



Memorandum from the Office of the Inspector General

June 14, 2007

Tom D. Kilgore, WT 7B-K

**REQUEST FOR FINAL ACTION – SPECIAL PROJECT 2007-016F – REVIEW OF
TVA'S ETHICS AND COMPLIANCE PROGRAM**

Attached is the subject final report for your review and final action. Your written comments, which addressed your management decision and actions planned, have been included in the report. Please notify us when final action is complete.

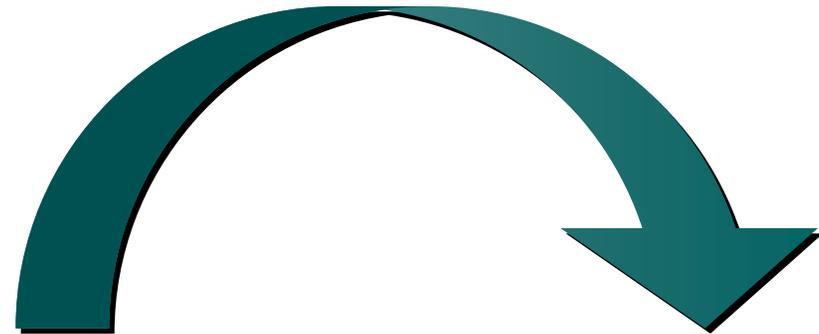
Information contained in this report may be subject to public disclosure. Please advise us of any sensitive information in this report which you recommend be withheld.

If you have any questions, please contact Lisa H. Hammer, Director (Acting), Financial and Operational Audits, at (865) 632-4731 or me at (865) 632-6309. We appreciate the courtesy and cooperation received from your staff during the review.

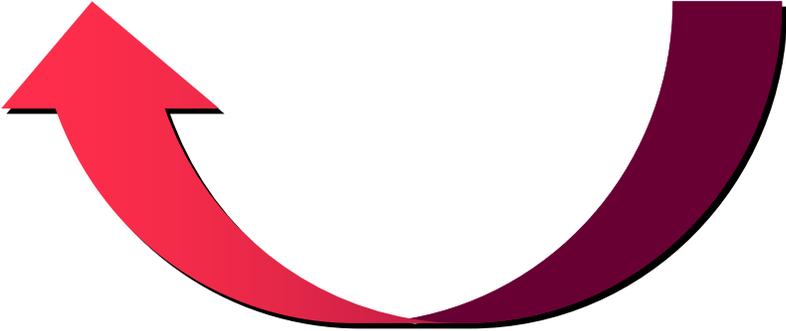
Ben R. Wagner
Assistant Inspector General
(Audits and Inspections)
ET 3C-K

LHH:SDB
Attachment
cc (Attachment):

Maureen H. Dunn, WT 6A-K
Peyton T. Hairston, Jr., WT 7B-K
Richard W. Moore, ET 4C-K
Emily J. Reynolds, OCP 1L-NST
OIG File No. 2007-016F



Ethics and Compliance Assessment for TVA



Objective, Scope and Methodology

- **Objective**
 - Conduct a program evaluation of TVA's current Ethics and Compliance Program and compare to leading practices in publicly traded companies.
- **Scope and Methodology**
 - Reviewed relevant program documentation;
 - Interviewed key executives; and
 - Compared TVA activities to leading practices.

Definitions

- **Ethics:** The standards for overall good behavior of both individuals and the organization, based on generally accepted views of correct behavior and the fair treatment of others, i.e., “the spirit of doing the right thing.”
- **Compliance:** The fulfilling of specific requirements, frequently defined by an outside authority, i.e., “following the letter of the law or regulation.”

Why Do Organizations Need Ethics Programs?

- The immediate need:
 - Significant business scandals generated public reactions.
 - The U.S. government responded: Sarbanes-Oxley (SOX), amendments to the Federal Sentencing Guidelines for Organizations, more regulations, increased regulatory resources.
 - Greater scrutiny of business behavior: the public now distrusts “big business.”
 - The impact of unethical behavior is magnified by instant, wide-ranging communications.
 - Reputations can be damaged immediately.
- The long-term benefits:
 - Most people want to do the right thing – ethical organizations attract good people.
 - The evidence is in – good organizations outperform their peers in *business* measures over time.
 - Our free market system operates on trust, and trust makes business/commercial efforts both more effective and more efficient.

Background



Summary of Observations

- TVA's current ethics and compliance program has many pockets of activities that, in themselves, appear to be well managed.
- However, a centralized and more broadly defined program would provide a coherent approach to address these key elements:
 - Creating a more extensive ethics program
 - Training and communications
 - Principles to guide behavior
 - Reviewing and tracking ethics issues
 - Organizing a corporate approach to ethics and compliance

I. Creating a More Extensive Ethics Program

Training and Communications

Leading Practice	Observations at TVA	Recommendation
<p>An effective ethics training program reaches all employees.</p>	<p>TVA's ethics training is presently driven by the requirements of the Office of Government Ethics (OGE). The Annual Ethics Training module (2005) from the Office of the General Counsel (OGC) is a computer-based method of instruction. While the module briefly mentions general principles, it focuses primarily on three rules: gift acceptance, conflicts of interest, and use of resources. OGC advised that approximately 20 percent of the TVA officer/employees population take this ethics training.</p>	<p>Develop and deliver ethics training to <i>all</i> officers and employees, using both facilitated and computer-based training. The training should address basic principles to guide behavior and apply those principles in real-life scenarios from the work environment. In addition to this organization-wide training, further emphasize basic ethics training in new hire orientation.</p>
<p>Key attributes ("integrity," "character") are integrated in personnel processes (hiring, performance management, rewards).</p>	<p>Interviews with senior management showed TVA approaches hiring in a deliberate manner, with background checks, references, and interviews. TVA could incorporate more behavior-based interviewing techniques to probe character as part of the hiring process. Regarding performance evaluations, TVA indirectly incorporates some aspects of ethical behavior in its performance management process, such as references to the Winning Behaviors. However, the emphasis on Winning Behaviors appears to emphasize getting along with others, as opposed to applying core values that help the enterprise succeed.</p>	<p>Commitment to basic TVA values should be explicitly incorporated into all performance evaluation tools. Behavior-based interviewing techniques should be taught for all hiring interviews to probe for ethical behavior. All rewards and promotions should be reviewed for consistency regarding ethical behavior.</p>

I. Creating a More Extensive Ethics Program

Training and Communications (cont'd)

Leading Practice	Observations at TVA	Recommendation
<p>A core message links ethical behavior to overall organizational success.</p>	<p>As a federal agency, TVA must use the OGE <i>Standards of Conduct for Employees of the Executive Branch</i> (Standards). While the Standards provide specifics related to gifts, conflicts of interest, and use of resources, the Standards do not articulate a broader commitment to ethical behavior or the practical reason for such a commitment. TVA's New Employee Experience (NEE) curriculum for TVA employees links the goal, <i>Achieve Excellence in Business Performance and Public Service</i>, to the 6 strategic objectives and 12 critical success factors, one of which relates generally to ethical behavior. <i>TVA Employment Practice 1 Business Ethics</i> states that "ethical business practices increase TVA's efficiency and integrity by leading to sound business decisions and improved internal operations." (However, other frequent references to values tend to emphasize "getting along," as opposed to "accomplishing the mission." That is why the link to overall success should receive more emphasis.)</p>	<p>In its statements about ethical conduct, TVA should strengthen the connection between ethical behavior and overall organizational success by consistently stating that ethical behavior is a key factor in fulfilling the mission of TVA.</p>

I. Creating a More Extensive Ethics Program

Training and Communications (cont'd)

Leading Practice	Observations at TVA	Recommendation
<p>Robust processes exist for the raising of ethical issues by employees.</p>	<p>Employees currently have several methods through which to raise ethical issues, such as Human Resources (HR), the TVA Ombudsman, OGC, chain of command, and/or Office of the Inspector General (OIG) EmpowerLine. EmpowerLine is communicated through posters and through the current NEE materials. However, the Annual Ethics Training for selected employees does not discuss the availability and use of EmpowerLine nor how managers and supervisors should address issues raised by subordinates. Since ethics training is not mandatory for all employees, training is not currently a channel to disseminate information on use of the hotline on a broad basis.</p>	<p>Communicate the availability and use of all channels to raise ethical issues. Incorporate discussion of channels and how to manage raised issues in expanded ethics training.</p>

I. Creating a More Extensive Ethics Program

Training and Communications (cont'd)

Leading Practice	Observations at TVA	Recommendation
New hire orientation emphasizes the importance of ethical behavior.	TVA's NEE is a well-structured program to orient new employees. Many of the NEE's messages, particularly the "Committed to Excellence" section, touch on underlying organizational values (the foundation of ethical behavior), but there is little emphasis on how a commitment to these values contributes to organizational success. While the NEE booklet refers to ethics, the references are to specific rules rather than to guiding principles or values. In addition, none of the introductory courses that are part of new hire orientation address ethical standards.	In new hire orientation, make explicit references to organizational values and how ethical behavior is crucial to organizational success. A senior leader from TVA should personally discuss values with new employees. A course in ethics should be developed to include in the introductory courses for new hires.

I. Creating a More Extensive Ethics Program

Principles to Guide Behavior

Leading Practice	Observations at TVA	Recommendation
<p>The Code of Conduct is expressed in concise form (principles-based) and tied to mission and culture.</p>	<p>As a federal agency, TVA must use the OGE Standards. These Standards provide a statement of basic obligation to the public and 14 general principles but primarily contain detail about specific rules. Any changes or additions to the Standards must be approved by OGE.</p>	<p>TVA should distill the 14 general principles of the Standards into a one-page summary that is easy to remember and clearly linked to the success of TVA's mission.</p>
<p>The Code of Conduct contains a non-toleration clause (i.e., employees have an <i>obligation</i> to report unethical behaviors. Failure to report these violations would be a violation of the Code of Conduct and therefore subject to disciplinary action to include termination of employment).</p>	<p>There is no non-toleration clause in the OGE Standards nor could a non-toleration clause be identified in the reviewed TVA documents.</p>	<p>At a minimum, TVA should emphasize the importance of individuals identifying and raising ethical issues to protect the operations and reputation of TVA, as well as the consequences of not reporting.</p>

I. Creating a More Extensive Ethics Program

Principles to Guide Behavior (cont'd)

Leading Practice	Observations at TVA	Recommendation
Management links basic principles to business decisions, when applicable.	Interviews with TVA senior management revealed that this approach was understood and valued but unevenly practiced.	TVA executives should communicate when ethical issues have influenced business decisions and should coach managers and supervisors to do likewise.
Basic principles are communicated to business partners (vendors, customers, etc.).	TVA communicates basic principles to selected business partners. For example, the <i>TVA Supplier Code of Conduct</i> , January 2005 is a good summary of expectations and includes references to the use of the OIG hotline.	In addition to the <i>TVA Supplier Code of Conduct</i> , suppliers should be provided with a condensed version of the TVA Code of Conduct in order to better facilitate the communication of basic expectations for the conduct of all business partners.

II. Reviewing and Tracking Ethical Issues

Leading Practice	Observations at TVA	Recommendation
<p>Ethical issues and trends are addressed by management and compared to emerging information from more specific activities, such as fraud prevention, controls, and testing to help identify “hotspots.”</p>	<p>Senior managers interviewed stated that contract management and safety reporting were activities where there could be pressure for employees to make bad ethical decisions. Confidentiality of investigations was also viewed as limiting the ability to learn from incidents across the organization. One executive expressed the desire to “figure out” how to respect confidentiality while enabling him to benefit from examples of emerging issues in other parts of TVA.</p>	<p>TVA senior leadership should periodically identify several current activities where the probability of bad ethical judgment is highest. These activities may or may not be common across different business units or functions. These areas should receive focused attention on metrics/reporting, training, and audit, as well as on the exercise of basic preventive actions (job or client rotation, targeted training, spot checks, formal controls). Emerging issues and ongoing investigations from these areas should be tracked as part of the management process.</p>

II. Reviewing and Tracking Ethical Issues

Leading Practice	Observations at TVA	Recommendation
<p>Raised issues are addressed systematically. High-level decisions taken on ethical matters are disseminated to the organization.</p>	<p>According to the TVA senior managers interviewed, issues are assigned to different “silos” (OIG, OGC) for investigation, with no central tracking of issues. Senior executives remarked on the lack of a consolidated report of issues.</p>	<p>Create a process for centrally tracking ethical issues from initial identification to resolution. These tracked issues can be summarized and trended for reporting to executive management and the Board on a consistent basis. In addition, the information on ethical issues should be shared across business units, so operational leaders are aware of issues arising in other business units and can be alert for similar issues in their units. Each issue should also be evaluated to effectively communicate the issue and resolution to the organization at large (with adequate provisions for privacy considerations).</p>

III. Why the Trend to Move Ethics and Compliance Out of the General Counsel's Office?

- The roles and skills are different:
 - Managing ethics and compliance requires “baking” actions and behaviors into business activities. Ethics and compliance is fundamentally a *management* effort.
 - The General Counsel represents and protects the organization as a legal entity. This is a highly *specialized* role.
- A separation of duties benefits the organization:
 - The tools of the legal process, such as attorney-client privilege, should be used in a targeted way, not broadly.
 - The General Counsel, like Internal Audit, is a specialized group that can assist in independently evaluating the effectiveness of the Ethics and Compliance Programs.

III. Why the Trend to Oversee Compliance on a More Centralized Basis?

- Senior leaders see themselves today as more accountable for compliance (due to SOX, Federal Sentencing Guidelines for Organizations, public demands, and visible “bad” examples).
- When the management of compliance is too decentralized in silos, emerging issues may not see the full “light of day.”
- Lateral communications of issues across business units are highly beneficial:
 - Issues emerging in one unit can alert other units of the issue.
 - Reactions to emerging issues can become more uniform.
 - Best practices can be communicated quickly.
- Central oversight of compliance does NOT mean diluting expertise, accountability, or responsibility in a business unit (e.g., compliance expertise in the nuclear and fossil fuel business units).
- The trend: Compliance Program Management at the corporate level.

III. Background, Expanded



III. Organizing a Corporate Approach to Ethics and Compliance

Leading Practice	Observations at TVA	Recommendation
<p>The organization's Chief Ethics and Compliance Officer (CECO) possesses sufficient organizational credibility and influence to manage and address emerging issues and to coordinate with business unit and functional leaders.</p>	<p>Like the vast majority of federal agencies, TVA has its Designated Agency Ethics Officer (DAEO) reporting to the General Counsel. The role of the DAEO is also a part-time duty for the Assistant General Counsel. There is no corporate CECO.</p>	<p>Establish the position of CECO, reporting to Chief Executive Officer with a dotted line to the Audit Committee. The CECO would be responsible for:</p> <ul style="list-style-type: none"> • Directing the ethics program as the DAEO and coordinating the compliance programs across TVA. • Inventorying the various compliance demands that guide TVA's business activities. • Sharing ethics and compliance issues and actions across business. • Identifying different areas of expertise within TVA that must keep current with regulations and regulatory decisions. • Coordinating with ethics and compliance officers in business units (dotted line to the corporate CECO). • Chairing the Ethics and Compliance Management Group that brings together the functions (e.g., Finance, HR) and business units to review and trend ethics and compliance issues. • Reporting to executive leadership and the Board.

III. Compliance Program Management – Leading Practices

The leading practices on the following pages guide corporate CECOs in managing an organization’s compliance. Adoption of these leading practices would enable TVA to “stay ahead” of compliance requirements, disseminate essential compliance insights across TVA, and achieve a coherent approach to compliance throughout the entire organization.

Based on interviews with TVA management and review of TVA documentation, TVA is already engaged in leading practices in highly regulated areas, such as TVA Nuclear and TVA Fossil Power Group.

III. Compliance Program Management – Leading Practices

- The corporate CECO coordinates the management of compliance and the sharing of information across the corporation through a compliance management group.
 - At the corporate level, all key functional leaders (Finance, Marketing, Information Technology, HR, General Counsel, Internal Audit, etc.) and representatives from the business units coordinate the approach to compliance and benefit from comparing issues.
 - Coordination fosters identification of compliance “hotspots,” areas that could require concentrated efforts and corporate attention.
 - Compliance performance expectations are integrated into routine processes, such as hiring and staffing criteria, job descriptions, performance evaluations, and rewards/recognition.

III. Compliance Program Management – Leading Practices

- Inventory and prioritize compliance requirements.
 - Extensive “waterfront” of various and varied compliance requirements is captured at the corporate level.
 - Compliance responsibilities are clearly assigned to functional and business unit leaders.
 - Compliance requirements are prioritized by risk within each major compliance grouping.
- Map requirements to processes, roles, and tasks.
 - Compliance requirements are clearly defined for all business processes, down to specific tasks.
 - Compliance requirements are identified for each specific role.
 - Technology is employed where applicable to facilitate integration of compliance requirements to business activities.

III. Compliance Program Management – Leading Practices

- Compliance Training
 - From the mapping of compliance requirements to business activities and roles, compliance training is structured by job position.
 - A detailed plan for compliance training is established and linked to the company's training system.
 - Compliance training is tracked and enforced. In high-risk, high-visibility activities, compliance training is set as a pre-condition to perform in a given role.
 - Compliance training is assessed and upgraded as needed, especially in light of new or altered regulations or court decisions.

III. Compliance Program Management – Leading Practices

- Compliance structure and accountability – integrate compliance into basic operations.
 - Functional leaders have clearly defined accountabilities and responsibilities (i.e., center of expertise, updates, voice to regulators, setting performance standards, monitoring controls and testing, reporting).
 - Business unit leaders have clearly defined accountabilities and responsibilities (i.e., setting and enforcing performance standards, executing controls and testing, reporting, raising issues).

Management's Comments and Our Evaluation

TVA's President and Chief Executive Officer agreed with our recommendation to establish the position of Ethics and Compliance Officer and indicated implementation details would be addressed after the appointment. We concur in the proposed actions.