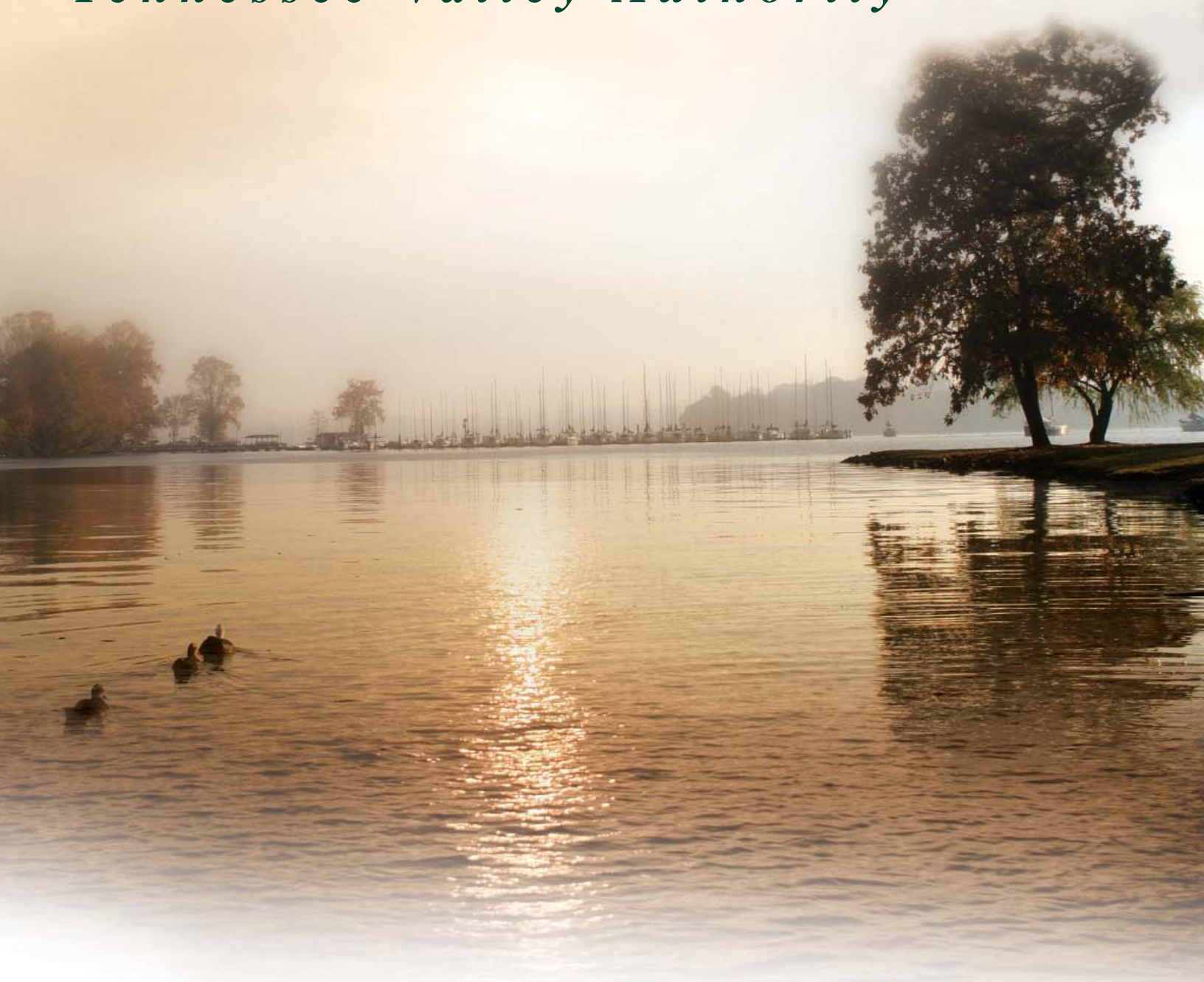


Office of the Inspector General

Tennessee Valley Authority



Semiannual Report

April 1 ~ September 30, 2005

The Office of the Inspector General (OIG) is an independent organization charged with reporting to the Tennessee Valley Authority (TVA) Board of Directors and Congress on the overall efficiency, effectiveness, and economy of TVA programs and operations. The OIG meets this responsibility by conducting audits, investigations, and inspections.

The OIG focuses on the prevention, identification, and elimination of

- (1) waste, fraud, and abuse;
- (2) violations of laws, rules, or regulations; and
- (3) inefficiencies in TVA programs and operations.



Tennessee Valley Authority

Office of the Inspector General

Message From the Inspector General

Visitors to the Inspector General's office here at TVA must walk past a large picture of the Fontana Hydro Plant. The inscription at Fontana, etched 63 years ago, reads, "1942 - Built for the people of the United States of America." This simple phrase epitomizes the vision that gave birth to TVA. TVA was not to be merely another well-intentioned government program. The focus was not bricks and mortar. The focus was the American people. Whether it was power production, navigation, flood control, malaria prevention, reforestation, or erosion control, this New Deal innovation was about making life better in the Tennessee Valley.

Today, TVA has many stakeholders, but ultimately it belongs to the people. The return on the investment made by the American people in TVA continues to yield readily observable benefits. The present day stewards of TVA are entrusted with continuing the legacy of public benefit and accountability. The OIG is one of those stewards responsible for identifying fraud, waste, and abuse, and promoting economy and efficiency through our audits, inspections, and investigations. Our work adds an additional level of transparency to TVA. The ultimate result is a more efficient, productive, and accountable organization.

With issuance of this semiannual report to Congress, we are for the first time also publishing some audit and inspection reports on our website. My belief is that making these audits and inspections available is consistent with TVA's obligation to be accountable to the public. In the future, we will post selected audit and inspection reports on our website as they are completed rather than releasing them with the semiannual report. Many of my Inspector General (IG) colleagues who are members of the President's Council on Integrity and Efficiency (PCIE) follow this practice as well. There are, of course, audit and inspection reports that cannot be released; for example, those containing security information or those which if released would put TVA and/or a contractor at a competitive disadvantage.

Finally, I am pleased the PCIE selected an OIG review team for an Award of Excellence in recognition of the team's efforts to help TVA prepare for compliance with the Sarbanes-Oxley Act of 2002. Congress enacted the Sarbanes-Oxley Act to bring more transparency to corporate financial reporting. The TVA Board and TVA management continue to demonstrate a commitment to making necessary improvements to comply with both the spirit and the letter of the Sarbanes-Oxley Act. To assist in this effort by helping management evaluate the design and operating effectiveness of financial reporting controls, the TVA OIG is performing process control reviews of most major processes across TVA. The PCIE Award of Excellence recognizes the significance of this undertaking as being an achievement at the forefront of the IG community.

Richard W. Moore
Inspector General
October 31, 2005



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Executive Summary

During this reporting period, we continued to support TVA by conducting objective audits, investigations, and inspections. In accordance with our mission, our reviews are designed to promote economy, effectiveness, and efficiency while detecting and preventing fraud, waste, and abuse. In total, we identified nearly \$14 million in recoveries, fines/penalties, potential savings, questioned costs, or funds which could be put to better use, as outlined in the chart below.

STATISTICAL HIGHLIGHTS	
April 1 ~ September 30, 2005	
Audit Reports Issued	29
Questioned Costs	\$6,422,040
Funds Recovered	\$5,015,650
Funds Put to Better Use	\$5,634,500
Funds Realized by TVA	\$6,001,859
Investigations Opened	84
Investigations Closed	84
Fines/Recoveries/Restitution/Savings	\$1,923,167
Criminal Actions	9
Administrative Actions (No. of Subjects)	13
Inspections Completed	13

Our 29 audits and 10 other audit-related projects during this reporting period resulted in significant questioned costs and the identification of areas for improvement. Highlights include (1) contract audits which identified over \$6.4 million in questioned costs and over \$5.6 million in funds which could be put to better use, (2) information technology (IT) audits which identified needed control improvements, and (3) financial-related and operational reviews which found most internal controls were adequately designed to mitigate risks, but identified opportunities to improve control effectiveness. TVA management used information from our audits to recover or disallow about \$5 million and negotiated about \$6 million in contract cost savings.

Investigative highlights include (1) recoveries, projected savings, and fines/penalties of over \$1.9 million; and (2) continued fraud prevention efforts, including fraud risk assessments, across TVA programs and fraud awareness training. We continued our



participation on interagency task forces and our activities to develop more proactive investigative initiatives through actions such as data mining, and by working with TVA management to resolve allegations that did not warrant a full OIG investigation.

Our Inspections unit completed 13 projects which identified over \$118,000 in cost savings and opportunities for improved program operations. Inspections ranged from reviews of physical and environmental controls to process reviews to a comparison of vendor and TVA coal weights.

Definitions

Questioned Costs - Costs that are unnecessary, unreasonable, unsupported, or an alleged violation of law, regulation, contract, etc.

Unsupported Costs - Questioned costs that are not supported by adequate documentation.

Funds Put to Better Use - Funds that could be used more efficiently by implementing recommended actions.

Disallowed Costs - Costs that management agrees should not be charged to TVA.



TVA Profile

TVA was created during 1933. President Franklin Roosevelt asked Congress to create “a corporation clothed with the power of government but possessed of the flexibility



and initiative of a private enterprise.” On May 18, 1933, Congress passed the TVA Act, creating TVA as a federal corporation. TVA’s threefold mission includes power production, environmental stewardship, and economic development.

Today, TVA is the nation’s largest public power company. TVA’s power facilities include 11 fossil plants, 29 hydroelectric dams, 3 nuclear plants, 6 combustion turbine plants, a pumped-storage facility, and 17,000 miles of transmission lines. TVA also produces energy from three renewable sources—sun, wind, and methane gas from waste. The TVA service area covers 80,000 square miles in the Southeastern United States, including almost all of Tennessee and parts of Mississippi, Kentucky, Alabama, Georgia, North Carolina, and Virginia. By providing wholesale power to 158 municipal and cooperative power distributors, and by directly serving 62 large industries and government installations in the Valley, TVA supplies the energy needs of 8.5 million people.

As a regional development agency, TVA not only supplies affordable, reliable power, but also supports a thriving river system and stimulates sustainable economic development in the public interest. TVA manages the nation’s fifth largest river system. TVA dams are part of a totally integrated resource management system for a 41,000-square-mile watershed where each dam operates in relationship to the others for multiple purposes and public benefits, including flood control, maintaining navigation, providing recreational opportunities, and protecting water quality.

TVA contributes to the Valley economy chiefly by keeping power rates competitive. This helps attract and retain industries that provide quality jobs in the region. TVA also helps communities promote sustainable economic development by providing assistance in job creation and retention and productivity improvements via capital investment, support of business incubators, specialized technical services and advice, and recruitment for new and existing industries.



Office Authority

Created by the TVA Board of Directors during 1985, the TVA OIG became statutory under the IG Act Amendments of 1988. The authority to appoint the TVA IG was transferred to the President in November 2000 by Public Law No. 106-422. The IG is responsible for conducting audits and investigations relating to TVA programs and operations while keeping the TVA Board and Congress fully and currently informed about problems and deficiencies. The TVA IG is independent of TVA management and subject only to the general supervision of the TVA Board. The IG's authority includes conducting audits or investigations the IG deems necessary or desirable, issuing subpoenas, administering oaths, and granting confidentiality to individuals who provide information to the OIG.

Organization

The OIG's primary location is in the TVA headquarters in Knoxville, Tennessee. To obtain broader coverage throughout the Valley, the OIG also has an Inspections unit located in Chattanooga, Tennessee, and Investigations has offices at the Browns Ferry Nuclear Plant (BFN) in Alabama, in Mayfield, Kentucky, and in Chattanooga. The OIG consists of three primary components: Audits, Investigations, and Inspections.



AUDITS AND INSPECTIONS



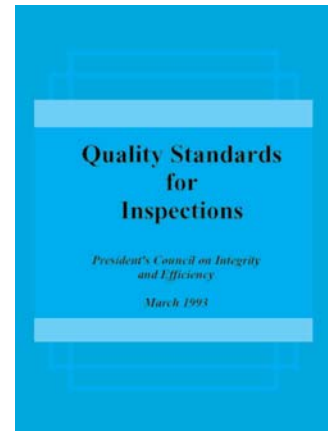
Audit Operations (AO) conducts, and/or supervises, comprehensive financial and performance audits of TVA programs and operations. Based upon the results of such audits, AO makes recommendations to ensure that program objectives and operational functions are achieved effectively and efficiently. AO develops an annual audit plan to effectively allocate audit resources. The audit plan addresses those issues, programs, operations, and activities that hold the greatest exposure for TVA to significant risks and/or vulnerabilities.

AO consists of three departments—Contract Audits, Financial/Operational Audits, and IT Audits.

- Contract Audits has lead responsibility for contract compliance and preaward audits. In addition, this group performs reviews of TVA contracting processes and provides claims assistance and litigation support.
- Financial/Operational Audits has lead responsibility for (1) oversight of TVA's financial statement audits performed by TVA's external auditor; (2) reviews of TVA's internal controls related to financial reporting, operational efficiency, and compliance with laws and regulations; and (3) operational reviews to assess the results and economy and efficiency of TVA programs.
- IT Audits has lead responsibility for audits relating to the security of TVA's IT infrastructure, application controls, and general controls associated with TVA systems. This group also performs operational reviews of the effectiveness of IT-related functions. In addition to its audit mission, IT Audits is responsible for developing and supporting an independent OIG computer network.

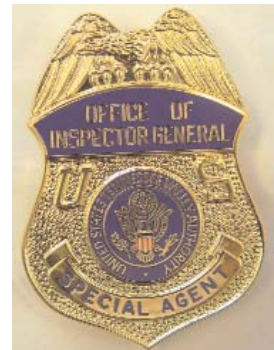


The Inspections unit, which is staffed by auditors, was formed at the beginning of fiscal year (FY) 2004. Inspections provides flexibility to conduct limited scope policy and program evaluations to promote economy and efficiency in the management and administration of TVA programs. In accordance with the Quality Standards for Inspections, the objectives of our Inspections unit include providing a source of factual and analytical information, monitoring compliance, measuring performance, assessing the efficiency and effectiveness of operations, and/or conducting inquiries into allegations of fraud, waste, abuse, and mismanagement.



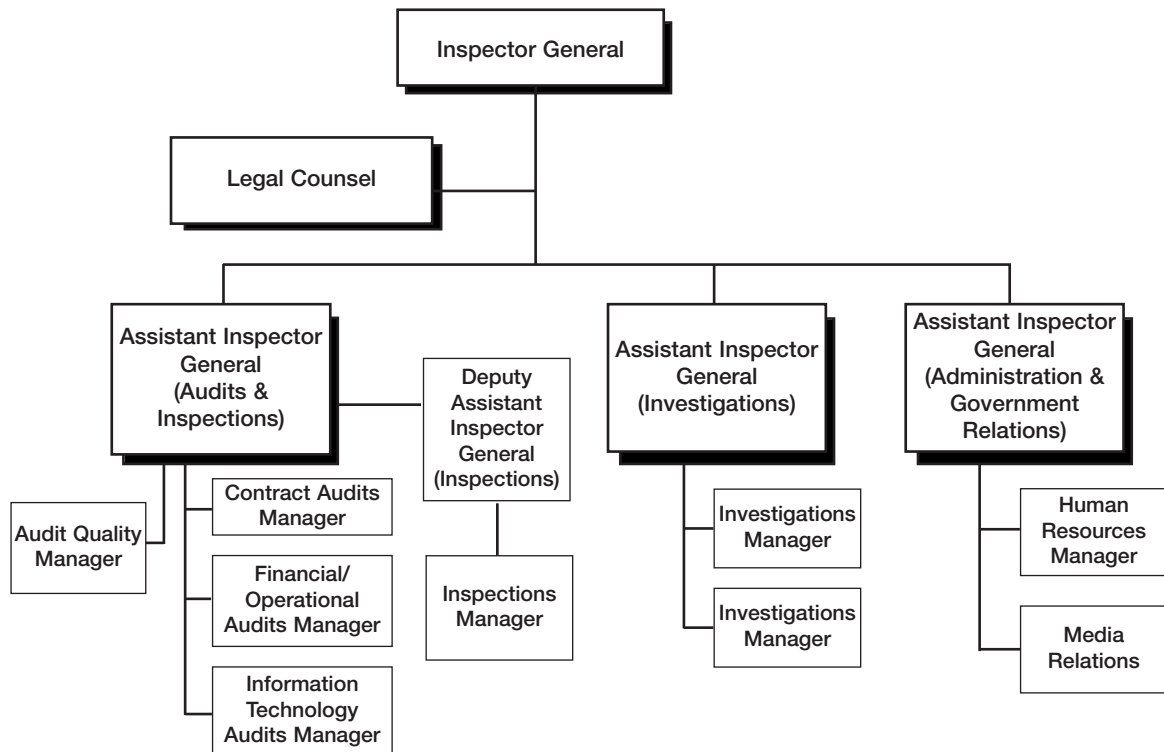
INVESTIGATIVE OPERATIONS

Investigative Operations (IO) conducts and coordinates investigative activity related to fraud, waste, and abuse in TVA programs and operations. The activities investigated include possible wrongdoing by contractors, employees, economic development loan recipients, and others. IO maintains liaisons with federal and state prosecutors and reports to the Department of Justice whenever the OIG has reasonable grounds to believe there has been a violation of federal criminal law. IO works with other investigative agencies and organizations on special projects and assignments, including interagency law enforcement task forces on terrorism, the environment, and health care.





Office of the Inspector General



Contacts

Inspector General
Richard W. Moore(865) 632-4120

Legal Counsel
Richard P. Levi(865) 632-6197

Assistant Inspector General (Audits & Inspections)
Ben R. Wagner(865) 632-2272

Deputy Assistant Inspector General (Inspections)
Greg C. Jaynes(423) 751-7821

Assistant Inspector General (Investigations)
Charles A. Kandt(865) 632-7720

Assistant Inspector General (Administration & Government Relations)
Ronald Wise(865) 632-4752

Audit Quality Manager
Paul E. Ivie(865) 632-3891

Contract Audits Manager
David P. Wheeler(865) 632-4770

Financial/Operational Audits Manager
Louise B. Beck(865) 632-2622

Information Technology Audits Manager
Jill M. Matthews(865) 632-4730

Inspections Manager
R. Darryl Bryant(423) 751-4415

Investigations Manager
Curtis D. Phillips(865) 632-2584

Investigations Manager
C. Dale Hamilton(865) 632-3956

Human Resources Manager
Kay T. Myers(865) 632-7718

OIG Media Relations
Anne B. Ferrell(865) 632-3505

OIG website: <http://oig.tva.gov>



OIG Review Team Receives PCIE Award for Excellence

The PCIE selected an OIG review team for an Award of Excellence in recognition of the team's efforts to help TVA prepare for compliance with the Sarbanes-Oxley Act of 2002. An Award of Excellence is given for unusual or distinguished achievements that are at the forefront of the IG community.

Congress enacted the Sarbanes-Oxley Act in response to a series of corporate scandals. The Act is intended to make corporate accounting and reporting more transparent; make executives accountable by giving them personal responsibility for financial statements and financial reporting controls; and enhance efforts to make sure appropriate controls are in place to ensure accuracy in financial reports used by investors and stakeholders.



Pictured above from left to right: (back row) Richard Moore, Greg Stinson, Rick Taylor, Paul Ivie, Sylvia Whitehouse, Greg Jaynes, Andrea Williams, Ben Wagner, Cheryl Liles; (first row) Mike Blair, Sharon Bates, Karla McCamy, Nikolaus Jordan, Lisa Hammer, Louise Beck, Melissa Neusel, Amy Rush, Phyllis Palmer, Jill Matthews, Janet Previtera, Kristi Reynolds, Betty Spence

Under this law, corporate management is responsible for establishing, validating, and monitoring effective financial reporting controls. Due to congressional action regarding the jurisdiction of the Securities and Exchange Commission (SEC) over TVA, TVA will be subject to some Sarbanes-Oxley requirements. Among other things, TVA will be required to assess and file a report with the SEC on its internal control over financial reporting. To meet this requirement, TVA management identified about 80 business processes and over 30 systems throughout the company that impact financial reporting. TVA management is currently documenting and assessing the design and operating effectiveness of internal controls.

The OIG began immediately working collaboratively with TVA management to address this new requirement by providing information and documentation from prior audits as a starting point in identifying controls. In addition, the OIG developed an action plan to perform process-control reviews to assist TVA management in its evaluation of the



Special Features

design and operating effectiveness of financial reporting controls. The OIG Sarbanes-Oxley Review Team has completed a number of these reviews across several business processes at TVA. The results from this collaborative effort have been significant and wide-ranging in scope, subject matter, and outcome, including raising the level of awareness of the purpose and need for internal controls, as well as improving those controls.

The general process areas being reviewed by the OIG include revenues, billings, fixed assets, fuel and purchased power, power trading, treasury and corporate credit, procurement, inventory management, payroll, and information systems management. Identified areas for improvement in the design and operating effectiveness of controls include (1) enhancing policy and procedures related to payroll processing, inventory management, and accounts payable; (2) tightening controls related to system access and change management; and (3) tightening controls related to bulk power trading and managing direct charge material at the BFN Unit 1. To make the results more user-friendly, we also have developed a standardized report format which includes a chart which rates each internal control and provides suggested remediation where necessary. The scope of this project will eventually encompass most major processes across TVA, and the Team continues to work with TVA's process owners to complete the control reviews by identifying needed improvements in the design, documentation, and/or operating effectiveness of control activities in these process areas.

TVA Responds to Diverse Challenges

As TVA faces fundamental changes to its business environment due to evolving competition in the electric utility industry, it is responding to challenges in a number of areas. These areas include (1) competitive rates, (2) operational excellence, (3) environmental compliance, and (4) corporate responsibility. OIG audit and investigative work contributes to TVA's efforts to meet these challenges.



COMPETITIVE RATES

TVA management has indicated it believes competition for TVA and more choices for its customers will likely be introduced in the Tennessee Valley in the future, and increased competition will significantly impact how TVA finances and carries out its diverse mission. When its captive customer base is freed to purchase power elsewhere, TVA's revenue streams will be less certain even as TVA encounters increased pressures to produce power at competitive rates to retain customers.

Two key efforts in maintaining competitive rates are controlling operating and maintenance costs and debt reduction. Controlling costs is a challenge when TVA is faced with increases in fuel, purchased power, and other costs. However, TVA is seeking maximum efficiency from its current generating units and is planning to bring more low cost nuclear generation on line which will reduce TVA's dependence on higher-priced fuel and purchased power. TVA also plans to conduct ongoing reviews of its costs and efficiencies and benchmark its activities and is urging every employee to take a role in controlling costs.



TVA's strategic plan calls for paying down its debt by \$3 to \$5 billion over the next 10 to 12 years. However, with competition on the horizon, TVA is looking at accomplishing debt reduction in an even shorter time frame. Reductions in debt will decrease interest expense and provide TVA greater financial flexibility in a more uncertain market.

The OIG supports TVA's cost saving efforts through (1) performing economy and efficiency reviews of TVA operations and programs, (2) working closely with TVA's Procurement organization to identify cost savings through preaward contract audits and contract compliance audits, (3) investigating fraud allegations and proactively seeking out fraud, and (4) assisting TVA organizations to conduct fraud assessments to improve their antifraud processes and internal controls related to the prevention, identification, and detection of fraud. Over the last five years, OIG audits and inspections have identified opportunities for cost savings of over \$296 million, of which TVA management has agreed to approximately \$210 million, or about \$42 million per year. Separately,



Special Features

Investigations has annually identified on average over \$4.2 million in savings and recoveries.

OPERATIONAL EXCELLENCE

In addition to providing competitive rates, TVA has to meet growing generation and transmission demands with a high degree of reliability. Also, as a part of the nation's critical infrastructure, it must ensure the security of its physical assets and information systems.

TVA faces increased demand with aging generation assets. In addition, although TVA has over 31,000 megawatts of capacity, it is a net purchaser of power, purchasing more power from other generators than it sells into the off-system market, and these costs have been increasing. TVA installed additional combustion turbines to generate peaking power, but their cost effectiveness is dependent on gas prices which have

gone up. In response to these challenges, TVA (1) has improved the reliability of its fossil system, reducing unplanned outages and load reductions; (2) has undertaken the modernization of the power production equipment at its major hydro facilities; and (3) is working to bring BFN Unit 1 back on line in 2007, adding an additional 1,280 MW of base-load capacity.



TVA is also facing increasing demand on its transmission system. TVA's transmission system was designed to serve native load and sufficient interchange capability to ensure regional reliability, not to accommodate the much larger evolving interregional electricity markets. Yet for the sixth year in a row, TVA provided transmission

system reliability of 99.999 percent. TVA has built over 800 miles of line in the last eight years and is planning on building additional lines, substations, and a new interconnection. It has also signed a Joint Reliability Coordination Agreement to actively manage reliability of seams between the wholesale electricity markets of the signing parties.



The OIG conducts audits and inspections to identify opportunities to improve the effectiveness, efficiency, and controls of TVA's programs and processes. In the past five years, these reviews have addressed such topics as data reliability and integrity in the energy trading decision support model, watershed revenue collection processes, the coal procurement process, the dam safety inspection process, controls and accuracy of the Transmission and Energy Scheduler System, the capital project justification process, and TVA's enterprise-wide risk management program. Security of TVA facilities and systems has also received significant attention, including reviews of nuclear and non-nuclear physical security, qualifications of nuclear security personnel, participation with TVA staff and outside consultants in an IT security assessment program, and reviews of logical and physical controls and continuity plans for specific critical systems and IT infrastructure. The OIG also participates in other activities to stay abreast of operational issues and contribute to TVA efforts. These include participation on TVA's Enterprise Risk Council and serving in an advisory capacity on TVA task forces and pre-implementation teams.

ENVIRONMENTAL COMPLIANCE

TVA must comply with environmental laws and regulations related to air quality, water quality, and solid and hazardous waste handling and disposal. Of particular concern and impact are Environmental Protection Agency standards for outdoor pollutants, particularly sulfur dioxide (SO₂) and nitrogen oxide (NO_x), requiring TVA to reduce such emissions.

TVA has instituted an aggressive emission-control program. Among other activities, TVA has installed selective catalytic reduction equipment on 57 percent of its coal-fired generation capacity to control NO_x and scrubbers on 30 percent of its coal-fired capacity to control SO₂. With the next decade, TVA plans to spend \$5.7 billion on air quality improvements. TVA has stated, moreover, that it believes even more stringent environmental regulations and therefore higher compliance costs are likely in the future.



Special Features

In December 2004, 15 new wind turbines were added to the TVA wind site on Buffalo Mountain near Oak Ridge, Tennessee. These turbines create no air pollution and, if



sited properly, have minimal environmental impact. TVA is also in the process of modifying Unit 1 at BFN to bring it back on line. This will allow TVA to meet future demand without increasing air emissions.

OIG environment-related audit work has focused primarily on operational reviews of TVA's environmental audit program and polychlorinated biphenyl remediation efforts.

However, we continually monitor environmental issues facing TVA and assess the associated risks in order to determine whether additional reviews are appropriate. We also provide investigative support to the Environmental Crimes Joint Task Force in the Eastern District of Tennessee. Task force cases over the last several years have involved problems such as Clean Water Act violations, illegal storage of hazardous waste, improper use of pesticides, and illegal dumping.

CORPORATE RESPONSIBILITY

Corporate failures and scandals such as Enron and WorldCom have caused companies, including TVA, to come under increased scrutiny regarding corporate governance practices. TVA needs to ensure the highest integrity in its financial and performance reporting, ensuring full disclosure to stakeholders and promoting integrity at all levels of the agency.

Recent legislation has affected TVA in these areas and in its governance structure. TVA will be subject to SEC reporting requirements, including Sarbanes-Oxley internal control reporting. In addition, TVA will soon be led by a nine-member, part-time Board and a Chief Executive Officer appointed by that Board. The legislation also creates an audit committee composed solely of Board members independent of management who will (1) recommend, in conjunction with the IG, an external auditor to the Board, (2) receive



and review reports from the external auditor and the IG, and (3) make such recommendations to the Board as it deems necessary.

TVA has expressed a commitment to conducting its business in a manner that retains the continued confidence and support of its investors, customers, and other stakeholders. Toward this end, it has developed a corporate accountability and disclosure plan, as well as adopting a disclosure control policy, a disclosure and financial ethics code, and an information certification policy. TVA is also in the process of strengthening its internal control design and documentation for its business processes, preparatory to Sarbanes-Oxley reporting.

The OIG is responsible for the technical contract management and funding for TVA's external audit and for assuring the work of the external auditors complies with Government Auditing Standards. To meet the latter responsibility, we perform concurrent reviews of the external auditor's annual audit of TVA's financial statements and their reviews of TVA quarterly financial results. We participate in key meetings with the external auditor and TVA management, review the external auditor's workpapers, review the independence of the auditor, and perform supplemental tests, as needed, to assess the overall quality of the work. We have also taken an active role in support of TVA's implementation of the Sarbanes-Oxley Act, including its Section 404 compliance initiative. We serve in an advisory role on TVA's Disclosure Control Committee and have advised TVA's Board on topics such as Sarbanes-Oxley implementation and TVA risk management policy issues. We are looking forward to meeting with the new TVA Board and audit committee when they are in place and to continuing our efforts in support of TVA's governance responsibilities.



Summary of Representative Audits

Audits are initiated from (1) the OIG annual workplan, (2) additional issues identified by the OIG subsequent to the annual workplan, (3) issues identified by cooperative efforts with TVA management, and (4) concerns raised by TVA management or other stakeholders. During this reporting period, we completed 29 audits which identified over \$6.4 million in questioned costs and over \$5.6 million in funds which could be put to better use. We also identified numerous opportunities for TVA to improve program operations. Our audits included (1) pre- and postaward contract audits, (2) financial-related audits, (3) IT audits, and (4) operational audits.

PREAWARD CONTRACT AUDITS

To support TVA management in negotiating procurement actions, we completed four preaward audits that identified \$4.4 million in potential savings opportunities. During this reporting period, TVA management successfully negotiated \$6 million in savings as a result of audits issued during this and previous reporting periods. Highlights of two of the preaward audits where management has decided to proceed with a contract follow.

- We reviewed the cost proposals submitted by two contractors for providing Fossil & Hydro plant maintenance and modification services under two separate contracts. We determined one contractor's proposal was fairly stated. The second contractor's proposal was fairly stated with the possible exception of a proposed billing category for nonmanual employees who receive union benefits instead of nonmanual benefits. We estimated the contractor's proposal would result in TVA paying an extra \$400,000 over the four-year extension period than it would pay if the employees were classified and paid in accordance with TVA's craft labor agreement. TVA management subsequently decided the contractor's proposed labor classifications were proper.



- We reviewed the cost components of a contractor's fixed price proposal for designing and installing a hydrated lime injection system at a TVA fossil plant. Although we determined the pricing methodology used by the contractor was reasonable for pricing future projects, we provided information on certain cost components of the fixed price that TVA should consider for future projects. Additionally, we identified \$72,000 in overstated freight costs in the Cumberland Fossil Plant fixed price proposal. TVA management is using the information we provided to restructure the pending contract.

CONTRACT COMPLIANCE AUDITS

During this reporting period, we completed ten contract compliance audits that identified over \$6.4 million in ineligible and unsupported costs and another \$1.2 million in costs to be avoided. Highlights of some of the more significant audits follow.

- We reviewed \$109.8 million in costs paid by TVA to a contractor for providing engineering services associated with the restart of BFN Unit 1. We questioned \$2.5 million, including (1) the contractor's inclusion of the labor costs of its affiliate company in its performance fee base and (2) overcharges for labor and related costs and other direct costs. TVA decided to (1) allow the contractor to include the labor cost of its affiliate in its performance fee base and (2) recover any remaining costs that were not directly billable under the contract.
- We reviewed \$104.4 million in costs paid by TVA to a contractor for providing construction services for the restart of BFN Unit 1. We found the contractor overbilled TVA \$1.5 million due to (1) the use of a craft labor category, incentive fee, and safety awards not provided for by the contract; (2) wrong indirect cost markups and unsupported labor costs; and (3) other miscellaneous overbillings. Additionally, we estimated TVA would save \$995,000 by disallowing continued use of the unauthorized labor classification. TVA subsequently decided to disallow \$1,087,914 of the questioned costs and to discontinue use of the labor classification.



Audits

- We determined a contractor had overbilled TVA \$563,773 (out of \$6.2 million that had been billed) for providing welding services for various nuclear projects. The overbilling included (1) labor costs due to the contractor's use of incorrect labor rates, misclassifications of personnel, and unsupported labor hours; (2) ineligible or unsupported mobilization, travel, and per diem costs; (3) direct-billed overhead labor; and (4) duplicate costs. TVA agreed with most of our findings and is working with the contractor to resolve the overbillings.
- We determined TVA had been overbilled \$103,007 (out of \$10.9 million that had been billed) for services performed at BFN Unit 1 by a subcontractor. The overbilling included (1) unsupported labor hours, (2) ineligible fees that had been applied to travel and relocation costs, and (3) ineligible jury duty hours. TVA is assessing our recommendations.
- We audited \$33.6 million of costs billed to TVA by a contractor for the administration of TVA's dental benefit program. We questioned \$381,392, including (1) unsupported and duplicate claims, (2) claims paid for ineligible individuals, (3) claim payments that exceeded plan limits, and (4) ineligible orthodontic benefits. TVA is negotiating resolution of the overbillings with the contractor.
- We reviewed \$615.5 million TVA had paid a contractor from 1999 through 2004 for providing modification and supplemental maintenance services for TVA's fossil plants. We questioned \$833,655, including (1) payroll taxes and General & Administrative (G&A) costs where recovery rates for these costs had been applied to non-salary costs, (2) additional G&A costs where craft employees had been classified as nonmanual craft supervisors, and (3) temporary living allowance payments for employees who may not have been eligible to receive the payments because they did not provide adequate certifications and documentary evidence of permanent residences. TVA is (1) planning to recover any overbilled costs and (2) assessing our finding regarding the contractor's classification of craft employees as nonmanual craft supervisors.



FINANCIAL-RELATED AUDITS

During the reporting period, we completed eight financial-related audits, including two audits of TVA's external auditor's review of interim financial information for the second and third quarters of FY 2005. Highlights of the audits follow.

- In support of TVA readiness initiatives for Sarbanes-Oxley Section 404 compliance, we completed reviews of the control design and documentation for 15 business processes, including Fixed Assets, Fossil Fuel, Bulk Power Trading, Material and Supplies Inventory, and Accounts Payable. The results of our reviews were reported to the Chief Financial Officer's organization which is working with the process owners to remediate the findings. We are currently developing plans to test operating effectiveness of key controls for these processes, beginning in the first quarter of FY 2006.
- We determined controls related to the identification and reduction of inventory and financial reporting could be improved. Specifically, we determined (1) policy and procedure documentation were not complete, (2) business unit reviews for surplus/obsolete inventory were not effective, (3) signatory authorization of approval by the business units for inventory write-offs was not obtained, (4) inventory purchases were made for items held as surplus, and (5) quarterly inventory reserve calculations were incorrect, however, corrections were made for quarterly reporting accuracy. Management plans to take corrective action.
- We found no instance where TVA's external auditor's reviews of TVA interim financial information for the second and third quarters of FY 2005 did not comply with Government Auditing Standards in all material respects, including required communications to appropriate parties.

IT AUDITS

During this reporting period, we completed five audits in the IT environment, including a review of TVA's progress in complying with federal security requirements. In this review, we found TVA's security program structure is adequate to meet federal



Audits

requirements, and TVA is making substantial progress in correcting significant security deficiencies. The remaining four reviews pertained to (1) a security review of the system housing TVA IT Security program-related data and (2) internal controls for three financially significant applications. We found improvements were needed to address weaknesses in the following areas:

- Logical security controls designed to prevent unauthorized access to system programs and data. Various weaknesses related to access management, secure communication protocols, security configurations, documentation of various procedures, documentation of spreadsheet input reviews, direct data change approval documentation, and lack of sensitive information and/or login banners.
- Physical controls designed to prevent unauthorized access to IT resources. The weakness related to the physical protection of servers at a vendor hosting one of TVA's financially significant systems.
- General controls designed to ensure ongoing operations. Weaknesses related to development of contingency plans and documentation and testing of disaster recovery plans.



TVA management agreed with our findings and either has implemented or is in the process of implementing corrective actions. Some of the corrective actions to address our findings are part of an ongoing agency-wide effort to improve security controls in TVA's existing IT infrastructure.

OPERATIONAL AUDITS

TVA'S CORPORATE CONTRIBUTION PROGRAM

We determined TVA's contributions totaled \$1.261 million and \$1.646 million during FYs 2003 and 2004, respectively. TVA's Corporate Contributions organization administered about 51 percent of the contributions in FY 2003 and 36 percent in



FY 2004; other TVA organizations administered the remaining contributions. In reviewing a sample of contribution transactions, we noted (1) the Contributions Committee did not review numerous transactions as required by policy and (2) several transactions, including \$160,580 in purchasing card payments that appeared to be contributions, were charged to incorrect cost classifications. Also, TVA's Contribution Tracking System is not reconciled and may not reflect all TVA contributions. Management agreed with the findings and has taken or plans to take appropriate corrective actions.

AGREED-UPON PROCEDURES FOR GREEN PRICING ACCREDITATION PROGRAM

We completed agreed-upon procedures to assist the Center for Resource Solutions (CRS) in determining TVA's compliance with the annual reporting requirements of CRS' Green Pricing Accreditation Program for the year ended December 31, 2004. The required information on TVA's renewable energy initiative, "Green Power Switch[®]," was provided to CRS.

***energy right*[®] PROGRAM PAYMENTS**

We determined market value payments (MVPs) to distributors for installed water heaters and heat pumps were generally applied correctly and total invoice amounts were generally accurate, including adjustments to applicable invoices. However, (1) the *energy right*[®] Information System does not provide the means to document and track adjustments, (2) some MVPs were paid without complete and/or accurate information, (3) no verification occurred to ensure MVPs were made to distributors as approved by Customer Service & Marketing district specialists, and (4) distributors' noncompliance with certain *energy right*[®] program process/documentation requirements increased TVA's financial risks. Management agreed with the findings and is taking corrective action.





Summary of Representative Investigations

During the past six months, we closed 84 investigations based, in part, on allegations and concerns received from ratepayers, TVA management and employees, and OIG auditors. Our investigations, including task force projects, resulted in (1) over \$1.9 million in recoveries, projected savings, and fines/penalties; (2) four subjects indicted; and (3) five subjects convicted.

Our investigative activities are designed to prevent and detect fraud, waste, and abuse. While our investigations in the past have largely been reactive, we are implementing programs to become more proactive. Our proactive efforts include (1) placing an additional emphasis on testing for fraud during audits and having auditors make referrals to Investigations, (2) devoting one employee to full-time data mining to look for anomalies and fraud indicators in TVA data sets, (3) working with TVA management to conduct fraud risk assessments, (4) assigning OIG special agents to be responsible for specific TVA plant sites and develop relationships with the people there, and (5) developing an Intelligence Unit to look for trends or patterns which might indicate fraud. In this connection, we are working with TVA management to ensure that allegations which do not rise to the level of warranting an OIG investigation are appropriately considered and acted upon.

We also recognize the importance of sharing investigative resources and information with other federal agencies and task forces in order to focus enhanced law enforcement resources by applying the most effective criminal and civil statutes against individuals and companies who are breaking the law. During this period, we continued to provide investigative resources to the Environmental Crimes Joint Task Force and a Health Care Task Force, sponsored by the United States Attorney for the Eastern District of Tennessee, and the Joint Terrorism Task Force, led by the Federal Bureau of Investigation, Knoxville Field Division.



Below we discuss illustrative investigations and our program for handling allegations of employee misconduct. Because our mission includes preventing fraud as well as detecting it, however, first we will discuss our proactive efforts in fraud risk assessments and fraud awareness training.

FRAUD RISK ASSESSMENTS AND FRAUD AWARENESS TRAINING

Due to changes in the law, TVA will be subject to certain provisions of the Sarbanes-Oxley Act. Under Sarbanes-Oxley and as recommended by the Committee on Sponsoring Organizations (COSO), management is responsible for establishing, validating, and monitoring effective internal controls over fraud. The elements of a strong program to detect and deter fraud include assessments to identify fraud risks and controls which mitigate those risks, evaluations of the effectiveness of those controls, and addressing residual risks.

The OIG, working with TVA management, has undertaken a fraud risk assessment initiative throughout TVA. These fraud risk assessments are intended to identify (1) types of frauds that can occur, (2) the likelihood and significance of fraud occurring, (3) the controls in place to prevent fraud, and (4) actions needed to improve fraud prevention controls. We intend for this to be an ongoing process to assist TVA in effectively ensuring there are adequate antifraud controls across all TVA business units. Because of the importance of this effort, we are devoting significant investigative resources to this initiative.

We recognized at the outset of this initiative that management support would be an essential element for this program to be successful. Employees and managers may hesitate to provide information because they may think it would reflect negatively on them or the company, and they may not want attention focused on themselves. That has not been our experience at TVA. We have experienced nothing but the strongest support from TVA management in this undertaking, and we have been pleased with the candor and information provided by TVA employees during the fraud risk assessment process.



Investigations

Fraud risk assessments completed during this reporting period included (1) a BFN Unit 1 restart contract, (2) the TVA-wide inventory process, (3) fixed assets, and (4) the Watts Bar Nuclear Plant steam generator replacement project. In each case, based on an assessment of fraud risk areas and possible fraud schemes, we collaboratively developed several recommendations to improve internal controls.

In addition to the fraud risk assessments, we conducted eight fraud awareness training sessions for contract managers in conjunction with Procurement and Audit Operations. The training, conducted at the request of the Senior Vice President, Procurement, focused on the common types of contract fraud and indicators of potential problems.

CONTRACT-RELATED INVESTIGATIONS

We identified several possible fraud schemes involving TVA contracts through our proactive methods as discussed at the beginning of this section. We closed several investigations leading to possible contract fraud where there was insufficient evidence to show actual fraud, and several others are ongoing. Results from completed contract investigations included the following.

- An individual who fraudulently obtained a loan from TVA was previously convicted of bank fraud in the United States District Court for the Middle District of Tennessee. On August 15, 2005, the individual was sentenced to 18 months' confinement, 18 months' home detention, 3 years' supervised probation, and was ordered to pay full restitution, including \$255,366.89 to TVA.

- We previously reported an employee at BFN was indicted for misusing his TVA purchasing card by accepting kickbacks to purchase overpriced janitorial supplies in quantities far in excess of what TVA needed. In return, the former employee received about \$14,500 in store gift cards and merchandise. An individual responsible for providing the kickbacks has since been convicted of conspiracy. He was sentenced to 5 years' probation, 6 months' home confinement, and ordered to pay \$196,062 in restitution to TVA.





- Our investigation raised serious questions about the appropriateness of actions by a contractor manager working at a TVA site. The contractor manager (1) promoted a woman, with whom he had a dating relationship, to a supervisory position; and (2) received and sent inappropriate e-mails. The contractor manager was replaced shortly after we issued our investigative report.
- We continued our efforts to review temporary living expenses paid to contractor employees. Those expenses are intended to reimburse contractor employees on temporary assignment who maintain both a temporary residence and a permanent residence located more than a certain distance from the TVA site. To obtain temporary living expenses, contractor employees must certify they maintain both a permanent and a temporary residence. During this reporting period, we investigated a subcontractor who had not obtained the required certifications from its employees. TVA subsequently recovered approximately \$45,000 paid for employees who had not submitted certifications. Our investigation also resulted in improvements to the process.

THEFT INVESTIGATIONS

We have the following updates on theft cases previously reported.

- We previously reported a TVA employee had been charged with theft and mail fraud in an eleven-count federal indictment. The indictment charged the former employee used TVA credit cards to purchase items for personal use, including color televisions, storage sheds, and other items. A breakdown in internal controls in that case allowed the alleged misuse to continue for several months before it was detected. During this reporting period, the former TVA employee pled guilty to mail fraud. The former employee admitted using TVA purchasing cards, over nearly a three-year period, to obtain personal services and merchandise. As part of the guilty plea, the former employee agreed to make restitution to TVA totaling over \$86,000. In addition, the TVA organization has taken corrective action to prevent any similar schemes.



Investigations

- A TVA employee was previously terminated for having personal travel expenses paid by TVA. The former TVA employee entered a pretrial diversion agreement subsequent to being charged with theft by a state grand jury. The agreement required the former employee to reimburse TVA approximately \$4,100 and to avoid any additional legal issues for a period of two years.

HEALTH CARE RELATED INVESTIGATIONS

Health care fraud has been identified as a major problem across the country, including in government programs. TVA operates a self-insured health care plan, and during



FY 2004 spent roughly \$140 million on health care costs. We have found, however, that fraud by individual providers is usually spread out among many insurance programs, and TVA by itself often does not suffer enough damages to warrant a criminal prosecution. Accordingly, we participate on the Health Care Task Force for the Eastern District of Tennessee, and we seek other opportunities for joint investigations to establish a large enough fraud to warrant prosecution. Results during this reporting period included the following.

- Our investigations determined two pharmacies submitted duplicate claims to the Office of Workers' Compensation Program when they converted from paper to electronic claims. They each reimbursed TVA the overpayment, totaling about \$50,000.
- Three individuals were sentenced as a result of investigations conducted in conjunction with the Health Care Task Force for the Eastern District of Tennessee. In one case involving billings for medical services not rendered, two individuals were sentenced to prison terms of 34 months and 60 months, followed by 3 years' probation, and ordered to make restitution totaling over \$1.3 million. In another Task Force case involving the unlawful distribution of controlled substances, the final two of six defendants were sentenced, respectively, to 18 months' imprisonment, 3 years' probation, and a \$1,200 assessment; and 27 months' imprisonment, 3 years' supervised release, and a \$100 assessment.



ENVIRONMENTAL INVESTIGATIONS

As a result of an investigation conducted in conjunction with the East Tennessee Environmental Crimes Task Force, two individuals employed by a wastewater treatment facility pled guilty to state water pollution charges. Both individuals were sentenced to two years' probation and fined a total of approximately \$2,800.

EMPLOYEE CONDUCT

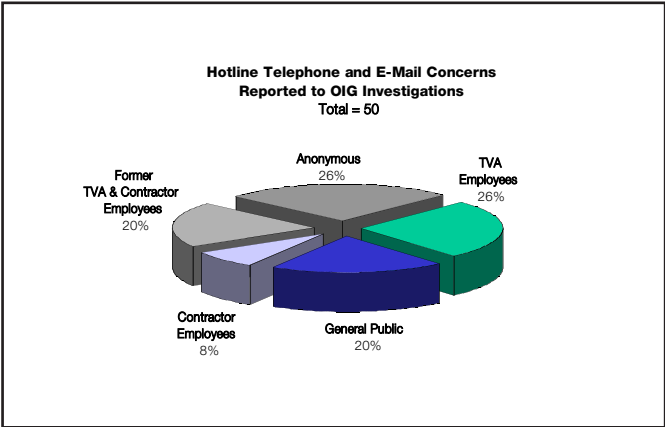
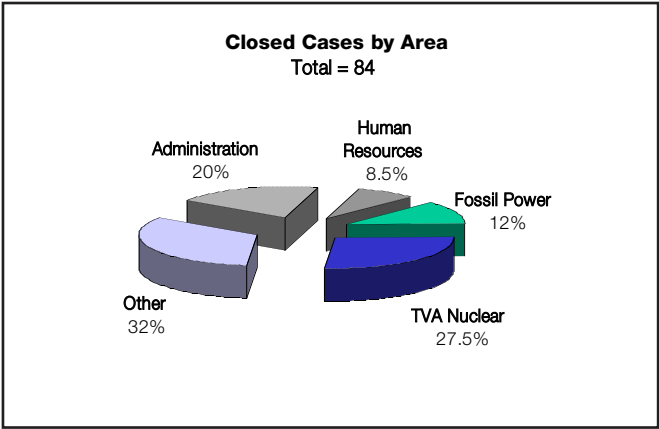
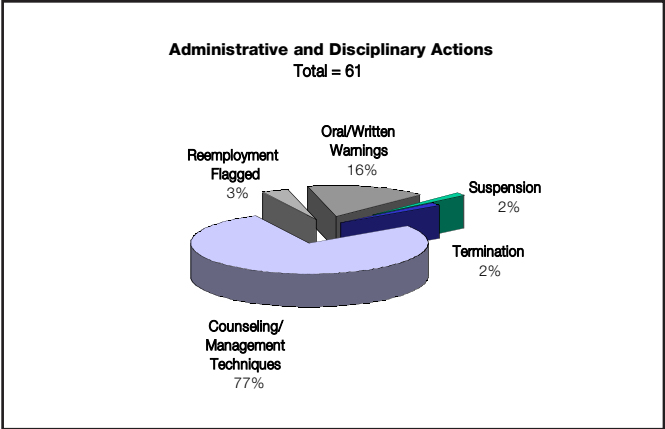
We evaluate each misconduct allegation we receive to determine if it meets the threshold to warrant an investigation. We generally investigate potentially criminal matters or allegations involving senior TVA managers. In other cases, we often decide it would be more appropriate to refer the matter to the Designated Agency Ethics Official or an appropriate level of TVA management for corrective action. Factors we consider in deciding whether to refer a matter to management include the potential monetary amount involved, the risk to TVA, the nature of corrective action required if substantiated, and the likelihood that management can resolve the matter. We have found management to be responsive to referred issues, and we track each referral to ensure appropriate action is taken. Illustrative investigations and management referrals are outlined below.

- Our investigations did not substantiate several allegations of reprisal for raising safety concerns or providing information to the OIG and Nuclear Regulatory Commission. In one of those cases, however, we determined a contractor supervisor made comments that could be interpreted as inappropriate. The supervisor was counseled.
- Another investigation did not substantiate an allegation that a manager was removed from his TVA position because he raised safety concerns. That investigation did, however, raise questions about TVA's personnel action. The issues involving that employee subsequently were resolved, and the individual returned to work in another TVA organization.



Investigations

- Our investigation found a TVA employee used TVA property and equipment in connection with his outside business and installed pirated software on TVA computer equipment. The employee was suspended for 14 days without pay.
- In response to referrals from this office, management implemented numerous control improvements and counseled several individuals. The identified issues being corrected included computer misuse, contractor monitoring, and vehicle use.





Summary of Representative Inspections

Inspections may be initiated from various sources including: (1) annual project planning, (2) management requests, (3) audit/investigative referrals, and (4) spin-off reviews resulting from an ongoing inspection. During this reporting period, we completed 13 inspections which identified over \$118,000 in questioned costs. We also identified various opportunities for TVA to improve program operations. Highlights of our inspections follow.

TRAVEL EXPENSE REIMBURSEMENT

At the Chief Financial Officer organization's request, we assessed the cost effectiveness of the actual travel expense reimbursement program and the Chief Operating Officer (COO) flat rate reimbursement program. We determined that the COO flat rate method cost about \$115,000 more than the actual expense reimbursement method during a three-month period we reviewed. We also identified control weaknesses, including a lack of system edits to prevent flat rate reimbursements which exceeded the allowable rate, and numerous instances where employee expenses were reimbursed for direct-billed hotel expenses under both methods of travel reimbursement. TVA management is considering appropriate corrective actions.

PHYSICAL AND ENVIRONMENTAL CONTROLS FOR TVA'S DATA CENTERS

We reviewed the physical and environmental controls at two of TVA's data centers to determine the adequacy of (1) physical controls to ensure only authorized access to system resources and (2) environmental controls to appropriately protect computing assets from hazards. We determined both data centers' physical access controls and one data center's environmental controls need improvement. TVA management agreed with the findings and initiated or plans to initiate corrective actions needed to implement our recommendations.



BACKUP CONTROLS FOR TVA'S DATA CENTERS

We reviewed controls pertaining to program and data backup storage and retrieval for TVA's data centers and the physical controls of an off-site storage facility to determine if controls surrounding the backup storage and retrieval process were adequate to ensure ongoing system operation, and if physical and environmental controls were sufficient to protect the off-site facilities from unauthorized access and environmental hazards. We determined that both the (1) storage and retrieval process controls and (2) environmental controls need improvement. Management agreed with our findings and plans to initiate corrective actions.

WORK MANAGEMENT PROCESS

We assessed the extent COO organizations were complying with the work management requirements outlined in COO SPP 7.0, COO Work Management. The work management process includes the "establishment of Program elements required to manage work in a safe, reliable, environmentally conscious, and efficient manner." In general, organizations were complying with the requirement to complete a work package. However, (1) most work package documentation was not retained, (2) inconsistencies exist in the development and use of work packages, and (3) multiple computer applications contribute to inconsistencies. TVA management agreed with our findings and plans to initiate corrective actions.

TVA'S ETHICS REQUIREMENTS/PRACTICES AND INDUSTRY BEST PRACTICES

We reviewed TVA's ethics practices and identified industry best practices which TVA could implement including (1) an ethics committee to oversee the ethics initiative, (2) a communication strategy that ensures all employees have ethics information, (3) requiring all employees to complete ethics training, (4) assessing and rewarding ethical conduct, (5) assessing the extent to which employees accept organizational values and policies, and (6) communicating to all employees that ethics standards are a high priority with top management. We provided this information to the President and COO for his consideration.



WIDOWS CREEK FOSSIL PLANT COAL RECEIPTS ANALYSIS

We compared invoiced vendor/terminal weights to TVA delivered weights for both



Widows Creek Fossil Plant rail and barge coal deliveries. We determined (1) significant variances between vendor/terminal invoiced weights and TVA delivered weights, (2) weights were not recorded for many coal shipments, and (3) delivery weight documentation requirements or retention policy did not exist. Management agreed with our findings and plans to initiate corrective actions. OIG Investigations is reviewing selected trend variances to determine if any warrant further inquiry.



Under the IG Act of 1978, one of the IG's responsibilities is to review legislation and regulations which may have an impact on the economy and efficiency in the administration of the programs and operations of TVA. Accordingly, we follow legislative areas of interest pertaining to the IG community and TVA. The TVA IG, Richard W. Moore, serves on the Legislation Committee for the PCIE, and we worked with the PCIE to provide comments on legislation involving the IG community. In the current reporting period, the TVA OIG followed a number of pieces of proposed legislation including the following:



H.R. 6 Energy Policy Act of 2005

H.R. 1271 Repealing Provision Relating to Privacy Officers

H.R. 2489 Improving Government Accountability Act

S. 394 Open Government Act of 2005

S. 1181 Amending the Freedom of Information Act

S. 1499 Amending the Federal Power Act

APPENDICES



Appendix 1

Index of Reporting Requirements Under the Inspector General Act

REPORTING REQUIREMENT	PAGE
Section 4(a)(2) Review of Legislation and Regulations	32
Section 5(a)(1) Significant Problems, Abuses, and Deficiencies	8-31
Section 5(a)(2) Recommendations With Respect to Significant Problems, Abuses, and Deficiencies	8-31
Section 5(a)(3) Recommendations Described in Previous Semiannual Reports on Which Corrective Action Has Not Been Completed	Appendix 4
Section 5(a)(4) Matters Referred to Prosecutive Authorities and the Prosecutions and Convictions That Have Resulted	Appendix 5
Section 5(a)(5) and 6(b)(2) Summary of Instances Where Information Was Refused	None
Section 5(a)(6) Listing of Audit Reports	Appendix 2
Section 5(a)(7) Summary of Particularly Significant Reports	15-31
Section 5(a)(8) Status of Management Decisions for Audit Reports Containing Questioned Costs	Appendix 3
Section 5(a)(9) Status of Management Decisions for Audit Reports Containing Recommendations That Funds Be Put to Better Use	Appendix 3
Section 5(a)(10) Summary of Unresolved Audit Reports Issued Prior to the Beginning of the Reporting Period	None
Section 5(a)(11) Significant Revised Management Decisions	None
Section 5(a)(12) Significant Management Decisions With Which the Inspector General Disagreed	None
Section 5(a)(13) Information under Federal Financial Management Improvement Act of 1996	None



Audit Reports Issued

AUDIT REPORT NUMBER AND DATE	TITLE	QUESTIONED COSTS	UNSUPPORTED COSTS	FUNDS PUT TO BETTER USE
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CONTRACT

2005-024C 04/21/05	DZNPS - Fossil Maintenance & Supplemental Maintenance Services - Preaward			
2005-030C 06/29/05	G-UB-MK's Proposed Indirect Cost Rates for Extension of Contract - Preaward			\$400,000
2004-012C-02 04/25/05	Stone & Webster Construction, Inc. - BFN Unit 1 Restart	\$1,189,621		995,000
2004-003C-02 05/05/05	Bechtel Power Corporation	2,542,211		
2005-042C 06/09/05	Stone & Webster Construction, Inc. - Excess Costs Billed for Super General Foreman Labor Classification	313,921		
2005-004C-01 06/21/05	Welding Services, Inc.	143,588		
2005-036C 06/24/05	Nol-Tec Systems, Inc. - Preaward			72,000
2005-016C 06/29/05	United States Enrichment Corporation	438,437		244,000
2005-004C-02 07/07/05	Welding Services, Inc. (Nuclear)	420,185		
2005-019C 07/25/05	Stone & Webster Construction, Inc. - Subcontract with Engineered Services, Inc.	103,007	\$99,774	
2005-006C-01 07/29/05	Connecticut General Life Insurance Company (CIGNA Dental)	381,392	40,566	
2005-026C 09/12/05	Stone & Webster Construction, Inc. - Subcontract with Shook & Fletcher	56,023		
2005-048C 09/21/05	The Wackenhut Corporation - Preaward			3,923,500
2005-013C 09/27/05	Day & Zimmermann NPS, Inc.	833,655	387,885	



Appendix 2

Audit Reports Issued

AUDIT REPORT NUMBER AND DATE	TITLE	QUESTIONED COSTS	UNSUPPORTED COSTS	FUNDS PUT TO BETTER USE
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FINANCIAL

2005-037F 05/27/05	Audit of PWC's Review of TVA's FY 2005 Second Quarter Financial Information			
2005-032F-01 06/01/05	Controls Over Receiving and Inspecting Inventory			
2005-023F-01 06/13/05	Controls Over Depreciation Expense & Accumulated Depreciation			
2005-008F 06/14/05	Verizon Wireless Credits			
2005-028F-01 06/15/05	Controls Over Managing Site Material			
2005-015F 06/27/05	Controls Over TVA's Inventory Write-Off			
2005-056F 08/22/05	Audit of PWC's Review of TVA's FY 2005 Third Quarter Financial Information			

INFORMATION TECHNOLOGY

2005-007T 05/02/05	Contractor Workforce Management System			
2005-009T 06/30/05	Review of TVA's Information Factory Application, Access, and General Controls			
2005-012T 06/30/05	Integrated Business System Application, Access, and General Controls			
2005-022T 08/30/05	Security, Test, and Evaluation of the IT Security Data System			
2005-058T 09/15/05	Federal Information Security Management Act Evaluation			



Audit Reports Issued

AUDIT REPORT NUMBER AND DATE	TITLE	QUESTIONED COSTS	UNSUPPORTED COSTS	FUNDS PUT TO BETTER USE
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PERFORMANCE

2004-058F

04/11/05 TVA's Corporate Contribution Program

2005-040F

06/30/05 Agreed-Upon Procedures for
Green Pricing Accreditation Program

2005-003F

07/19/05 *energy right*® Program Payments

TOTAL	29	\$6,422,040*	\$528,225	\$5,634,500**
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* Questioned costs include \$438,437 for unreasonable or unnecessary expenditures not recoverable.

** This figure includes \$3,923,500 identified in preaward audits of proposals for contracts that were not subsequently awarded.



Appendix 3

Audit Reports Issued With Questioned Costs

	NUMBER	QUESTIONED COSTS	
		TOTAL	UNSUPPORTED
A. For which no management decision has been made by the commencement of the reporting period	2	\$1,926,884	\$52,537
B. Which were issued during the reporting period	10	\$6,422,040	\$528,225
Subtotals of A and B	12*	\$8,348,924	\$580,762
C. For which a management decision was made during the reporting period	10**	\$7,050,502	\$93,103
(i) Dollar value of disallowed costs	9	\$4,968,981	\$46,385
(ii) Dollar value of costs not disallowed	7	\$2,081,521	\$46,718
D. For which no management decision has been made by the end of the reporting period	4	\$1,298,422	\$487,659
E. For which no management decision was made within six months of issuance	0	\$0	\$0

* The total number of reports (A+B) differs from the sum of C and D when the same reports contain recommendations with and without management decisions.

** The total number of reports differs from the sum of C(i) and C(ii) when the same reports contain both costs disallowed and not disallowed by management.



Audit Reports Issued With Recommendations for Better Use of Funds

	NUMBER	DOLLAR VALUE
A. For which no management decision has been made by the commencement of the reporting period	1	\$184,000
B. Which were issued during the reporting period	5	\$5,634,500
Subtotals of A and B	6	\$5,818,500
C. For which a management decision was made during the reporting period	5	\$1,895,000
(i) Dollar value of costs agreed to by management	3	\$1,251,000
(ii) Dollar value of costs not agreed to by management	2	\$644,000
D. For which no management decision has been made by the end of the reporting period	1	\$3,923,500
E. For which no management decision was made within six months of issuance	0	\$0



Appendix 4

Audit Reports With Corrective Actions Pending

Final corrective actions on recommendations in two contract compliance audits, three operational audits, four financial audits, and nine IT audits have not yet been fully implemented; however, all are being implemented in accordance with currently established milestones.

AUDIT REPORT NUMBER AND DATE

DESCRIPTION

2001-074T 01/07/02	Application Review of Pegasys This report contained recommendations regarding facility access control. TVA issued a request for proposal for a new access control system in August 2005. A decision on the new system will be made after responses to the proposal are received and evaluated by management.
2002-025T 08/07/02	Security of Windows 2000/Windows XP This report contained recommendations to strengthen environmental and logical controls of TVA's implementation of Windows 2000 and Windows XP. TVA is currently evaluating options for implementation of a login banner for desktops.
2003-004C 03/30/04	A&G Tree Service, Inc. A Contracting Officer's decision was issued in March 2005 that concurred with the audit findings and directed A&G to reimburse TVA for overpayments of \$638,542 under a closed contract. During May 2005, TVA stopped A&G from performing work under a subsequent contract and recovered part of TVA's damages by withholding payment on invoices under the subsequent contract totaling \$88,362. A&G has sued TVA under the subsequent contract for the withheld payments but has not yet appealed the Contracting Officer's decision. A&G has until March 2006 to appeal that decision.
2003-015F 07/28/03	Review of Completed Plant Retirements This report contained recommendations to correct completed plant retirement inaccuracies, improve accounting for completed plant retirements, and strengthen management's controls over retirements processing. TVA management notified the OIG on October 14, 2005, that planned actions had been completed.
2003-024F 11/18/03	Review of TVA's Accounts Receivable and the Allowance for Doubtful Accounts This report contained recommendations to (1) develop, document, and implement guidelines for estimating the allowance for doubtful accounts; (2) ensure reconciliation of the general ledger and subsidiary accounts include documentation of corrections and adjustments made during power and nonpower reconciliations and management review and approval of all nonpower adjusting journal entries; (3) make modifications to the write-off process to ensure invoices are written off in a timely manner; (4) develop and implement procedures to track written off accounts for future collection efforts or business decisions; (5) ensure accounts are written off in accordance with policy; and (6) review and update Accounting Procedure 25 to clarify the criteria for referring past due customers to the General Counsel's Office. TVA management agreed to implement our recommendations and has transitioned the responsibilities to a new group. Processes and procedures will be evaluated and updated by March 2006, and a new system is planned.
2003-040T 03/30/04	Nuclear Plant IT Security This report included recommendations to strengthen logical and physical controls at a nuclear generation facility. TVA management is implementing planned remediation actions that are expected to be completed November 30, 2006.



Audit Reports With Corrective Actions Pending

AUDIT REPORT
NUMBER
AND DATE

DESCRIPTION

<p>2003-053F-01 06/03/04</p>	<p>Controls for Generation Data in Operations Data Store System and Web Based Data Entry Page This report included recommendations to strengthen controls over generation data in the system. TVA management expects to issue a new policy addressing generation data requirements and each organization's responsibilities by December 2005. Changes to organizations' policies and procedures and necessary system modifications are expected to be completed by March 2006.</p>
<p>2003-054T 11/13/03</p>	<p>Hydro Plant IT Security This report included recommendations to strengthen logical, physical, and management controls over IT assets at a hydroelectric facility. TVA management notified the OIG on October 18, 2005, that planned actions had been completed.</p>
<p>2003-056T 03/18/04</p>	<p>Pre-Implementation Review of TVA's New Fuelworx Application This report included a recommendation to strengthen user access controls. The recommendation will be addressed as part of a TVA-wide effort that is expected to be completed in December 2006.</p>
<p>2003-067P 02/02/04</p>	<p>TVA's Compliance With the National Energy Conservation Policy Act This report included a recommendation to continue to evaluate opportunities to reduce energy consumption including promoting sustainable building design when appropriate. Management plans to implement a new energy process that will address sustainable building design by March 2006.</p>
<p>2004-006F 07/13/04</p>	<p>Public Power Institute This report included a recommendation that TVA develop improved program performance measures. TVA management notified the OIG on October 17, 2005, that planned actions had been completed.</p>
<p>2004-016T-01 12/07/04</p>	<p>Payroll System Controls This report included recommendations to strengthen controls over the payroll process and system. TVA management is implementing planned remediation actions which are expected to be completed by December 31, 2005.</p>
<p>2004-028F 10/22/04</p>	<p>Controls Over Short-Term Trading Activities This report included recommendations to improve the operational effectiveness of certain control activities. TVA management notified the OIG on October 14, 2005, that planned actions had been completed.</p>



Appendix 4

Audit Reports With Corrective Actions Pending

AUDIT REPORT
NUMBER
AND DATE

DESCRIPTION

2004-044C 03/14/05	McCartin McAuliffe Mechanical Contractors, Inc. A Contracting Officer's Decision was issued in August 2005 which agreed with the audit findings. McCartin has 90 days (or until November 4) to appeal the Decision to the TVA Contract Board of Appeals. If they do not appeal to the TVA Board of Appeals, they have until August 2006 to file in federal court.
2004-051F 01/24/05	Convenience Check Program This report included recommendations that TVA management institute actions to ensure compliance with TVA's convenience check procedure and accounting procedure. TVA management plans to complete actions by November 30, 2005.
2004-059T 11/24/04	Pre-Implementation Review of Security of New Servers for IBS, Fixed Assets, and BOSS Applications This report included recommendations that TVA management take action to improve the security of the servers. TVA management is expected to complete planned remediation actions by September 30, 2006.
2004-060T 11/19/04	IT Security Review of New Servers for HR and PR Applications This report included recommendations that TVA management take action to improve the security of the servers. TVA management is expected to complete planned remediation actions by September 30, 2006.
2005-001T 11/19/04	Vulnerability Assessment on Solaris Standard Image This report included recommendations to strengthen controls within the standard solaris image. TVA management is expected to complete remediation by December 31, 2005.



Investigative Referrals and Prosecutive Results*

Referrals

Subjects Referred to U.S. Attorneys	6
Subjects Referred to State/Local Authorities	2

Results

Subjects Indicted	4
Subjects Convicted	5
Referrals Declined	6
Other (Pretrial Diversion)	1

* These numbers include task force activities.



Highlights

	SEPT 30, 2005	MAR 31, 2005	SEPT 30, 2004	MAR 31, 2004	SEPT 30, 2003
ANNUAL BUDGET (In Millions of Dollars)	\$9.1	\$9.1	\$8.8	\$8.8	\$8.5
CURRENT STAFFING	85	80	82	78	78

AUDITS

AUDITS IN PROGRESS

Carried Forward	30	28	29	37	38
Started	41	35	38	36	41
Canceled	(11)	(2)	(5)	(5)	(8)
Completed	(29)	(31)	(34)	(39)	(34)
In Progress at End of Reporting Period	31	30	28	29	37

AUDIT RESULTS (Thousands)

Questioned Costs	\$6,422	\$8,859	\$1,763	\$14,127	\$1,908
Disallowed by TVA	4,969	7,586	2,948	10,453	137
Recovered by TVA	5,016*	2,312	1,113	697	3,499

Funds to Be Put to Better Use	\$5,634	\$24,306	\$1,471	\$11,904	\$6,951
Agreed to by TVA	1,251	20,181	7,021	5,800	6,551
Realized by TVA	6,002	7,886	7,196	11,708	0

OTHER AUDIT-RELATED PROJECTS

Completed	10	3	8	30	15
Cost Savings Identified/Realized (Thousands)	\$0	\$0	\$0	0	0

INVESTIGATIONS**

INVESTIGATION CASELOAD

Opened	84	84	118	162	100
Closed	84	103	163	76	92
In Progress at End of Reporting Period	157	157	176	221	135

INVESTIGATIVE RESULTS (Thousands)

Recoveries	\$1,880.3	\$216.3	\$460	\$3,412	\$100
Savings	36	1,581.5	447.7	863	875
Fines/Penalties	6.7	.4	451.6	10	421

ADMINISTRATIVE AND DISCIPLINARY ACTIONS

Recommended (# of Cases)	10	11	14	8	21
Actions Taken (# of Subjects)	13	16	30	75	24
Counseling/Management Techniques Employed (# of Cases)	16	12	16	13	21

PROSECUTIVE ACTIVITIES (# of Subjects)

Referred	8	12	25	17	63
Indicted	4	3	9	3	4
Convicted	5	4	3	3	10

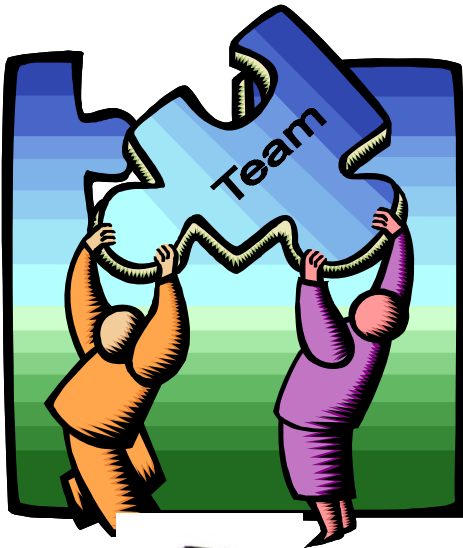
INSPECTIONS

Completed	13	14	8		
Cost Savings Identified/Realized (Thousands)	\$118	\$0	\$226		

* Includes excess funds recovered by TVA of \$33,219.

** These numbers include task force activities.

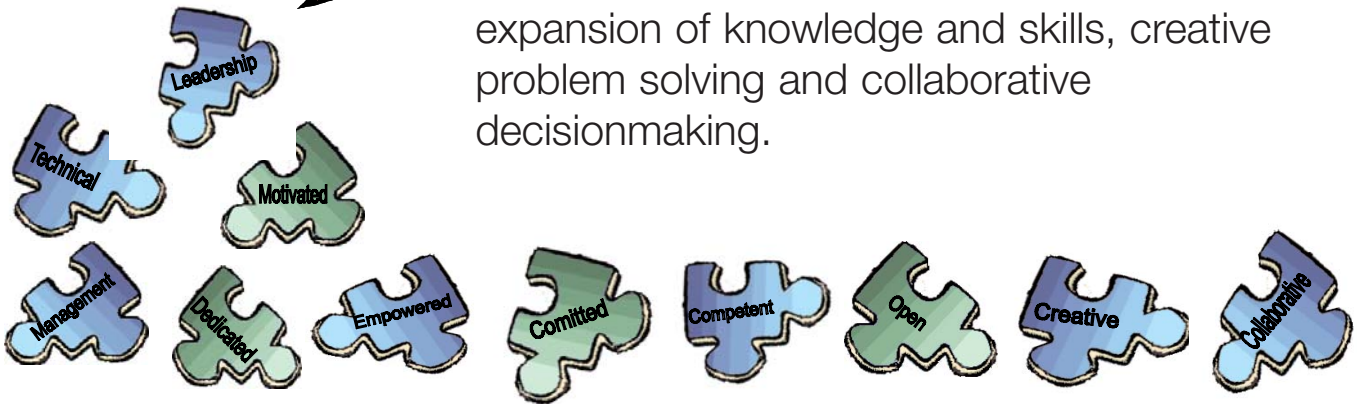
OIG LEADERSHIP PHILOSOPHY



The TVA OIG strives to be a high performing organization made up of dedicated individuals who are empowered, motivated, competent, and committed to producing high quality work that improves TVA and life in the Valley.

Each of us has important leadership, management, team, and technical roles.

We value integrity, people, open communication, expansion of knowledge and skills, creative problem solving and collaborative decisionmaking.





OFFICE OF THE INSPECTOR GENERAL OF THE TENNESSEE VALLEY AUTHORITY
400 WEST SUMMIT HILL DRIVE
KNOXVILLE, TENNESSEE 37902-1401