



Memorandum from the Office of the Inspector General

June 28, 2007

Paul R. LaPointe, WT 3A-K

FINAL AUDIT 2007-020F – REVIEW OF SURPLUS MATERIAL

As part of our annual audit plan, we reviewed the processes related to identifying and managing surplus materials to determine if surplus material is identified and managed in accordance with TVA policies and procedures. In summary, we found:

- Inconsistencies in the methods used to identify surplus.
- Surplus inventory overages totaling \$58,756 and inventory shortages totaling \$617,524 at the Hartsville facility.
- Receipts of surplus material redeployed from Hartsville to a facility are not being completed or cancelled in PassPort in a timely manner.
- Discrepancies between actual bids and awarded bids for the April 2006 sealed bid auction.

We recommend (1) Procurement management ensure compliance with process documentation related to identification of surplus materials,¹ (2) Investment Recovery (IR) personnel ensure the accuracy and completeness of the information in PassPort related to the locations and quantities of the surplus material at the Hartsville facility, (3) Procurement management ensure transfers are completed in PassPort in a timely manner, and (4) IR management ensure the accuracy and completeness of the sealed bid process.

Procurement management stated they had (1) received confirmation from each Site Procurement Manager that they are complying with process documentation related to identification of surplus material, (2) corrected all items addressed in the draft audit report related to accuracy of surplus inventory, (3) planned to issue a reminder to Site Procurement Managers regarding the timely completion of transfers in PassPort, and (4) established guidelines to ensure the completeness and accuracy of the sealed bid process. See Appendix B for TVA management's complete response.

¹ During our review, TVA Procurement management reiterated to Site Procurement Managers the need to comply with process documentation and policy requirements by using the designated reports to identify surplus.

BACKGROUND

TVA's Procurement organization has responsibility for identifying and managing surplus materials. TVA Procurement's Materials Management Services is responsible for identifying potential surplus material and utilizing surplus when available. Procurement's IR group is responsible for the management and disposition of surplus material. Materials Management personnel at each site are responsible for managing site inventory, including identifying potential items for surplus and utilizing surplus materials when available. Plant personnel determine if the item is surplus material based on the criteria in TVA's Inventory Management Policy. Surplus material is sent by the plant to the Hartsville Investment Recovery Center (Hartsville). When surplus material arrives at Hartsville, the IR personnel count and receive the material and then enter the appropriate information in PassPort. Upon receipt,² IR personnel develop a strategy for disposing of the material to reduce inventory carrying costs. Methods of material disposition include redeployment, selling, donating, and disposing.

As of February 2007, TVA Nuclear reported write-offs totaling \$438,000 and redeployments totaling \$748,000 of surplus material. Fossil facilities reported write-offs and redeployments of \$721,000 and \$614,000, respectively, during the same period. Records of TVA's surplus materials are maintained in TVA's Inventory Management System, PassPort. Based on information in PassPort as of February 21, 2007, TVA's surplus material³ at Hartsville was approximately \$40 million.

FINDINGS AND RECOMMENDATIONS

We reviewed processes related to identifying and managing surplus materials to determine if surplus material is identified and managed in accordance with TVA policies and procedures. In summary, we found:

- Inconsistencies in the methods used to identify surplus.
- Surplus inventory overages in the amount of \$58,756 and shortages in the amount of \$617,524 at Hartsville.
- Receipts of surplus material redeployed from Hartsville to a facility are not being completed or cancelled in PassPort in a timely manner.
- Discrepancies between the actual bids and the awarded bids for the April 2006 sealed bid auction.

² The responsibility of receiving surplus material in PassPort transferred from plant personnel to IR personnel in April 2006.

³ Surplus material is valued based on average unit price (AUP).

IDENTIFICATION OF POTENTIAL SURPLUS MATERIALS

We visited Colbert Fossil Plant (COF), Cumberland Fossil Plant (CUF), Watts Bar Nuclear Plant (WBN), and Widows Creek Fossil Plant (WCF) and observed various methods used to identify surplus material. For example, COF and WCF relied on walk-downs,⁴ craft labor personnel, and/or equipment replacement to identify surplus material, while CUF and WBN relied on a report which identifies potential surplus based on activity. Process documentation for the Manage Site Inventory process requires the use of a “report of no receipt or issue by last activity date” to identify potential surplus material. During our review, TVA Procurement management reiterated to Site Procurement Managers the need to comply with process documentation and policy requirements by using the designated reports to identify surplus.

SURPLUS INVENTORY

As of February 21, 2007, surplus materials at Hartsville totaled approximately \$40 million for more than 28,589 Catalog Identification Numbers (CAT IDs) as listed in PassPort. Material Management System (MMS) 3.0 – Inventory Accuracy Policy provides guidance for “ensuring the accuracy of TVA materials and supplies inventory.” We conducted a physical inventory of 134 surplus CAT IDs totaling approximately \$5.2 million based on the stratified sample described in the attachment. We identified \$58,756 in material overages and \$617,524 in material shortages. We were unable to determine the correct quantity for six of the 134 selected CAT IDs totaling \$1,152,580 because the material was not properly labeled. We also found 24 CAT IDs with a value of \$726,901 that were stored in a location other than that listed in PassPort. Based on our sample, we are 97.5 percent confident that quantities and/or locations of at least 16.4 percent of CAT IDs in PassPort are incorrect. We found that 21 CAT ID location errors were subsequently corrected in PassPort. The remaining three were shown as either transferred to another facility or sold and therefore are no longer considered an issue.

PURCHASES OF PREVIOUSLY SURPLUS INVENTORY

Prior to purchasing new material, TVA plant personnel are required by MMS 2.0 – TVA Inventory Management Policy to utilize surplus material to satisfy needs for material requests. We tested compliance with this policy by selecting a sample of CAT IDs listed in PassPort as surplus inventory at Hartsville. We compared 124⁵ of the CAT IDs inventoried above to purchases listed in PassPort for the same materials. We found 16 CAT IDs that had been previously declared surplus were later purchased. Of those 16 CAT IDs, four were purchased while available at Hartsville. However, the purchases made up less than one percent of the total value of sampled inventory and were considered immaterial.

⁴ Engineering and maintenance personnel walk through storage areas to identify surplus material based on their professional experience.

⁵ We did not select the 10 CAT IDs with a value of \$0.

TRANSFERS OF SURPLUS MATERIALS

During our physical inventory at Hartsville, we noted CAT IDs in an incomplete transfer status. MMS 1.0 – Material Receipt/Inspection, Material Storage and Handling, Material Issue, Control, and Return Policy states “the receipt transaction should be entered into PassPort within fifteen (15) working days of the dock date, including unsatisfactory receipt inspections (OSD&D).” We selected ten items with a total value greater than \$10,000 each to determine the length of time the material had been in transfer status. We found all ten were redeployments from Hartsville to a facility. Two had been in transfer status since fiscal year (FY) 2005, two since FY06, and the remaining six had been in transfer status since December 2006. We contacted the appropriate Site Procurement Manager to determine status and obtain explanation. Specifically, we found:

- Six of the items with a total value of more than \$500,000 related to an incomplete transfer to Kingston Fossil Plant (KIF). The transfer was originally initiated in December 2006; however, the e-mail requesting the material be transferred was dated July 2006. In September 2006, TVA’s Chief Financial Officer’s organization changed its SPP 13.8 Accounting for Materials and Supplies Inventories policy to allow items to be redeployed at \$0 versus the total value. When the transfer was completed in March 2007, KIF’s inventory was affected by \$1⁶ instead of \$500,000 which would have been the case if the transfer was completed in July 2006.
- Two items were not received at Browns Ferry Nuclear Plant (BFN) due to quantity discrepancies. According to the Manager Warehouse Operations, BFN, the items were probably originally sent to Hartsville in incomplete condition. One of the two transfers was initiated in April 2005 and the other was initiated in August 2005.
- One item could not be received at Sequoyah Nuclear Plant (SQN) because the kit included a lubricant which was not on the approved chemical list for SQN. The transfer was initiated in December 2005 and is now being cancelled.
- The remaining item was not received at BFN because it appeared to be damaged. The transfer was initiated in September 2006.

We also noted transfers to Hartsville will affect the FY07 WP Net Margin indicator for each fossil plant. However, redeployments do not impact the FY07 Net Margin indicator due to the policy change allowing items to be redeployed at \$0 versus the total value.

DISPOSITION OF SURPLUS MATERIAL

TVA’s Disposal of Surplus policy “establishes a guideline and purpose on how Investment Recovery (IR) disposes of TVA surplus.” The policy states the two most advantageous methods of disposition are redeployment (discussed above) and selling. Periodically, TVA IR will dispose of surplus inventory through a sealed bid auction which is available to the public. All acceptable bids are documented by IR personnel. When bidding is closed, IR personnel award the lots to the highest bids.⁷ We reviewed the documentation related to the auction completed in April 2006 and found:

⁶ As of the date of the transfer, PassPort would not accept a transfer at \$0; therefore, \$1 was used.

⁷ IR reserves the right to reject any bid.

- Two auction lots were awarded to a bidder who had not submitted a bid for the lots. As a result, no sale occurred. The actual winning bids for the two lots totaled \$125; however, they were not awarded to those bidders due to the error.
- Three bids were not documented by IR personnel. One of the three bids was a winning bid that would have resulted in an additional \$43.48 being received for the lot.
- One instance where a tie for the highest bid occurred. One of the bidders was awarded the bid; however, we found no justification for awarding the lot to one bidder over the other.

RECOMMENDATIONS

We recommend (1) Procurement management ensure compliance with process documentation related to identification of surplus materials; (2) IR personnel ensure the accuracy and completeness of the information in PassPort related to the locations and quantities of the surplus material at the Hartsville facility; (3) Procurement management ensure transfers are completed in PassPort in a timely manner; and (4) IR management ensure the accuracy and completeness of the sealed bid process.

Procurement Management's Response and Our Evaluation – In their response to our draft audit report (see Appendix B), Procurement management concurred with all of our recommendations. Specifically, Procurement management stated:

- (1) Written confirmation has been received from each Site Procurement Manager that they are complying with process documentation related to identification of surplus material. Procurement management has established a follow-up date to ensure compliance.
- (2) All items addressed in the draft audit report related to location and quantity have been corrected by IR. According to Procurement management, the items identified in the report were sent to Hartsville prior to FY06. Prior to FY06, surplus material sent to Hartsville by TVA plants was not "procedurally required to be verified by IR." Procurement management stated that the "Hartsville Site Plan," initiated in FY06 and scheduled to be completed in FY08, will correctly identify locations and quantities of all material located at Hartsville.
- (3) A reminder will be issued to Site Procurement Managers regarding the timely completion of transfers in PassPort.
- (4) Guidelines have been established to ensure the completeness and accuracy of the sealed bid process.

We agree with the actions planned and taken. However, we believe the accuracy of inventory related to recommendation number 2 should not have been significantly impacted by procedural changes.

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Your written comments, which addressed your management decision and actions planned or taken, have been included in the report. Please notify us when final action is complete. Our objective, scope, and methodology are included in Appendix A.

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. Recipients of this report are responsible for safeguarding it to prevent publication or other improper disclosure. If you have any questions, please contact Kristi U. Reynolds, Senior Auditor, at (865) 632-4021 or Lisa H. Hammer, Director (Acting), Financial and Operational Audits, at (865) 632-4731. We appreciate the courtesy and cooperation received from your staff during the audit.



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

KUR:SDB

Attachments

cc (Attachments):

- William H. Bonham, WT 3A-K
- Tom D. Kilgore, WT 7B-K
- John E. Long, Jr., WT 7B-K
- Richard W. Moore, WT 4C-K
- Emily J. Reynolds, OCP 1L-NST
- Michael W. Metcalf, LP 4T-C
- OIG File No. 2007-020F

OBJECTIVE, SCOPE, AND METHODOLOGY

Our objective was to determine if surplus material is identified and managed in accordance with TVA policies and procedures. Our scope included TVA material identified as surplus in PassPort as of February 21, 2007. In order to achieve our objective, we:

- Gained an understanding of the processes for identifying and managing surplus materials by (1) obtaining and reviewing MMS 1.0 – Material Receipt/Inspection, Material Storage and Handling, Material Issue, Control, and Return Policy; MMS 2.0 – TVA Inventory Management Policy; MMS 3.0 – Inventory Accuracy Policy; and 2.09 Investment Recovery – Process Surplus Material; and (2) interviewing IR and Materials Management personnel.
- Judgmentally selected three fossil plants and one nuclear plant¹ and obtained an understanding of how inventory is surplus at those sites by (1) interviewing site Materials Management personnel, (2) obtaining and reviewing reports used for identifying potential surplus, and (3) obtaining and reviewing supporting documentation for identification of surplus material.
- Conducted a physical inventory of sampled surplus material listed in PassPort at Hartsville as of February 21, 2007. We selected three samples of Catalog Identification Numbers (CAT IDs) totaling approximately \$5.2 million for testing as follows:
 - Greater than \$100,000 – We selected all 26 CAT IDs with a total value greater than \$100,000 as recorded in PassPort.
 - Between \$1,000 and \$100,000 – We randomly selected 98 CAT IDs from the universe based on sampling criteria that provided 95 percent confidence the exception rate does not exceed 3 percent.
 - Equal to zero² – We judgmentally selected 10 CAT IDs based on similar name descriptions as those in the “greater than \$100,000” sample noted above.
- Determined if transfers to and from Hartsville were completed in a timely manner by obtaining transfer reports and explanation for any outstanding items with a total value greater than \$10,000.
- Selected a sample of CAT IDs listed in PassPort as surplus inventory at Hartsville to verify no purchases had been made.
- Reviewed documentation related to the April 2006 sealed bid auction to confirm the highest bids were awarded appropriately.

This audit was performed in accordance with generally accepted government auditing standards. Although we did not test for compliance with laws and regulations, nothing came to our attention during the audit that indicated noncompliance with laws and regulations.

¹ Judgmentally selected based on (1) no issue, no receipt, and (2) quantity overmax reports generated from PassPort.

² In July 2001, the Materials Management System (MAMS) was converted to PassPort. The average unit price did not transfer from MAMS into PassPort. Instead, the average unit price in PassPort defaulted to zero.

June 21, 2007

Ben R. Wagner, ET 3C-K

REQUEST FOR COMMENTS - DRAFT AUDIT 2007-020F - REVIEW OF SURPLUS MATERIAL

This responds to your June 4, 2007 memorandum to me on the subject audit of surplus material. We appreciate the opportunity to review and comment on the draft report.

Our comments to your findings and recommendations are as follows:

Recommendation 1: Procurement management ensures compliance with process documentation related to identification of surplus material.

Response: We concur with the recommendation. As the report indicated, when we learned of this finding during your review, we issued a notice to our site managers on April 9, 2007, reminding them that the review process is a directive included in the Materials Management Procedure MMS 2.0 and the Sarbanes-Oxley Control Matrix and Narrative. We also received written confirmation from each site manager that they are now utilizing the report to identify potential surplus to their respective plant management personnel. We have also established a follow-up date to ensure continued compliance.

Recommendation 2: IR Personnel ensure the accuracy and completeness of the information in PassPort related to the locations and quantities of the surplus material at the Hartsville facility.

Response: We concur with the recommendation. IR has corrected all items addressed in the draft audit report. The material items identified in the report are items that were sent to Hartsville before FY06. Prior to FY06, surplus material sent to Hartsville by originating plant sites was not procedurally required to be verified by IR. We recognized the deficiency and initiated changes to MMS Procedures and IR Receiving Processes in FY06 that address all issues relating to overages, shortages, quantities, and locations to establish complete accuracy for HAR surplus inventory. We discussed this fact with the auditors in pre-audit meetings and reached an agreement the audit would cover the time period after April 2006. When the auditors arrived on site to conduct the audit, they told the IR Manager they were going back several years at the direction of their manager. We knew these irregularities would surface due to the old procedures and processes that we had since corrected. Additionally, in FY06, IR initiated the "Hartsville Site Plan" which will correctly identify all material located at Hartsville as to locations and quantities, the plan is scheduled to be complete in FY08.

Therefore any audits that include material received prior to FY06 may be incorrect until we complete the plan in FY08.

Recommendation 3: Procurement management ensures transfers are completed in PassPort in a timely manner.

Response: We concur with the recommendation and will issue a reminder to our site managers concerning this recommendation.
Due Date: June 30, 2007

Ben R. Wagner
Page 2
June 21, 2007

Recommendation 4: IR management ensures the accuracy and completeness of the sealed bid process.

Response:

1. We concur with the recommendation. IR has looked at the review of all sealed bids that are processed and have established guidelines that include (1) documented management review of the sealed bid data for accuracy and completeness and (2) procedures for addressing tie bids. The guidelines include: All hard copy bids are received and collected by Material specialist and recorded in data file by Bidder name, Bidder number, lot number, and bid amount.
2. The data file is verified for accuracy by Material Specialists and IR Manager by reviewing each Bidder name, Bidder number, lot number, and bid amount.
3. The hard copy bid sheets and data file are initialed by Material Specialists and IR Manager after verification.
4. Winning bidders are notified and all documentation filed accordingly.
5. In cases of a tie bid with 2 or more bidders, IR shall contact each bidder with the tie bids and request a new bid to be submitted. All phone calls and communication with bidders will be documented in file.

Thank you for your audit and review of our surplus material processes. As always, we value your input to our processes as a means to assist us in improving our practices and services. We also appreciate the professionalism, courtesy, and cooperation from your staff members who performed this audit. Please let me know if I may be of further assistance.



Paul R. Lapointe
Senior Vice President
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cc: William H. Bonham, WT 3A-K
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