined that 37 actions were appropriate.

2. Concerns Unsubstantiated

The OIG has determined that 56 concerns were unsubstantiated. The majority of these were claims of harassment or intimidation.

3. Concerns Administratively Closed

The OIG has administratively closed 47 concerns. Of these concerns, 19 were already being investigated by other TVA offices, and 18 were made by anonymous complainants. The anonymous complaints have been deferred to the NRC to determine if additional information is available to conduct an investigation.

B. Concerns Not Investigated

Releases of confidentiality have not been granted by persons who expressed 373 concerns to QTC. Therefore, the NRC has not provided the OIG with any information that might disclose the interviewees' identities. Without the names of the complainants, relevant witnesses, or the alleged wrongdoers, it is virtually impossible to investigate concerns.

The OIG has requested NRC's assistance in obtaining releases of confidentiality from these complainants. The OIG and the NRC are working together to identify alternatives for ensuring that these concerns are resolved.

C. Investigations In Progress

Investigations of 290 employee concerns are in progress: fieldwork is in progress for 214; reports are being written for 75; and the U.S. Department of Labor is investigating 1.

II. TVA'S PROGRAMS FOR HANDLING EMPLOYEE CONCERNS

ONP has two programs to resolve employee concerns--the Watts Bar Employee Concerns Special Program (ECSP) and the Employee Concern Program (ECP). The Watts Bar program was established to examine employee concerns expressed prior to February 1, 1986. The ECP, a permanent program, receives and investigates ONP employee concerns on an ongoing basis.

The OIG audited these programs for handling employee concerns to determine if the programs were accomplishing their objectives. In brief, the audit disclosed that both programs were accomplishing their objectives, although opportunities existed for making both more effective. The ECP staff is concentrating on safety-related concerns consistent with our recommendation. In addition, ONP is implementing procedural recommendations on investigative reporting, accountability, and responsiveness to employees.

III. TVA'S NUCLEAR QUALITY ASSURANCE PROGRAM

Owners of nuclear power facilities are required by NRC regulations to establish a nuclear quality assurance (NQA) program. The NQA program must be designed to provide control over activities affecting safety and quality by verifying conformance with TVA procedures which, in turn, must comply with NRC regulations.

About 700 TVA employees perform NQA activities in Chattanooga and Knoxville offices and at the four nuclear sites.

The OIG is currently auditing the NQA to determine if the program provides reasonable assurance that safety and quality issues are systematically identified and promptly resolved. As a by-product of this audit, a regular cycle of OIG audits will be established for NQA activities.

IV. TVA'S CONFLICT-OF-INTEREST GUIDELINES

The OIG has developed an independent program to determine whether there is reasonable assurance that TVA's employees and contractors comply with the General Manager's guidelines for preventing and detecting conflicts of interest when acquiring management and advisory services for the nuclear program.

As reported in the last OIG "Semiannual Report," TVA had contracted with various engineering firms to acquire the services of "loaned employees" to support the ONP. Some of the loaned employees were placed in TVA line management positions normally held by regular TVA employees. Initially, the loaned employees were delegated authority which would allow them to take actions affecting their parent companies--actions which could create actual and perceived conflicts of interest. These contractual arrangements have been widely criticized for being vulnerable to conflicts of interest.

In May 1986, the TVA Board of Directors asked the OIG to investigate the contractual arrangements for acquiring loaned employees. TVA also arranged for independent counsel to assist in identifying any potentially criminal acts and in determining the legality of the contracts. The counsel reviewed the facts disclosed by the OIG investigation and performed a detailed review of the contracts. The counsel advised that no violations of criminal law were identified, but the credibility of TVA would be enhanced if the contracts were changed to eliminate hiring of staff by the loaned managers from the loaned managers' companies.

The OIG has since informed the Office of Government Ethics (OGE) of the results of the investigation. Subsequently, the OGE advised TVA to change the contracts to avoid the potential for violations of Federal conflict-of-interest law.

TVA has recently changed the contractual arrangements. TVA's General Manager has created guidelines to prevent and detect potential conflicts of interest. The guidelines apply to loaned employees filling line management or advisory positions and TVA employees.

Chapter 1
Nuclear Program Issues

The OGE requested that the OIG monitor the application of TVA's conflict-of-interest guidelines. The OIG complied with this request by developing a monitoring plan which includes proactive investigations and regular audits. Deviations from the guidelines will be reported by the OIG to the TVA Board of Directors and the OGE.

The OGE submitted the OIG investigative report to the Public Integrity Section, Criminal Division, U.S. Department of Justice. By letter dated December 9, 1986, the U.S. Department of Justice notified the OGE that it "had determined that criminal prosecution should not be pursued at this juncture because no substantial Federal interest would be served by taking prosecutive action, and administrative action, including the forceful action your office has initiated, should suffice."

CHAPTER TWO

INVESTIGATIVE OPERATIONS

In addition to the investigations of nuclear program concerns as discussed in Chapter One, the OIG performed two other types of investigative projects during the past six months. We investigated individuals against whom allegations have been made, and we reviewed programs to determine systemic causes of problems. The OIG referred appropriate matters to the U.S. Department of Justice for consideration of prosecution.

I. INVESTIGATIONS OF INDIVIDUALS

During the last six months, the OIG completed work on 202 cases which involved allegations against individuals. The highlights of these investigations are presented by major categories and by significant cases completed.

A. Major Categories of Completed Investigations

OIG completed investigations of personnel matters, discrimination or harassment, and employment suitability.

1. Personnel Matters

Investigations of 30 complaints involving personnel matters were completed.

- Fifteen allegations were determined to be unsubstantiated, and managers' actions were deemed appropriate.
- One allegation was substantiated, and TVA has reversed the manager's decision.
- Fourteen complaints either were referred to other investigatory agencies or did not merit investigation.

2. Discrimination and Harassment

Investigations of 23 complaints of discrimination and harassment were completed.

- Six management remedies were appropriate and adequate.
- Three complaints did not merit investigation.
- Fourteen complaints either were withdrawn by the complainant, referred to other investigative agencies, pending in Federal court, or consolidated with other OIG cases to avoid duplication.

3. Employment Suitability

The majority of OIG employees were hired in the last half of 1986. All employees are subject to a review to determine their suitability for OIG employment. This review consists of two stages: (1) a medical evaluation by TVA which includes psychological and drug testing, and (2) a background investigation by the OIG which focuses on the character and reputation of the employee.

Reviews of 67 new OIG employees were completed; all were determined to be suitable for continued employment.

B. Significant Investigations

Leading investigations of individuals include: misuse of inside information regarding the Retirement System, alleged theft of Government property, alleged coal "layer-loading," and sexual harassment.

1. Misuse of Inside Information

A retired TVA employee alleged that a senior TVA manager, while considering retirement, improperly received confidential information about proposed TVA retirement benefit changes. The OIG investigation confirmed the allegation.

By receiving the information, the senior manager was able to increase his retirement benefits by nearly \$9,000 a year by simply delaying his retirement. At the same time nearly 50 other TVA employees retired without benefit of the inside information and before the changes were made public.

The TVA Retirement System Board took action to give these retirees retroactive benefit of the changes in the Retirement System rules. The misuse of inside information may cost the Retirement System an estimated one-half million dollars in additional benefits over the next 20 years.

The unauthorized disclosure of confidential retirement information violated TVA regulations and will cause higher costs to the Retirement System. The OIG investigation disclosed that four TVA managers conveyed inside information to the retiring senior manager. During the investigation, one of these managers resigned and another retired after being placed on administrative leave. The TVA Board of Directors reprimanded the other two managers.

The OIG continues to investigate other allegations regarding the TVA Retirement System.

2. Alleged Theft of Government Property

The OIG has investigated the theft of Government property by a TVA employee. Office equipment, furniture, and guns valued at more than \$5,000 were recovered by law enforcement personnel pursuant to Federal search warrants. This matter is currently being presented to a Federal grand jury in Birmingham, Alabama.

3. Alleged Coal Layer-Loading

Two cases involving coal "layer-loading" have been referred to the U.S. Attorney for possible prosecution. These two cases involve 41 contracts totalling more than \$6 million in coal purchases.

Layer-loading involves filling the bottom and sides of a railroad car with low quality or mine refuse coal and filling the center top portion of the car with coal which meets contract specifications. When the coal in the railroad car is sampled, the entire car appears to uniformly contain coal meeting contract specifications. Consequently, the vendor may be paid more than the coal is worth.

4. Alleged Sexual Harassment

The OIG conducted an investigation of allegations that a senior TVA manager had sexually harassed his female subordinates. The OIG's investigation included interviews with the manager's former and current female employees and an evaluation of allegations that the manager had engaged in acts of sexual harassment. The manager resigned from TVA while the OIG's investigation was in progress and before the OIG's investigative report was presented to the TVA Board of Directors.

II. PROGRAM REVIEWS

Trends in individual cases are analyzed to determine the need for program reviews or special investigations to address causes of those trends. Four program reviews in progress concern voluntary reduction in force procedures, workers' compensation programs, the TVA Retirement System, and archaeological resources security. In addition, a review of the Public Safety Service is in the planning phase.

A. Voluntary Reductions in Force

TVA sometimes issues a general call for voluntary reductions in force (RIFs). In other instances, a person can volunteer to substitute for another person who is the subject of an involuntary RIF. Employees accepted for a voluntary RIF receive lump sum severance pay of up to 120 days.

Prior audits and employee allegations to the OIG have suggested that the system of voluntary RIFs is vulnerable to abuse. Alleged abuses include preferential selections, voluntary RIFs by employees eligible for retirement, filling vacancies created by a voluntary RIF, rehiring voluntarily RIF'd employees under personal service contracts, and deferring severance pay which causes higher Federal Employees Compensation Act costs to TVA.

This review will determine if there are opportunities for preventing abuses of the voluntary RIF system.

B. Workers' Compensation

The Federal Employees Compensation Act (FECA) provides benefits for Federal employees injured on the job. In both fiscal years 1985 and 1986, TVA's costs for FECA claims exceeded \$48 million.

The OIG has 60 ongoing cases involving alleged abuses of this program. Two major cases involve a total potential liability to TVA of more than \$1 million. These two cases will be referred to the U.S. Department of Justice for possible prosecution.

The program review will determine if there are ways to increase assurances that only eligible persons receive benefits.

C. TVA Retirement System Investigation

The OIG is investigating possible misconduct and violations of law involving TVA Retirement System. We are working closely with the U.S. Attorney's office and a Federal grand jury during the investigation.

D. Archaeological Resources Security

The OIG, in conjunction with TVA archaeologists, is designing a program to address the destruction and theft of rapidly disappearing archaeological resources. TVA archaeologists are concerned that individuals looking for Indian and Civil War artifacts are pilfering items, such as personal adornments, weapons, pottery, and basketry.

E. Public Safety Service

TVA employs over 1,000 public safety officers to provide security and safety for 30,000 employees and the public at 46 TVA facilities, including TVA's nuclear plants.

The OIG has developed a plan for determining if public safety operations are efficient and effective.

III. REFERRALS TO PROSECUTION

More than 130 criminal matters are under investigation and are being coordinated with the U.S. Attorneys in the Tennessee Valley. Federal prosecutors have supported the OIG's investigative activities and have agreed to prosecute individuals or organizations committing serious criminal offenses affecting TVA.

The OIG has referred seven matters to the U.S. Attorney for possible prosecution. The U.S. Attorney has declined to pursue three matters.

The four referrals still under consideration include the two previously discussed cases involving layer-loaded coal. Another case involves an alleged conspiracy between a TVA employee and a vendor to submit false field purchase orders. The fourth case involves the misuse of inside information by a senior Retirement System official.

Two of the three declinations involved small claims by employees on expense vouchers. The OIG has recommended disciplinary action against the employees. The third declination dealt with an employee who took annual leave and then destroyed the approved leave slips before they could be processed. The OIG has recommended disciplinary action for the employee and changes in procedures to reduce the chances for recurrence.

CHAPTER THREE

AUDIT OPERATIONS

The 17 audits completed in the past six months resulted in questioned contractor claims of more than \$34 million. About half of the questioned costs resulted from audits started by TVA's prior audit organization but completed by the OIG. At the end of this reporting period, 34 audits were in progress.

The work of the Division of Audit focused on audits of TVA's contractors and systems.

I. AUDITS OF CONTRACTORS

The OIG's approach to auditing contractors includes both a reactive program to respond to requests by TVA offices and a proactive program to audit other contractors selected through sampling techniques.

A. Reactive Program

During the last six months, the OIG completed 16 of 39 contract audits requested by TVA offices. These audits are classified as major audits and other audits.

1. Major Contract Audits

The OIG completed three audits totalling over \$42 million in claims filed against TVA. The audits were performed at the request of TVA's Office of the General Counsel (OGC). Two of the claims were for construction delays and for costs not specifically covered by the contracts. The other claim was for increased costs to enable a fuel supplier to comply with environmental regulations.

All three claims are in dispute and litigation. Disclosure will be restricted during the litigation. Two claims were subject to confidentiality agreements between the parties, and the third claim is covered by a Protective Order.

The purpose of these audits was to determine if the contractor's claims were fairly stated. The OIG reported that claims were overstated by \$33 million.

Questioned costs resulted from duplicate claims, inappropriate allocations, unauditible records, misclassifications, and undocumented transactions.

2. Other Contract Audits

The OIG completed 13 audits of procurements of coal, personal services, returnable containers, and replacement parts. The following are the more significant of these audits.

- (a) A contract between TVA's Office of Nuclear Power and a major corporation contains conflicting terms concerning the billing for certain engineering personnel. The OIG questioned \$800,000 due to labor rates and \$250,000 due to undocumented per diem costs. One matter disclosed by the audit is being investigated for potential fraud.
- (b) TVA executed a \$450,000 contract with a public accounting firm to perform the fiscal year 1986 audit of TVA's financial statements. A contract was also executed with this firm for \$400,000 to provide assistance to TVA in designing and implementing TVA's Accounting Information System (AIS). TVA considered this firm to be the best qualified for performing these services since the firm had audited TVA's financial statements for 38 of the last 54 years.

Amendments to increase the audit contract by \$300,000 and the AIS contract by \$1,005,000 were proposed to the TVA Board. The OIG reviewed these two amendments to determine whether contract planning and administration provided reasonable assurance that the services were needed, fairly priced, and of high quality.

The OIG reported that TVA missed opportunities to plan early, define requirements, evaluate prices, and monitor contractor performance. Management revised the AIS contract amendment, resulting in a \$360,000 cost avoidance, and subsequently complied with public notification requirements of Public Law 98-72.

- (c) A contractor's rates for actual indirect costs were about 15 percent less than the billing rates approved by TVA for 1986. The OIG recommended that TVA management consider this percentage difference when negotiating indirect rates for 1987. This recommendation provides TVA an opportunity to save about \$520,000 over the remainder of the contract.
- (d) A contractor agreed to supply replacement parts to TVA at cost plus a fixed markup. However, the company billed TVA more than the actual cost and markup.

The Federal Bureau of Investigation investigated and found about \$30,000 in overpayments by TVA. The U.S. Attorney prosecuted the case, and the company's president was sentenced to 60 days in prison after pleading guilty to a two-count indictment of fraud. The overpayments were recovered and returned to TVA.

TVA's OGC then asked the OIG to determine if other overpayments were made to this company. The OIG's audit identified an additional \$55,566 in overpayments, of which \$40,634 was recovered by TVA.

- (e) TVA contracted with a local organization to review loan applications submitted by minority businesses. TVA agreed to pay all direct costs incurred for loan review activities.

The OIG questioned costs of more than \$8,300 which were incurred prior to budget approval. Of these costs \$4,200 were not documented by vendor invoices or had no discernable program benefit.

The president of the organization has subsequently resigned. Certain matters have been referred for further investigation.

B. Proactive Program

The OIG has begun a major review of TVA's administration of its contracts for personal services, fuel and capital equipment, and cooperative economic development programs.

The objectives of this project are to determine if contracting processes provide reasonable assurance that acquisitions: (1) are justified and relate to the TVA mission, (2) provide maximum benefit at least cost, and (3) comply with laws, regulations, and contract terms.

This project will include a representative sample of contracts to determine allowability of costs and whether services or products were actually received.

II. AUDIT OF SYSTEMS

The OIG's first wave of systems audits is underway. Several projects are in progress to identify opportunities for improving efficiency and effectiveness of TVA operations. These projects include coverage of TVA's systems for: internal

financial control, policy formulation, contracting, power billing, environmental compliance, payment timeliness, health insurance, and retirement.

A. Internal Financial System

In July 1986, the OIG assumed responsibility for auditing TVA's financial systems. To allow for transitional planning, the OIG continued the financial audit program which was underway for 1986. The fiscal year 1986 financial audit program was designed by TVA's prior internal auditor to test the adequacy of TVA's system of internal accounting control. The financial work was historically relied on by the independent public accountant (IPA) which has audited TVA's financial statements.

During the fiscal year 1986 financial system audit, OIG did not identify any items significant to warrant adjustments to TVA's books of account or financial reports. However, the review identified opportunities for improving certain internal controls. Improvements are underway.

The OIG has planned and initiated a new financial audit program for fiscal year 1987. The program will determine if TVA's financial system provides reasonable assurance that (1) there is compliance with applicable laws and regulations, and (2) the system of internal accounting control secures assets from loss, executes transactions according to management authorizations, and records transactions properly.

As in the past, the fiscal year 1987 financial audit scope will be designed to compliment the work of the IPA.

B. Annual Financial Statement Audit

TVA's annual financial statements have been audited by the same independent public accounting firm for 27 consecutive years. TVA's financial managers were responsible for administering the audit contract.

During the last half of fiscal year 1986, the Inspector General and the General Manager worked on arrangements for the transfer of this audit function to the OIG. Agreement was reached in the first quarter of fiscal year 1987 for the transfer of financial audit responsibility to the OIG.

To facilitate the transition, the same firm will be retained for the fiscal year 1987 audit. Beginning with the fiscal year 1988 audit, qualified accounting firms will be allowed to compete for the audit contract.

In April 1987, the firm released its opinion on TVA's fiscal year 1986 year-end financial statements. The opinion was qualified subject to the effects of uncertainties in TVA's nuclear program. The opinion letter mentioned unresolved safety issues, uncertainty of approvals by the NRC to return nuclear plants to service, and the uncertainty of the level of demand for electricity. OIG will monitor the resolution of these qualifications through audits.

The OIG is currently negotiating with the firm for the audit of the fiscal year 1987 financial statements. Preparations have been made to advertise the fiscal year 1988 financial audit contract consistent with the November 1986 agreement between the Inspector General and the General Manager.

C. Policy Formulation Audit

The TVA Board of Directors relies on information from its managers when establishing major policies. The quality of the information depends upon the quality of analyses made by the managers.

Phase one of the audit will determine whether the policy formulation process provides reasonable assurance that (1) Board decisions are based on sound information and analysis, (2) management properly communicates Board decisions, and (3) management follows up to ensure that Board decisions are implemented. Phase two of the audit will test the effectiveness of the policy formulation process.

The audit will also identify future issues and strategies for auditing in TVA.

D. Contracting Systems

See discussion under Audits of Contractors.

E. Power Billing System

TVA annually bills over \$4.5 billion to distributors of TVA power and other customers directly served by TVA. Enhancements have recently been made to the power billing system.

The OIG has begun a review to determine if these enhancements meet the needs of users and reasonably assure that reports are fairly presented and that bills are correct.

F. Environmental Compliance

TVA's Environmental Compliance audit program is operated by TVA's Environmental Quality Staff (EQS). These audits are made on all TVA activities subject to State environmental permits and on other TVA operations where significant environmental impact may occur.

The EQS requested that the OIG determine if EQS audits are performed in accordance with audit standards and if TVA adequately follows up on audit recommendations. This review is in progress.

G. Payment Timeliness

TVA has had a relatively sharp increase in penalties paid under the Prompt Payment Act. The penalties increased from \$13,000 in fiscal year 1983 to \$256,000 in fiscal year 1986. For the first three months of fiscal year 1987, penalties totalled \$243,000.

The OIG has begun an audit of the timeliness of TVA's payment process to determine if there are cost-effective ways to reduce penalties. TVA management has expressed interest in taking appropriate action.

H. Health Insurance

TVA has four insurance plans to provide its employees health care at reasonable costs. The Salary Policy Health Plan, the Management Health Plan, the Annual Trades and Labor Health and Dental Plan, and the Salary Policy Dental Plan cost about \$55 million in fiscal year 1986.

The OIG is reviewing the Salary Policy, the Management, and the Annual Trades and Labor Health Plans because of concerns expressed by both management and employees regarding administration of the plans. Audit objectives are to determine (1) if TVA has met its obligations in providing needed quality health insurance to employees at a reasonable cost, and (2) if there is reasonable assurance that these plans are free from fraud and abuse.

I. Retirement System

The TVA Retirement System (TVARS) has nearly \$2 billion in assets which are not protected by Federal pension laws. Its general performance is not

subjected to regular governmental or TVA oversight. There have been allegations of fraud, waste, and abuse in the system.

As presented in the last "Semiannual Report," the TVARS Board of Directors believes that TVA's audit authority does not extend to the TVARS and therefore refuses to permit the OIG to perform an unrestricted audit of its records. Efforts to begin an audit have continued throughout the current reporting period.

On November 4, 1986, the Inspector General and the TVARS Board discussed an OIG audit of the TVARS. On November 6, 1986, the Inspector General (IG) followed up with a memorandum to the TVARS Board proposing a financial and compliance audit of TVARS in accordance with the Comptroller General's Standards for Audit of Governmental Organizations, Programs, Activities and Functions.

On January 29, 1987, the TVARS Board responded to the OIG proposed audit. The TVARS Board repeated its position that the OIG scope and procedures be limited to financial tests performed in prior years by the former TVA Office of Audit and Evaluation.

This limitation represents a significant impairment under auditing standards. OIG auditors must be free to apply whatever procedures are necessary in the circumstances without hindrance by the auditee. Accordingly, the OIG's audit will continue to be postponed until these impairments are eliminated.

The TVA Board of Directors has supported TVA's and the IG's responsibility to independently audit the TVARS. The TVA Board is continuing to seek a resolution of this matter which will assure that the Retirement System's operations are thoroughly, objectively, and independently reviewed by TVA.

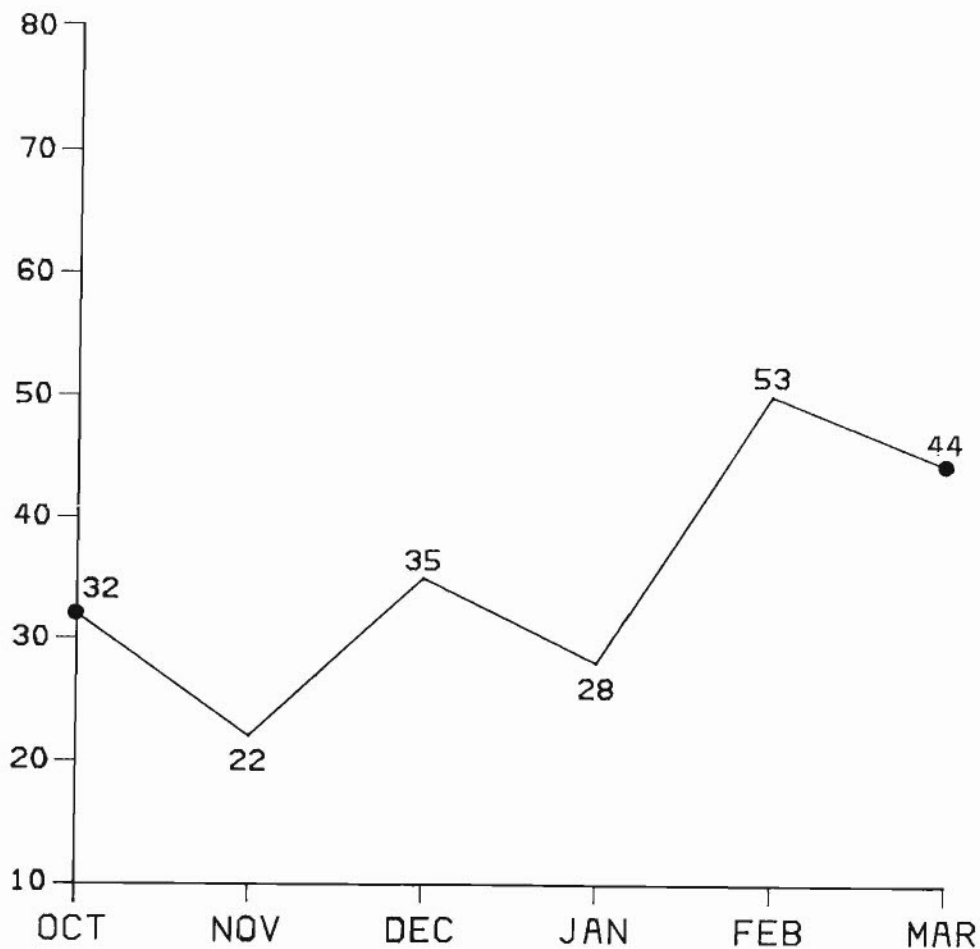
CHAPTER FOUR

OTHER OIG ACTIVITIES

Other OIG activities include the operation of an OIG Hotline, the use of subpoenas, analysis of proposed legislation, development of OIG regulations, development of OIG policies and procedures, and workload planning.

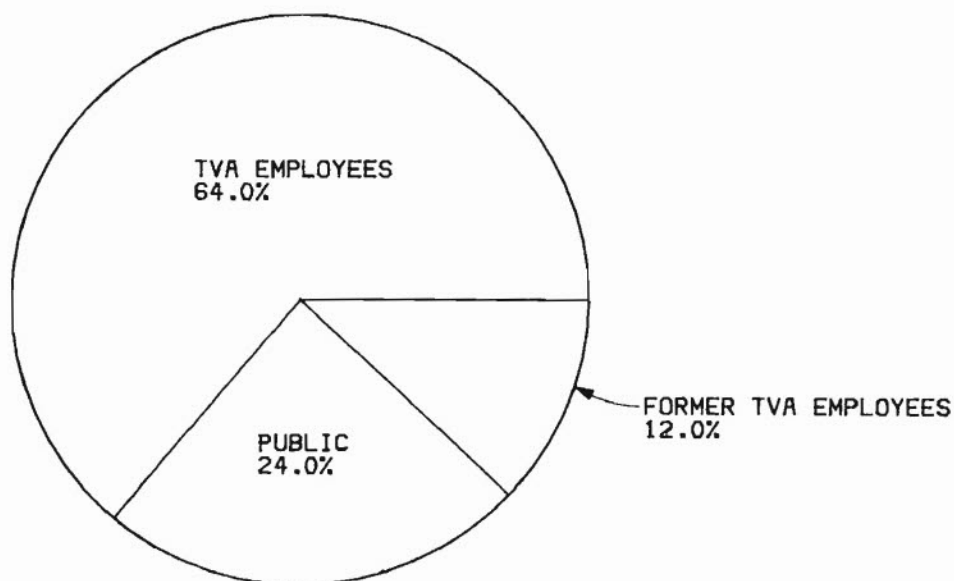
I. OIG HOTLINE

The OIG has operated a toll-free telephone hotline since February 1986. The Hotline staff receives and responds to calls from individuals wishing to report concerns or provide information. As shown in the following chart, the Hotline received between 22 and 53 calls a month during the six months ending March 31, 1987.



The complaints most frequently received involved personnel matters (28 percent), vehicle operations (18 percent), and discrimination or harassment (15 percent).

The Hotline received 214 calls during the six months ending March 31, 1986. The following chart shows the sources of Hotline calls.



Calls from current TVA employees increased by 16 percent during this reporting period. Calls from the public and former employees decreased by 12 percent and 4 percent respectively.

II. SUBPOENA AUTHORITY

The Energy and Water Development Appropriations Act of 1987 authorizes the Inspector General to issue subpoenas for documentary evidence during fiscal year 1987. The Inspector General has recently requested that Congress permanently authorize OIG to issue subpoenas for documents and also to administer oaths.

The Inspector General has issued subpoenas for documents in a number of OIG investigations. The information obtained through the use of these subpoenas has materially assisted OIG activities. Key records were obtained which otherwise would not have been available.

During this reporting period, the OIG developed an internal directive which contains guidance for issuing OIG subpoenas, including subpoenas covered by the Financial Right to Privacy Act of 1978.

III. LEGISLATIVE ANALYSIS

The OIG will review key legislative and regulatory proposals to assess their effect on TVA's economy and efficiency and on the detection and prevention of waste, fraud, and abuse. The review of legislative and regulatory proposals will be coordinated by the Inspector General's Legal Counsel in cooperation with support staff of the Assistant Inspectors General.

IV. TVA REGULATIONS AFFECTING THE OIG

TVA regulations have been modified or are being expanded to cover four areas significant to the OIG: the role of the OIG, the extension of confidentiality to complainants and witnesses, disciplinary guidelines for misconduct, and audit resolution.

A. OIG Mission

On February 19, 1987, the TVA Board of Directors adopted a resolution approving a TVA Code entitled "TVA Inspector General" and an Organization Bulletin entitled "Office of the Inspector General." These two documents describe the duties and responsibilities of the OIG and its relationship to other TVA offices and divisions. The code and bulletin are consistent with the Inspector General Act of 1978 and with the October 1985 Board resolution establishing the OIG.

B. Confidentiality Policy

The Inspector General has issued TVA instructions describing both the OIG's investigative jurisdiction and its policies and procedures governing confidentiality extended to TVA employees, witnesses, and complainants.

C. Disciplinary Guidelines

The OIG developed a proposal for the first TVA-wide administrative instruction containing guidance for taking disciplinary actions based on misconduct. The instruction will be issued by TVA's Division of Personnel following circulation for comments within TVA. The instruction will be used by TVA's personnel specialists and management in processing administrative actions. The instruction includes a table of penalties which lists the primary conduct and ethics offenses and outlines the appropriate range of penalties for each type of misconduct. Managers will be required to document the penalty

selected for misconduct and the mitigating and aggravating factors which affected selection of a particular penalty. The OIG will monitor agency practices in dispensing discipline in misconduct situations to assure that the procedures set forth in this section are applied fairly.

D. Audit Resolution

The OIG has reached an agreement with TVA management on a system for following up on reports to management by OIG and the General Accounting Office. The system will track reported findings until they are resolved.

The General Manager has appointed a Manager of Audit Compliance who is responsible for monitoring and coordinating management's responses to such independent reports and assuring timely corrective action. Major TVA offices have identified report action officers to facilitate resolution of findings at lower levels.

The system provides procedures which are substantially consistent with Federal policies on audit resolutions. Report resolution procedures will be published in TVA's regulations.

V. OIG STANDARDS AND PROCEDURES

The OIG has prepared a system of directives to guide auditors and investigators. The objective of the directive system is to provide reasonable assurance that the OIG complies with Federal policies and standards for Offices of Inspectors General.

The OIG has a plan for full office automation. All auditors and investigators will have access to a network of personal and minicomputers by the end of FY 1987. The Inspector General plans to maximize productivity and effectiveness through the use of computer technology.

VI. OIG PLANNING

In October 1986, the Inspector General approved a "Master Plan" with five principal goals and 40 issues. The goals focused on employee trust, TVA integrity, cost-effectiveness, resource protection, and public confidence. The 40 issue areas were those TVA programs and activities that had been identified because of their importance to TVA and their relation to the OIG's five goals. During the past six months, OIG projects have impacted half of the 20 issue areas, and progress has been made toward the five goals.

Chapter 4
Other OIG Activities

Eighty percent of the investigative workload in the first year of OIG operations has been in reaction to concerns and complaints. The remaining 20 percent was proactive. In the second year, the workload will begin to be more equally divided between reactive and proactive projects. In the next six months, investigations will address workers' compensation programs, employee concerns, and public safety.

Audit priorities in the next six months will focus on FY 1987 financial operations, other major contested claims, TVA contracting processes, TVA policy formulation, and nuclear quality assurance.

OIG activities during its first year of existence have demonstrated that the goals and issues previously identified in the Inspector General's "Master Plan" are consistent with the needs of TVA.

APPENDIX I

INVESTIGATIVE STATISTICS

1. Status of Investigation

	<u>Number</u>
Investigations in Progress 10/1/86	549
Investigations Started	588
Investigations Completed	<u>333</u>
Investigations Inactive	100
Investigations in Progress 3/31/87	804

Note: Investigations in Progress 3/31/87 include the number of inactive investigations.

2. Classification of Investigations

<u>Classification</u>	<u>Number of Investigations</u>			<u>In Progress 3/31/87</u>
	<u>In Progress 10/1/86</u>	<u>Opened</u>	<u>Closed</u>	
a. Employee Misconduct	29	19	8	40
b. Employee Concerns	83	336	151	268
c. Misuse/Abuse of Gov't Property	12	8	1	19
d. Vehicle Operations	25	10	13	22
e. Substance Abuses	7	1	3	5
f. Personnel Matters	75	57	30	102
g. Terrorism and Sabotage	2	0	0	2
h. Discrimination or Harassment	54	29	23	60
i. Safety	6	2	2	6
j. Trades and Labor	17	5	5	17
k. Theft	28	12	9	31
l. Falsification of Records	22	8	1	29
m. Contract-Related Misconduct	31	15	4	42
n. Fraud and Waste	49	36	5	80
o. General Criminal Activities	7	2	2	7
p. Employment Suitability	70	25	67	28
q. Public Concerns	10	8	5	13
r. Other	<u>22</u>	<u>15</u>	<u>4</u>	<u>33</u>
Total	549	588	333	804

APPENDIX II

AUDIT STATISTICS

1. Status of Audit Projects

	<u>Number</u>
Audit Projects in Progress as of 10/1/86	26
Audit Projects Started	25
Audit Projects Completed	17
Audit Projects in Progress as of 3/31/87	34

2. Audit Results

Audit Reports Issued	17
Disallowed Costs	\$16,724,874
Cash Recovery	\$ 52,377

NOTE:

The "Semiannual Report" pertaining to the period April 1, 1986 to September 30, 1986, stated that the OIG had 38 audits ongoing as of September 30, 1986. We now show 26 audits in progress as of October 1, 1986. The difference of 12 is accounted for as follows:

The previous report listed 13 audits separately as being in progress on September 30, 1986. These audits were implemented as part of the "Single Financial Audit of FY 86." They are now listed as one audit because one report will be issued for this effort.

APPENDIX III

AUDIT REPORTS ISSUED OCTOBER 1, 1986 THROUGH MARCH 31, 1987

<u>Report Number</u>	<u>Report Title</u>	<u>Date of Report</u>
86-16	Terra Tile, Inc. - Contracts 83K52-828335, 85K57-711421-3 and 85KAC-838124	11/05/86
86-17	National Technical Information Service - Contract 80KA6-585165	10/23/86
87-09-01	Contract Sampling - Personal Services Contracts - Review of Contracts with Coopers & Lybrand TV-68867A and TV-69344A for the period March 1-October 31, 1986	12/24/86
87-13	Employee Concern Programs in TVA	4/03/87
87-42	Falcon Coal Company, Inc. - Contract 72P-40-T18 Review of Supplemental Price Adjustments for Calendar Years 1982 and 1983	3/20/87
87-44	Mike Michalski and Company - Contract 79Z38-577554-2 Review of Possible Overpayments during the period November 1978-1985	3/31/87
87-47	Honeywell, Inc. - Review of Contract Labor Provisions Related to Subcontract of Blount Brothers under Contract 81K51-826976 for the period June 19, 1982-August 31, 1985	3/17/87
87-48	Review of Excise Tax on Fuel Used in Commercial Waterway Transportation-M/G Transport Services, Inc.	12/22/86
87-51	Selox, Incorporated - Review of Returnable Containers for Selected Contracts of the Division of Power Engineering and Construction at Paradise Fossil Plant for the period August 1, 1980-September 30, 1986	3/02/87
87-52	Review of the Contract with Knoxville Area Urban League - TV-59558A for the period April 4, 1985-June 20, 1986	4/22/87
87-53	Review of Contract with Knoxville Opportunities Industrialization Center - TV-67972A for the period September 25, 1985-August 20, 1986	2/10/87

APPENDIX III

AUDIT REPORTS ISSUED
OCTOBER 1, 1986 THROUGH MARCH 31, 1987

<u>Report Number</u>	<u>Report Title</u>	<u>Date of Report</u>
87-55	Tellico Reservoir Development Agency - Contract TV-60000A	2/06/87
87-64	Duke Power Company - Contract TV-65607A - Proposed 160-MW Atmospheric Fluidized Bed Combustion Demonstration Plant - Review of Phase III Design Engineering Services, Equipment and Materials Billed TVA and Changes in Actual Indirect Rates for the period October 1, 1985-September 30, 1986	2/26/87
87-70	Westinghouse Electric Corporation - Contract TV-69756A - Review of Costs Incurred for the period June 2, 1986-January 18, 1987	4/09/87

NOTE: This schedule excludes three audit reports covering claims filed against TVA. These claims are in litigation and disclosure of these reports will be restricted during litigation.

APPENDIX IV

HOTLINE STATISTICS

1. Hotline Calls Received:

<u>Source</u>	For the Period 10/1/86-3/31/87	
	<u>Number</u>	
Total Calls Received	214	
From Current TVA Employees	136	
From Former TVA Employees	26	
From the General Public	52	

2. Classification of Hotline Calls:

<u>Classification</u>	For the Period 10/1/86-3/31/87	
	<u>Number</u>	<u>Percent</u>
a. Employee Misconduct	16	7.5
b. Employee Concerns	5	2.3
c. Misuse of Government Property	7	3.3
d. Vehicle Operations	39	18.2
e. Substance Abuse	3	1.4
f. Personnel Matters	59	27.6
g. Terrorism and Sabotage	0	0
h. Discrimination or Harassment	3	1.4
i. Safety	4	1.9
j. Trades and Labor	8	3.7
k. Theft	6	2.8
l. Falsification of Records	1	0.4
m. Contract Misconduct	4	1.9
n. Waste and Fraud	22	10.3
o. General Criminal Activity	0	0
p. Public Concerns	7	3.3
q. Other Matters	---	---
Total	214	100

