



Memorandum from the Office of the Inspector General

September 28, 2015

Katherine J. Black, LP 6A-C
People and Performance Committee, TVA Board of Directors

**REQUEST FOR FINAL ACTION – AUDIT 2015-15307 – TVA'S EXECUTIVE
INCENTIVES**

Attached is the subject final report for your review and final action. 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. In accordance with the Inspector General Act of 1978, as amended, the Office of the Inspector General is required to report to Congress semiannually regarding audits that remain unresolved after 6 months from the date of report issuance.

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

If you have any questions or wish to discuss our findings, please contact me at (865) 633-7373 or Rick C. Underwood, Director, Corporate Governance and Finance Audits, at (423) 785-4824. We appreciate the courtesy and cooperation received from your staff during the audit.

David P. Wheeler
Deputy Assistant Inspector General
(Audits)
ET 3C-K

SLS:FAJ

Attachment

cc (Attachment):

William D. Johnson, WT 7B-K
Dwain K. Lanier, MR 3K-C
Justin C. Maierhofer, 7B-K
Richard W. Moore, ET 4C-K
R. Windle Morgan, WT 4D-K
Mary Margaret Painter, WT 7B-K
Rebecca C. Tolene, WT 7B-K
TVA Board of Directors
OIG File No. 2015-15307



Office of the Inspector General

Audit Report

To the Senior Vice President,
Human Resources and
Communications, and the People
and Performance Committee,
TVA Board of Directors

TVA'S EXECUTIVE INCENTIVES

Audit Team

Stephanie L. Simmons
Robert L. Dixon
Ricky L. Taylor

Audit 2015-15307
September 28, 2015

ABBREVIATIONS

CEO	Chief Executive Officer
EAIP	Executive Annual Incentive Plan
ELTIP	Executive Long-Term Incentive Plan
ELTRIP	Executive Long-Term Retention Incentive Plan
FY	Fiscal Year
OIG	Office of the Inspector General
TFO	Total Financing Obligations
TVA	Tennessee Valley Authority

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Audit 2015-15307 – TVA’s Executive Incentives

EXECUTIVE SUMMARY

Why the OIG Did This Audit

In October 2014, the OIG (Office of Inspector General) completed an audit of the Tennessee Valley Authority’s (TVA) executive retention.ⁱ As a follow-up to that audit, we initiated an audit of TVA’s executive incentives. Our objectives were to determine (1) if executive incentives align with TVA’s objectives and goals and (2) whether processes for establishing executive incentive performance measures are followed.

TVA currently has two executive incentive plans, the Executive Annual Incentive Plan (EAIP) and the Executive Long-Term Incentive Plan (ELTIP), which include performance-based incentives tied to the achievement of TVA’s goals and objectives. The performance measures associated with EAIP are based on the accomplishment of approved goals identified in TVA’s Winning Performance Team Incentive Plan balanced scorecards. Since the performance measures associated with EAIP are not executive specific, we focused this audit on the alignment and development of ELTIP performance measures.

What the OIG Found

In summary, we determined long-term performance measures currently included in the ELTIP align with three of the five strategic imperatives included in TVA’s Strategic Plan. However, we noted two of the five strategic imperatives, Debt and People and Performance Excellence, are not incentivized in the ELTIP. In our opinion, aligning long-term incentives with all strategic imperatives would (1) benefit TVA by promoting accountability in all areas identified as crucial to the achievement of TVA’s mission in TVA’s Strategic Plan and (2) continue to emphasize these areas as members cycle off of the TVA Board of Directors and executives leave TVA.

We also reviewed the process for establishing long-term performance measures for the ELTIP and found the process was followed by TVA and the TVA Board. However, one potential area for improvement was noted regarding the inclusion of additional information in the plan documents that clearly describe the ELTIP performance measures development process.

ⁱ Audit Report 2014-15030, TVA’s Executive Retention, October 22, 2014.



Audit 2015-15307 – TVA’s Executive Incentives

EXECUTIVE SUMMARY

What the OIG Recommends

1. The People and Performance Committee, TVA Board of Directors, consider including metrics that align with all strategic imperatives in long-term incentives.
2. The Senior Vice President, Human Resources and Communications, consider including a description of the performance measures/goals development and approval process in plan documents.

People and Performance Committee and TVA Management’s Comments

The People and Performance Committee stated they appreciate the feedback on additional metrics and will consider as they review the metrics and incentives for the future. They also provided a clarification on the strategic imperatives – noting there are four rather than five. The Committee noted the four are: Rates, Debt, Asset Portfolio, and Stewardship and that “It is through people, performance, and excellence we bring the imperatives to life.” See Appendix A for the People and Performance Committee’s complete response.

TVA management acknowledged our recommendation and stated Human Resources and Communications is currently in the process of updating the plan documents. In the update, they will review for appropriate inclusion of a better description of the approval processes. See Appendix B for TVA management’s complete response.

Auditor’s Response

The OIG concurs with the People and Performance Committee and TVA management’s planned actions. With regard to the committee’s comments regarding the number of Strategic Imperatives, we acknowledge TVA’s Strategic Plan for Fiscal Years 2014-2018 states, “we must realize four strategic imperatives” and “Through people performance excellence, we will bring these imperatives to life”. However, the Strategic Plan also lists People and Performance Excellence as a specific Imperative under the section titled “*Strategic Priorities & Key Performance Measures*”.

BACKGROUND

The Tennessee Valley Authority (TVA) Act, as amended, provides that the TVA Board of Directors will establish a compensation plan for employees which specifies all compensation for the Chief Executive Officer (CEO) and employees of the corporation. The TVA Compensation Plan, which is approved by the TVA Board, provides the framework for the Board and TVA management to establish and manage compensation for all TVA employees. According to the plan:

Performance-based compensation is critical to TVA in achieving its strategic goal of being a top-quartile organization in the energy sector. A key component of the Compensation Plan is a strong orientation toward 'pay for performance', which rewards improvement in TVA's overall performance as well as that of individual business units and individual participants.

There are currently three executive incentive plans in use:

- The Executive Annual Incentive Plan (EAIP).
- The Executive Long-Term Incentive Plan (ELTIP).
- The Executive Long-Term Retention Incentive Plan (ELTRIP).¹

Executive Annual Incentive Plan – The EAIP is an annual incentive plan designed to encourage and reward TVA executives for their performance and contribution to the successful achievement of goals. This is accomplished by linking a significant element of variable compensation to the accomplishment of approved goals identified in the Winning Performance Team Incentive Plan (i.e., Winning Performance) balanced scorecards. Winning Performance is the TVA-wide incentive plan for all employees. Participation in EAIP is approved by the TVA Board, CEO, or their delegates. In practice, employees included in the Officers and Executives pay band are included in the EAIP. The EAIP incorporates the use of performance measures which focus on key areas essential for the achievement of TVA's strategic objectives. For fiscal year (FY) 2010 through FY2014, the number of EAIP participants each year ranged from 76 to 95, and awards totaled approximately \$56.6 million for the 5-year period.

The Executive Long-Term Incentive Plan – The ELTIP is a long-term incentive plan designed to provide executives in "especially critical" positions with incentive opportunities based on successful achievement of established financial and/or operational goals measured over a multi-year period. Each performance cycle extends for a period of 3 consecutive FYs. The ELTIP also incorporates the use

¹ TVA is phasing out use of a fourth incentive plan, the Long-Term Deferred Compensation Plan. According to TVA's Compensation personnel, the Long-Term Deferred Compensation Plan will remain but TVA is phasing out use of this plan in favor of the ELTRIP. Participation in this plan decreased from 92 participants in FY2010 to 25 participants in FY2014. Deferred compensation payments totaled about \$18.5 million for FY2010 through FY2014.

of performance measures. Long-term incentives are designed to motivate and reward executives for their contributions to the successful achievement of TVA's long-term financial and operational strategic objectives. Participation in the plan is limited to executives that have the ability to directly impact TVA's long-term strategic objectives. The TVA Board, the CEO, or their delegates approve the participants. For FY2010 through FY2014, the number of ELTIP participants each year ranged from 76 to 89, and awards totaled approximately \$45.2 million for the 5-year period.

The Executive Long-Term Retention Incentive Plan – The ELTRIP was initiated in March 2014 and was designed to provide retention-based, long-term incentives to eligible executives to encourage them to remain with TVA and to provide a competitive level of total compensation. The plan, in combination with the ELTIP, enables TVA to provide a targeted level of total long-term compensation that is comprised of both (1) a variable at-risk, performance-based component and (2) a retention-based, time-vested component. All executives who have the ability to directly impact TVA's long-term strategic objectives are eligible to participate in the plan. An executive must also be a participant in the EAIP and ELTIP to participate in ELTRIP. Participation and awards granted are at the discretion of the TVA Board or the CEO. During FY2014, TVA entered into ELTRIP agreements with 39 participants totaling about \$1.6 million vesting December 31, 2016.

Goals – When establishing goals for performance measures, each measure has a threshold, target, and stretch goal, with increased payout percentages assigned to each successive goal level. The approximate achievability of these goals is intended to be 80 percent for threshold, 60 percent for target, and 20 percent for stretch. Therefore, it should be more common to see threshold and target goals met as opposed to stretch goals. Table 1 shows the distribution of actual ELTIP goal achievement for the performance cycles ending in FY2010 through FY2014.

ELTIP Performance Cycle							
<u>Goal Achieved</u>	<u>FY2008-2010</u>	<u>FY2009-2011</u>	<u>FY2010-2012</u>	<u>FY2011-2013</u>	<u>FY2012-2014</u>	<u>Total</u>	<u>Percentage</u>
Stretch	1	1	–	1	–	3	20%
Target	–	–	2	2	2	6	40%
Threshold	–	–	2	–	1	3	20%
Missed	1	2	–	–	–	3	20%
Total	2	3	4	3	3*	15	

* For the 2012 through 2014 ELTIP performance cycle there is an “external measures” performance measure that is a composite of five additional metrics. As these five metrics are aggregated to arrive at the “external measures” performance value, they are considered to be one performance measure in Table 1.

Table 1

As shown in Table 1, for ELTIP performance cycles ending in FY2010 through FY2014, performance measure goal achievement was 20 percent at the threshold level, 40 percent at the target level, and 20 percent at the stretch level.

In addition, actual achievement did not reach the threshold level (i.e., no incentive was earned) for 20 percent of ELTIP performance measures.

Over the last 5 FYs, EAIP performance has generally been better and varied less than ELTIP performance. EAIP payout percentages ranged from 100.44 percent to 121.42 percent, based on a weighted average for all EAIP participants. ELTIP payout percentages varied widely and ranged from 50 percent to 130.64 percent. Figure 1 illustrates the payout percentages and total awards from FY2010 through FY2014.

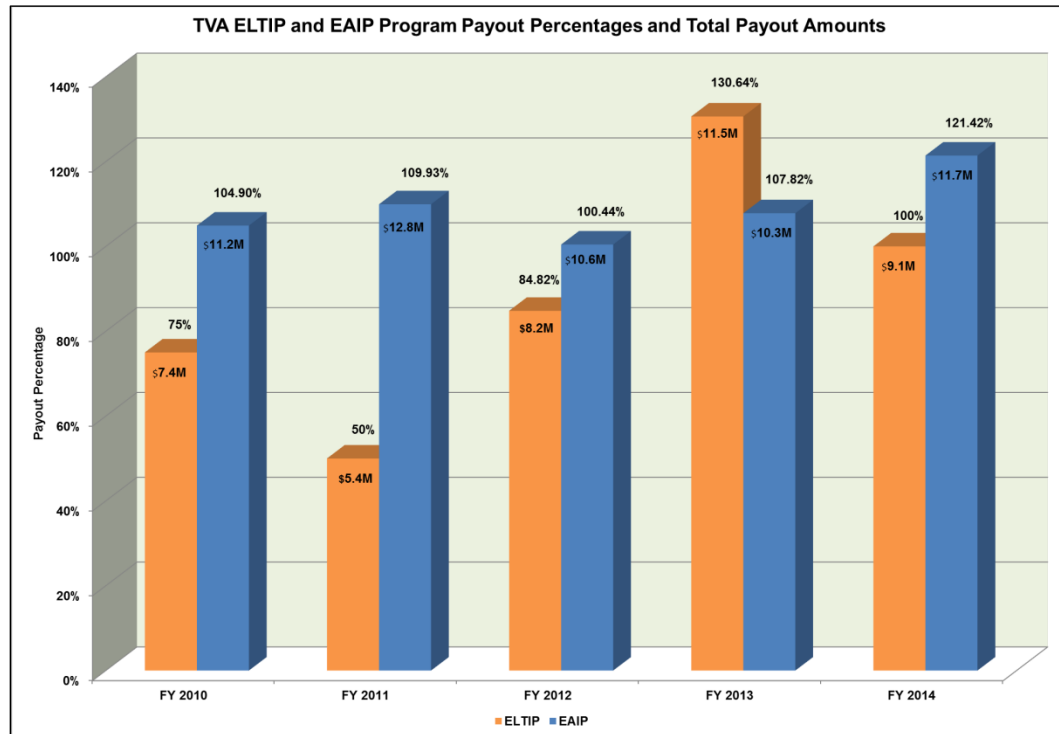


Figure 1

Strategic Imperatives – TVA’s mission, values, and strategic imperatives, among other things, are included in TVA’s strategic plan. The strategic plan for FY2014 through FY2018 outlines five strategic imperatives and the related priorities and key measures for each imperative. TVA’s current strategic imperatives and priorities are: (1) Rates, (2) Debt, (3) People and Performance Excellence, (4) Asset Portfolio, and (5) Stewardship.

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In October 2014, the Office of the Inspector General (OIG) completed an audit of TVA’s executive retention.² As a follow-up to that audit, we initiated an audit of TVA’s executive’s incentives. The OIG has performed agreed upon procedures in relation to TVA’s annual incentive calculations for several years but has not conducted any recent work specific to executive incentives. As summarized

² Audit Report 2014-15030, TVA’s Executive Retention, October 22, 2014.

above, TVA currently has two executive incentive plans, EAIP and ELTIP, which include performance-based incentives tied to the achievement of TVA's goals and objectives. Since the performance measures associated with EAIP are not executive specific, we focused this audit on the alignment and development of ELTIP performance measures.

OBJECTIVES, SCOPE, AND METHODOLOGY

Our audit objectives were to determine (1) if executive incentives align with TVA's objectives and goals and (2) whether processes for establishing executive incentive performance measures are followed. The objectives of this audit were not related to TVA's system of internal control; therefore, internal controls were not tested as part of this audit. To achieve our audit objectives, we:

- Compared executive incentive plans and any related performance measures to TVA's objectives, goals, strategic imperatives, and priorities.
- Interviewed TVA Board members and executives regarding the effectiveness and alignment of executive incentives and their involvement in the performance measures development process.
- Obtained executive incentive plan payouts and TVA operational and financial data for FY2010 through FY2014.
- Interviewed TVA personnel and reviewed documentation to determine how executive incentive performance measures are developed.

As discussed in the Background section of this report, the scope of our audit covered TVA's ELTIP, which was in place during FY2015, and all payments made under the plan for FY2010 through FY2014. Our audit focused on the alignment of ELTIP to TVA's objectives and goals as identified in TVA's strategic plan and the process followed to establish ELTIP performance measures.

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

FINDINGS

In summary, we determined long-term performance measures currently included in TVA's ELTIP align with only three of the five strategic imperatives included in TVA's Strategic Plan. We also found the process for establishing long-term performance measures for the ELTIP was followed by TVA and the TVA Board. However, one potential area for improvement was noted regarding the inclusion of additional information in the plan documents that clearly describes the ELTIP

performance measures development process. The following provides a detailed discussion of each of our findings.

LONG-TERM EXECUTIVE INCENTIVES ONLY ALIGN WITH THREE OF TVA'S FIVE STRATEGIC IMPERATIVES

TVA's mission, as documented in TVA's Strategic Plan, is described in three general areas: energy, environment, and economic development.

- Energy is providing affordable electric power throughout the Tennessee Valley region.
- Environment is acting as a steward of the Tennessee Valley's natural resources.
- Economic development is serving as a catalyst for sustainable economic development.

Further, TVA's Strategic Plan for FY2014 through FY2018 outlines the strategic imperatives TVA must realize in order to continue its mission of service to the region. The strategic imperatives are:

1. Rates – TVA must maintain low rates and align spending and revenues for long-term financial health.
2. Debt – TVA must live within its means and align spending and revenues for long-term financial health.
3. People and Performance Excellence – TVA must execute projects safely and effectively, align employees with the new organization and new expectations, and focus on values and behaviors.
4. Asset Portfolio – TVA must meet reliability expectations and provide a balanced portfolio, improve operational performance, and position Watts Bar for successful commercial operations in 2015.
5. Stewardship – TVA must be a responsible steward, stimulate economic development and investment in the Valley, expand customer loyalty and relationships, manage the Tennessee River system, and protect and improve the natural resources and the use and enjoyment of public lands.

We compared the long-term performance measures included in TVA's ELTIP for FY2015 through FY2017 to TVA's Strategic Plan for FY2014 through FY2018. As illustrated in Table 2, on the following page, we found the long-term performance measures align with only three of the five strategic imperatives identified in the strategic plan.

ELTIP Performance Measure	Weight	Strategic Imperative
Wholesale Rate Excluding Fuel	40%	Rates
System Reliability – Load Not Served	30%	Asset Portfolio
Responsibility – External Measures consisting of:	30%	
<i>External performance indicators for the TVA nuclear fleet</i>	(25%)	Asset Portfolio
<i>Percent of positive/balanced TVA news coverage compared to all TVA coverage</i>	(25%)	Stewardship
<i>Survey of public opinion of TVA</i>	(10%)	Stewardship
<i>Survey of TVA customers</i>	(10%)	Stewardship
<i>Board Level Significant Events</i>	(30%)	NA*
<i>Total</i>	(100%)	
* The board level significant events performance measure is not tied to a specific financial or operational goal. It is included so that the TVA Board may include in the ELTIP calculation their consideration of subjective performance information and/or significant positive or negative events that have occurred during the performance cycle. As such, this metric is not associated with a specific TVA strategic imperative. In addition to inclusion of this metric in the overall ELTIP calculation, the Board also retains the discretion to make additional adjustments (up or down) to the ELTIP payout for a given performance cycle.		

Table 2

While TVA's long-term executive performance measures align with three of the five strategic imperatives in TVA's Strategic Plan, two of the five strategic imperatives, Debt and People and Performance Excellence, are not incentivized in the ELTIP.

TVA's Debt Measure is Not Incentivized in the ELTIP

The reduction of statutory debt and/or total financing obligations (TFO) is currently a priority for TVA. In addition to being a strategic imperative, TVA has made a commitment to Congress and the Office of Management and Budget to reduce the debt in connection with the findings contained in the Lazard Report. The Lazard Report was released in 2014 in response to the Obama administration's strategic review of TVA. As noted in the Lazard Report as well as in TVA's FY2015 Long-Range Financial Plan, TVA's current business plan provides TFO will be reduced to \$21.8 billion by 2023. As of June 30, 2015, TVA's statutory debt was \$24.3 billion and TFO was \$26.6 billion. TVA's statutory debt ceiling is \$30 billion.

In the past, debt reduction has been a priority in multiple business plans. However, TVA has realized little reduction in debt over the years when compared to the goals that were set in those plans. For example:

- In the 1997 Ten Year Business Outlook, TVA stated it would need to reduce interest expense, and therefore debt, to approximately one-half of then-current levels. TVA's TFO in 1997 was \$26.9 billion. Although TVA's TFO subsequently declined to \$25.3 billion in 2001, it had increased to \$26 billion in 2004.
- In TVA's Strategic Plan issued in January 2004, TVA adopted a goal of reducing debt by \$3 to \$5 billion over 10 to 12 years. As noted above, TVA's TFO in 2004 was \$26 billion. Over the next 3 years TFO would decrease to \$24.9 billion in 2007.

- In TVA's 2007 Strategic Plan, TFO was projected to decrease by around \$5 billion over the next 10 years. However, over the following 6 years TFO increased to \$27.5 billion (in 2013), which was a higher level than 1997.

In 2013, TVA underwent a change in executive management and several TVA Board member rotations as well as a change in strategy regarding the management of long-term debt. As illustrated in Figure 2, TVA's TFO level, which had increased from 2010 to 2013, declined by about \$1.4 billion between 2013 and 2014.

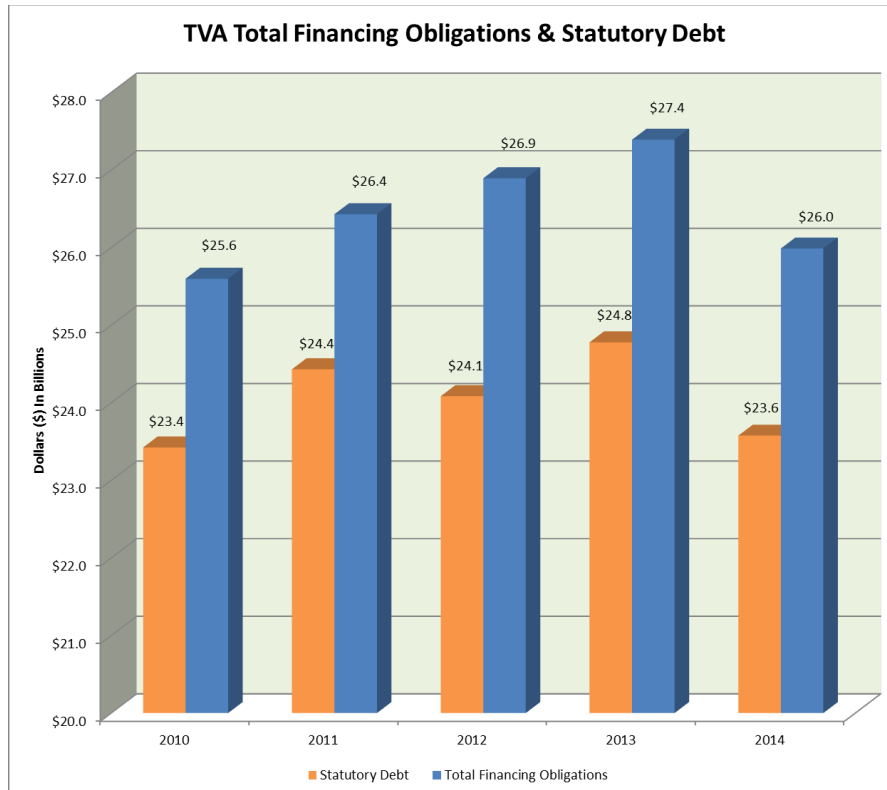


Figure 2

Under TVA's FY2015 Long-Range Financial Plan, TVA forecasts a TFO reduction of around \$5.5 billion between 2013 and 2023. As previously noted, TVA has identified debt reduction as an area of key strategic focus in current business plans. However, the only consideration given to the level of TVA's debt obligations in the calculation of any type of current executive incentive compensation is within the corporate multiplier used by the TVA Board to adjust annual TVA incentives (for both executive and non-executive personnel) where TFO is a component.

Based on TVA's current debt climate and past history with debt reduction, the inclusion of a long-term performance measure which aligns with TVA's strategic imperative for debt could help ensure the TVA Board and executive management continue to remain focused on debt reduction over the long term. As discussed above, debt reductions were seen the first few years following a new business

plan but then debt began to rise again the following years. While we understand many factors impacted debt fluctuations during the time frames discussed, management's outlook on debt reduction also may have been a factor.

During our conversations with TVA Board members and executives, concerns were raised regarding incentivizing debt reduction in the ELTIP. These concerns included:

- The addition of a debt metric could lead to competing priorities for management, such as paying down debt to meet a defined target when the money might be better utilized for a different or more critical purpose.
- Events impacting TVA's ability to meet reduction targets, such as weather volatility, may be largely out of the hands of TVA's senior leadership.
- TFO is included as a component of the corporate multiplier which impacts annual incentives for both TVA employees and executives.

While we agree these are valid concerns, we also considered the following:

- TVA has multiple performance measures that have the potential to conflict with each other. A long-term performance measure related to debt reduction does not have to be set so high as to limit management's ability to make decisions.
- The TVA Board still maintains the discretion to adjust ELTIP payouts and can take into consideration events that impacted targets which were outside of TVA executive management's control.
- While TFO is included as a part of the corporate multiplier, the level of TFO is only one component of an overall subjective consideration of TVA's annual performance. Payouts under annual incentive plans are based on scorecards which list specific performance measures and goals that are tracked to arrive at a calculated payout percentage. This percentage may be reduced by the corporate multiplier at the discretion of the CEO and the TVA Board. While components of the corporate multiplier may reduce the overall payout, the actual level of TFO at a given point in time does not have a direct correlation to annual incentive adjustments.

TVA's People and Performance Measure is Not Incentivized in the ELTIP

According to TVA's Strategic Plan, the People and Performance Excellence strategic imperative includes the following priorities: (1) executing projects safely and effectively, (2) aligning employees with the new organization and new expectations, and (3) focusing on values and behaviors. We noted two areas under People and Performance Excellence, safety and culture, where TVA appears to have currently placed a focus and/or has incentivized long-term performance in the past.

Safety, one of the priorities under this strategic imperative, is not included as a long-term executive performance measure. However, safety is included in the annual incentives for TVA via a goal/metric for safe workplace (i.e., recordable injury rate) in the corporate multiplier. As previously noted, while components of the corporate multiplier may reduce the overall payout, individual components do not have a direct correlation to annual incentive payouts or adjustments. The CEO has recently stated safety is one of his top priorities. Additionally, according to TVA's Safety policy, safety is the responsibility of management. Therefore, a long-term safety metric at the executive level may be appropriate.

For years, TVA has spent time and money to improve its culture, another element of People and Performance Excellence, through a string of various initiatives. Some aspects of these culture initiatives have been included in long-term performance measures in the past. Specifically:

- Strategic Teamwork for Action and Results (STAR) 7 was implemented in 1996. The last formal STAR 7 training was conducted in 2007.
- Organizational Effectiveness Initiative (OEI) was implemented in 2009. As part of this initiative, Organizational Health Index surveys were conducted until July 2012. During this time frame, the Organizational Health Index was included in the long-term performance measures for ELTIP in the FY2010 through FY2012 and FY2011 through FY2013 performance cycles.
- More recently, in June 2015, TVA completed an employee engagement survey with the goal of identifying opportunities for continuous improvement.

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In summary, while TVA's long-term executive performance measures align with three of the five strategic imperatives in TVA's Strategic Plan, two of the five strategic imperatives (i.e., Debt and People and Performance Excellence) are not incentivized in the ELTIP. In our opinion, aligning long-term incentives with all strategic imperatives would (1) benefit TVA by promoting accountability in all areas identified as crucial to the achievement of TVA's mission in TVA's Strategic Plan and (2) continue to emphasize these areas as members cycle off the TVA Board³ and executives leave TVA.⁴

³ According to the TVA Act, Section 2(d)(1), "A member of the TVA Board shall serve a term of 5 years. A member of the Board whose term has expired may continue to serve after the member's term has expired until the date on which a successor takes office, except that the member shall not serve beyond the end of the session of Congress in which the term of the member expires."

⁴ Audit 2014-15030, TVA's Executive Retention, found between March 2005 and May 2014, the average tenure of a TVA employee as an executive ranged from 5 to 7 years depending on whether the executive was hired as an executive or was promoted up to the executive ranks, respectively.

PROCESSES ARE FOLLOWED WHEN ESTABLISHING PERFORMANCE MEASURES

The TVA Compensation Plan states the TVA Board shall approve the design of executive incentives and the related performance measures and goals. Our review of the process associated with the establishment of ELTIP long-term performance measures found the process was followed by TVA and the Board.⁵ Establishing long-term performance measures and goals for the ELTIP is a Board driven process. Generally, modifications to the ELTIP and related performance measures are initiated by the Board or the Board's People and Performance Committee (i.e., Committee). TVA executive management may also propose modifications. TVA executive management develops and presents the proposals for any modifications to executive incentive plans and related performance measures to the Committee. The Committee may challenge the proposals and request additional information. When the Committee is satisfied, they submit their recommendation for approval to the full Board. The Board then considers the recommendations for approval.

Because the performance measures development process for ELTIP is TVA Board driven, TVA does not have a policy or procedure specifically for ELTIP. TVA executive management has stated a formal policy or procedure is not necessary to document the ELTIP performance measures development process and we agree. However, in our opinion, it would be beneficial for TVA to include additional information in the ELTIP plan documents describing the process. Currently, the plan documents include the following limited description of ELTIP performance measures and goals:

Performance Measures, Performance Measure weighting, and the identification of Performance Goals for each Performance Measure will be established for each performance cycle in accordance with reservations and delegations of authority under the TVA Compensation Plan and communicated in administration of the plan by the Vice President, Human Resources.

Clearly describing in the plan documents how ELTIP performance measures are developed and approved would facilitate knowledge transfer as TVA Board members rotate and TVA executive management changes.

⁵ As discussed in the Background section of the report, there are currently two executive incentive plans which incorporate performance measures and goals, the EAIP and ELTIP. We did not review the annual performance measures development process for the EAIP as those measures are developed for Winning Performance. Winning Performance is a TVA-wide incentive plan and not specific to executives.

RECOMMENDATIONS

The OIG recommends:

1. The People and Performance Committee, TVA Board of Directors, consider including metrics that align with all strategic imperatives in long-term incentives.

People and Performance Committee's Comments – The People and Performance Committee stated they appreciate the feedback on additional metrics and will consider as they review the metrics and incentives for the future. They also provided a clarification on the strategic imperatives – noting there are four rather than five. The Committee noted the four are: Rates, Debt, Asset Portfolio, and Stewardship and that “It is through people, performance, and excellence we bring the imperatives to life.” See Appendix A for the People and Performance Committee’s complete response.

Auditor's Response – The OIG concurs with the People and Performance Committee’s planned actions. With regard to the committee’s comments regarding the number of Strategic Imperatives, we acknowledge TVA’s Strategic Plan for Fiscal Years 2014-2018 states, “we must realize four strategic imperatives” and “Through people performance excellence, we will bring these imperatives to life”. However, the Strategic Plan also lists People and Performance Excellence as a specific Imperative under the section titled “*Strategic Priorities & Key Performance Measures*”.

2. The Senior Vice President, Human Resources and Communications, consider including a description of the performance measures/goals development and approval process in plan documents.

TVA Management's Comments – TVA management acknowledged our recommendation and stated Human Resources and Communications is currently in the process of updating the plan documents. In the update, they will review for appropriate inclusion of a better description of the approval processes. See Appendix B for TVA management’s complete response.

Auditor's Response – The OIG concurs with TVA management’s planned actions.

September 22, 2015

David P. Wheeler, ET 3C-K

**RESPONSE TO REQUEST FOR COMMENTS - DRAFT AUDIT 2015-15307 - TVA'S
EXECUTIVE INCENTIVES**

Reference: OIG Memorandum to Senior Vice President, Human Resources and
 Communications, and the People and Performance Committee, TVA Board of
 Directors

Thank you for your August 27, 2015, audit report on TVA's Executive Incentives.

The People and Performance Committee is responding to recommendation number one.

The People and Performance Committee, TVA Board of Directors,
consider including metrics that align with all strategic imperatives in
long-term incentives.

We would like to provide clarification on the strategic imperatives – there are four rather than
five. The four are: Rates, Debt, Asset Portfolio, and Stewardship. It is through people,
performance, and excellence we bring the imperatives to life.

Additionally, the Committee appreciates the feedback on additional metrics and will consider as
we review our metrics and incentives for the future. Each year the People and Performance
Committee reviews management's proposal with respect to the Executive Long-term Incentive
Plan (ELTIP) and determines what, in its judgment, are the most effective tools to incentivize
TVA management's long-term performance within the context of the imperatives.

Thank you for the effort of your staff to provide this report. Please contact me if you have
questions.



Richard Howorth

cc: Lynn Evans
Gina Lodge
Pete Mahurin

September 22, 2015

David P. Wheeler, ET 3C-K

RESPONSE TO REQUEST FOR COMMENTS - DRAFT AUDIT 2015-15307 - TVA'S
EXECUTIVE INCENTIVES

Reference: OIG Memorandum to Senior Vice President, Human Resources and
 Communications and the People and Performance Committee, TVA Board of
 Directors

This is in response to your August 27, 2015, draft audit report on TVA's Executive Incentives. Our comments regarding the findings and recommendations presented in the audit report relative to the recommendations for the Senior Vice President, Human Resources and Communications, are as follows:

Recommendation Number Two for Human Resources and Communications: Consider including a description of the performance measures/goals development and approval process in plan documents.

Human Resources and Communications' Response: We acknowledge the findings and are currently in the process of updating our plan documents. In the update, we will review for appropriate inclusion of a better description of the approval processes.

The People and Performance Committee will address Recommendation Number One.

Human Resources and Communications would like to thank the OIG staff for their professionalism and cooperation in conducting this audit. If you have further questions related to the executive incentives, please contact Donna Golden at 423-751-2507.



Katherine J. Black
Senior Vice President
Human Resources and Communications
LP 6A-C

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