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APPENDIX

MEMORANDUM DATED DECEMBER 5, 2007, FROM TOM KILGORE
TO ROBERT E. MARTIN

EXECUTIVE SUMMARY

River System Operations and Environment (RSO&E)ⁱ Internal/External Contractual Services' program, operated by Resource Management (RM), provides services/technologies to Tennessee Valley Authority (TVA) and external customers. In 1996, RM became a self-funded organization (i.e., revenue must cover expenses). In fiscal year (FY) 2006:

- Revenues generated totaled about [Redacted] (i.e., [Redacted] from external customers and about [Redacted] from internal TVA work).
- Work for other federal agencies totaled about [Redacted] or 95 percent of external revenue.
- Work for the Department of Defense (DOD) alone accounted for [Redacted] or 93 percent of the external revenue.

RM is responsible for (1) business development (including bid and proposal preparation), (2) product development activities, and (3) business coordination of external projects and operations. Our review covered the external contractual services' work being conducted by RM. Our objectives during this review were to determine if (1) work that is being performed by RM is in accordance with applicable policies and procedures and (2) costs associated with TVA employees working for outside entities/agencies are adequately recovered. In summary, we found:

- The majority of FY 2006 RM External Contractual Services' revenue was generated from work for other federal agencies, and the projects we selected for review appeared to be in compliance with the Economy Act of 1932, as amended (31 USC 1535). In addition, direct costs and approved overheads are captured on a project-specific basis and automatically billed to ensure cost recovery.
- The work performed is not a TVA core business and does not appear to align directly with TVA's Strategic Plan. RM stated that the work is consistent with the spirit and historical enablement of the TVA Act and is implicitly included and serves as an enabler for many parts of TVA's new Strategic Plan.
- The work being performed increases TVA's monetary, reputational, and environmental risks. RM stated, however, that they continue to improve the risk profile for the RM External Contractual

ⁱ With recent TVA reorganizations, some organizations in RSO&E became the Office of Environment and Research. This included the RSO&E External Contractual Services' program.

Services' efforts through completion of high-risk projects, through their strategy on the nature of future work, and through actions and processes to mitigate financial risks, including purchasing insurance and incorporating written indemnity clauses in certain contracts.

- For five of the 14 projects reviewed, a contract could not be provided. In addition, key decisions required by RM policies and procedures were not documented, or documentation was incomplete.

Based on the risks and the lack of a clear direct nexus to TVA's core business as discussed above, our draft report recommended that the President and Chief Executive Officer (CEO) terminate the RM External Contractual Services' program. Management stated in their comments to our draft report that RM plans to continue the program but will exit chemical agent work as it carries the greatest risk potential for TVA. Management also plans to (1) further review the risks associated with the program and update TVA's risk assessment as needed and (2) improve program documentation as TVA implements its new business management software in FY 2008.

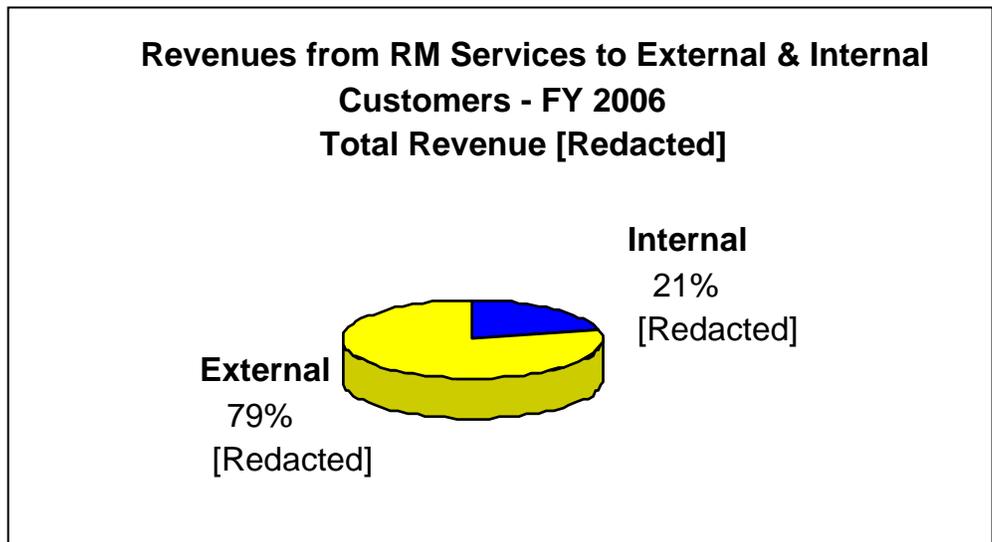
We agree with management that the chemical agent work carries the greatest risk potential for TVA. Since eliminating the chemical agent work once the current contractual commitments with DOD expire will greatly reduce the risks of the program, we have revised our recommendation. We now recommend that the CEO (1) eliminate chemical agent work once current contractual commitments expire and (2) direct RM officials to maintain adequate supporting documentation of projects and decisions made in regard to RSO&E–SPP–19.1, including maintaining contracts and proof of funding or Military Interdepartmental Purchase Requests. (See the Appendix for complete response.)

BACKGROUND

Resource Management (RM) operates River System Operations and Environment's (RSO&E)¹ Internal/External Contractual Services' program. RM provides services/technologies to Tennessee Valley Authority (TVA) and external customers.² RM's specific responsibilities include:

- Business development (including bid and proposal preparation).
- Product development activities.
- Business coordination of external projects and operations.

In fiscal year (FY) 2006, revenues generated totaled about [Redacted].



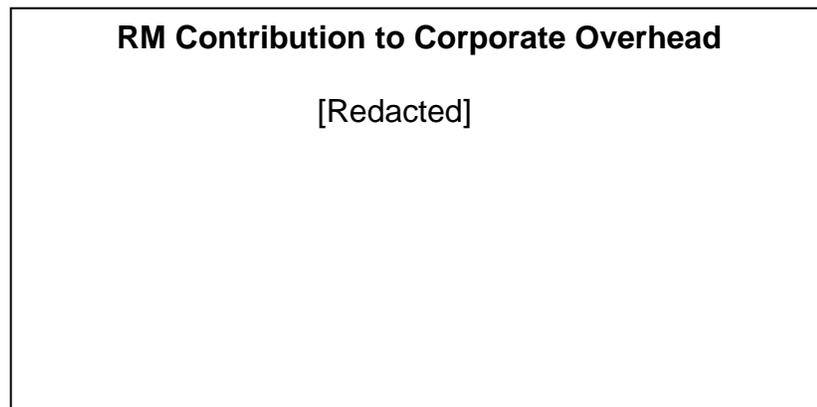
RM's stated mission "is to support RSO&E's efforts to make a contribution to the financial success of TVA." In 1996, RM was tasked with becoming a self-funded organization (i.e., revenue must cover expenses) and according to RM, revenue is largely a function of headcount.

¹ With recent TVA reorganizations, some organizations in RSO&E became the Office of Environment and Research. This included the RSO&E External Contractual Services' program.

² This review focused on the services being provided to external customers.

As of March 12, 2007, RM's reported headcount was [Redacted], including management and support personnel. Of this [Redacted] headcount, there were [Redacted] who showed an official station in the Tennessee Valley Region.

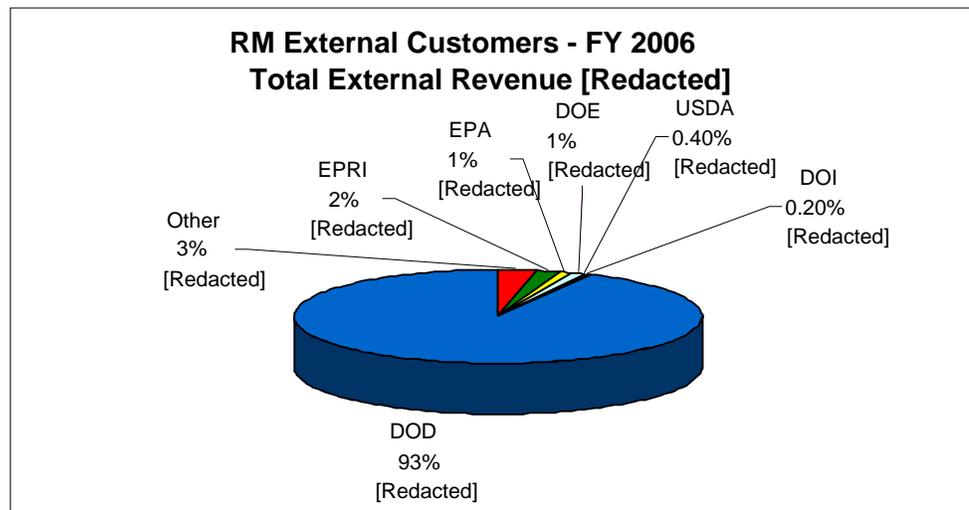
RM reported that the Internal/External Contractual Services' program returned [Redacted] to TVA corporate overhead in FY 2006. The following graph shows RM's reported contribution to TVA corporate overhead for FYs 2000–2006:



According to TVA InsideNet, “The RM business is a full-cost recovery, matrixed business where line organizations across RSO&E, particularly within Research & Technology Applications (R&TA), provide the services to fulfill the contractual requirements of the business.” RM stated they make about [Redacted] proposals per year and achieve about an [Redacted] percent success rate. As of December 31, 2006, RM information showed the backlog of contractual business was about [Redacted], and some current projects have estimated contract completion dates that stretch into the year 2011. RM reports that it meets the needs of utility, industrial, government, and resources management sectors of the United States and foreign markets. RM work has included decommissioning and decontaminating chemical plants and storage facilities in the United States and overseas, including Russia.

Work for Federal Agencies

In FY 2006, RM's revenue from external customers totaled about [Redacted], of which work for other federal agencies totaled about [Redacted] or 96 percent. The Department of Defense (DOD) alone accounted for [Redacted] or 93 percent of the revenue. TVA's work for other federal agencies was conducted under the provisions of the Economy Act of 1932, as amended (31 USC 1535).³ The Economy Act authorizes an agency to place orders for goods and services with another government agency when the head of the ordering agency determines that it is in the best interest of the government and decides ordered goods or services cannot be provided as conveniently or cheaply by contract with commercial enterprise.



Previous TVA Economy Act Work

We included in our FY 2007 Audit/Inspection Workplan a review of the RM External Contractual Services' program based in part on the fact that in the early 1990s some TVA Economy Act work had received substantial negative publicity. TVA Office of the Inspector General's (OIG) and DOD OIG's findings regarding TVA's Technology Brokering Program (TBP) led to a congressional hearing where the TVA Inspector General and the President, Resource Group, testified. The audit reports and congressional hearing prompted the termination of the program. Our review disclosed no similar problems in the current program.

³ Referred to throughout this report as the Economy Act.

OBJECTIVE, SCOPE, AND METHODOLOGY

Our objectives during this review were to determine if (1) work that is being performed by RM is in accordance with applicable policies and procedures and (2) costs associated with TVA employees working for outside entities/agencies are adequately recovered. Our scope included work performed by RM for other agencies/entities during FY 2006. To achieve our objectives, we:

- Obtained an understanding of the RM External Contractual Services' program's (1) mission and goals and/or (2) key processes and procedures, including those pertaining to contract award and external billing, by:
 - Interviewing TVA RM, Procurement, and Chief Financial Officer (CFO) personnel.
 - Reviewing (1) project listings which included contract and cost information, (2) a February 2007 program briefing presentation presented to TVA executive management, (3) selected project and contract documentation, and (4) other RM program and project information.
- Reviewed the following policies and procedures to identify key control activities:
 - RSO&E Standard Process and Procedure (SPP) RSO&E—SPP—19.1, titled *Resource Management Business Process*.
 - The stated purpose of the SPP is “to manage and maintain the RM business, which can be viewed as a series of steps beginning with generation of opportunities and ending with project completion and closeout, including documentation and distribution of lessons learned and client feedback.”
 - TVA Accounting Practice CFO SPP 13.7, titled *External Billing Process*.
 - The stated purpose of the accounting practice is “to document and communicate the roles and responsibilities, processes, controls, and systems associated with accounting and billing for external business activities.”
- Assessed whether work being performed for selected contracts involving other federal agencies was appropriately justified under the auspices of the Economy Act.

- Reviewed TVA's 2007 Strategic Plan and other corporate documents to determine if the RM External Contractual Services' work is in accordance with TVA's core mission and business and aligns with TVA's current strategic actions.
- Used program, contract, interview, and other information to assess the potential risks and benefits of the RM External Contractual Services' business.
- Judgmentally selected 14 projects to determine whether the *Resource Management Business Process* was followed. Our review included, but was not limited to, obtaining and reviewing the applicable contracts, contract supplements, scopes of work/individual work plans (IWP), funding documents/credit analyses, memorandums of understanding (MOUs), and cost estimates. The contract ceiling amounts and FY 2006 revenue were as follows:

Contract	Contract Ceiling	FY 06 YTD Revenue
1	[Redacted]	[Redacted]
2	[Redacted]	[Redacted]
3	[Redacted]	[Redacted]
4	[Redacted]	[Redacted]
5	[Redacted]	[Redacted]
6	[Redacted]	[Redacted]
7	[Redacted]	[Redacted]
8	[Redacted]	[Redacted]
9	[Redacted]	[Redacted]
10	[Redacted]	[Redacted]
11	[Redacted]	[Redacted]
12	[Redacted]	[Redacted]
13	[Redacted]	[Redacted]
14	[Redacted]	[Redacted]
Total	[Redacted]	[Redacted]

- Reviewed billing policies and procedures and interviewed RM management and CFO personnel to determine if costs are captured and billed correctly. RM management and CFO personnel explained that all costs are captured and billed electronically using the BillOut SubSystem (BOSS). Based on the information obtained, we deemed no further fieldwork was necessary in regards to billing.

This inspection was conducted in accordance with the "Quality Standards for Inspections."

FINDINGS

Our review of selected RM External Contractual Services' projects found (1) work performed for other federal agencies appeared to be in compliance with the Economy Act and (2) TVA's external billing process should ensure the recovery of direct costs and overhead. However, we also noted the RM External Contractual Services' work (1) is not a TVA core business; (2) does not appear to align directly with TVA's Strategic Plan; and (3) increases TVA's monetary, reputational, and environmental risks. In addition, key decisions required by RM policies and procedures were not documented, or documentation was incomplete.

COMPLIANCE WITH THE ECONOMY ACT AND COST RECOVERY

In FY 2006, the majority of RM External Contractual Services' revenue was generated from work for other federal agencies. Our review of selected projects found the work appeared to be in compliance with the Economy Act.⁴ The Economy Act basically states that another federal agency can be used for services if it is determined to be in the best interest of the government, and ordered goods or services cannot be provided as conveniently or cheaply by contract with commercial enterprise. We also noted that RM's listing of commercial projects (i.e., work for nonfederal agencies) showed that the Electric Power Research Institute and TVA customers were the primary clients.

In addition, TVA policies and procedures should ensure recovery of direct costs and overheads. Specifically, billing arrangements for external contracts/agreements and their supplements/revisions are set up in BOSS, direct costs are captured on a project-specific basis, and BOSS automatically bills direct costs captured under each project and applies approved overheads.

CONTRIBUTIONS TO CORE BUSINESS, STRATEGIC ALIGNMENT, AND ASSOCIATED RISKS

We noted the RM External Contractual Services' work (1) is not a TVA core business; (2) does not appear to directly align with TVA's Strategic Plan; and (3) increases TVA's monetary, reputational, and environmental risks. As stated in TVA's Strategic Plan, "TVA's mission is to improve the quality of life in the Tennessee River Valley

⁴ Our review did not test to determine if work performed for federal agencies was properly authorized by the agency in accordance with federal procurement policies.

region through its work in three key areas: energy, the environment, and economic development. For nearly 75 years, TVA's unique mission has served as the foundation of its business endeavors, providing the context for TVA to establish its business objectives and internal processes.”

- Energy—TVA supplies reliable, affordable electricity to the Tennessee Valley region.
- Environment—TVA manages the natural resources of the Valley for the benefit of the region and the nation.
- Economic Development—TVA helps to bring jobs to the Tennessee Valley and make the economy stronger to benefit the region.

While RM acknowledged that the RM External Contractual Services' program is not a TVA core business, RM stated the Strategic Plan does not provide detailed guidance for day-to-day operations, and their work serves as an enabler for many parts of the plan. RM further stated that (1) the program aligns with TVA's Strategic Plan in that the program's contributions to TVA corporate overhead support TVA's mission to provide affordable electricity to the Tennessee Valley region and (2) program risks have been adequately mitigated.

Core Business

We noted that RM External Contractual Services' work is not a core TVA business. Specifically, the work does not (1) involve the generation or transmission of electricity, (2) relate to environmental stewardship in the Tennessee Valley, or (3) help bring jobs to the Tennessee Valley through capital investment.⁵ While the program does provide the Tennessee Valley some economic benefit by providing some jobs and most of the employees still have their official duty station in the Valley, the majority of the revenue is being generated outside the region.⁶ Examples of work performed include:

- Demolition and disposal activities associated with former chemical weapon production facilities, including (1) Rocky Mountain Arsenal (Colorado), (2) Pine Bluff Arsenal (Arkansas), (3) Aberdeen Proving Ground (Maryland), and (4) Newport Chemical Depot (Indiana).

⁵ TVA's Strategic Plan states, "TVA's economic development growth strategy will focus on recruitment and retention of targeted businesses and industries that complement TVA's anticipated load shape, increase job creation and capital investment in the market sectors of women and minority-owned companies, and provide technical services and training needed to support community and regional development."

⁶ We noted that many of the RM employees working on the projects have been in extended/constant travel status and some were relocated outside the TVA region.

- Decontamination of containers with a 25-ton capacity that were used to store chemical weapons located in Pine Bluff, Arkansas.
- Transportation through the Tennessee Valley region and disposal of hazardous and nonhazardous waste, including Polychlorinated Biphenyls (PCBs).
- Support in the area of materials management in Tooele, Utah. “The Program Manager for Chemical Demilitarization requires support in the area of Material Management for establishing PMCD level Material Management policies, procedures, and guidance, and project level support to the individual project managers in all areas of Material Management. The support required by the PMCD will include preparation of draft policy documents and procedures, coordinating these with the Project Managers and PMCD staff, and submitting a final product to the PMCD for signature.”
- Project management of the dismantling of a former chemical warfare production facility in Russia. Work was performed by local labor.

Although RM confirmed that RSO&E external service is not a core TVA business, RM stated the work performed is a result of a directive from Congress and is consistent with the spirit and historical enablement of the TVA Act. Specifically, RM stated the External Contractual Services' program was a result of the Energy and Water Development Appropriations Act, 1996 (Public Law 104-46). We found the law did not direct any specific program; rather it stated, “The Tennessee Valley Authority shall, not later than March 30, 1996, submit to Congress a preliminary plan for funding the environmental research center from sources other than direct appropriations for the Tennessee Valley Authority after fiscal year 1996.” RM further stated:

- TVA's plan, which was submitted to Congress, relied heavily on providing TVA's environmental expertise to federal, state, and local governments in the United States and to selected international customers.
- The RM External Contractual Services' model is consistent with models of other federal entities and it continues to evolve to meet the guidance and intent of successive TVA Boards.

Strategic Plan

We noted that the RM External Contractual Services' program does not appear to align directly with TVA's new strategic direction as set forth in TVA's Strategic Plan. When discussed with RM, RM stated

that the program does align with TVA's Strategic Plan. Specifically, RM cited that contributions to TVA corporate overhead support TVA's mission to provide low-cost electricity. In fact, Winning Performance goals are tied to the RM External Contractual Services' contribution to TVA corporate overhead. RM further stated the current Strategic Plan does not provide detailed guidance for day-to-day operations, and the internal/external business model, while not explicitly spelled out in the new strategic plan, serves an enabler for many of the parts of the plan. RM stated many other federal agencies have such programs to serve as a multiplier for their intellectual capital in terms of a more robust work force that can do similar things at the parent organization, as well as for others, thus increasing their bench strength and preserving their intellectual seed corn. According to RM, TVA's External Contractual Services' program serves this function by preserving engineering and scientific experts for TVA support in its Science and Technology efforts, its Resource Conservation Recovery Act (RCRA) obligations, future site clean-up activities (especially those in Muscle Shoals), and experts for key regulatory compliance efforts.

Strategic Plan Focus

We found nothing in the strategic plan that explicitly indicates that TVA's future success encompasses a self-sufficient organization providing services for outside entities. Specifically, TVA's 2007 Strategic Plan focuses on TVA's core mission, businesses, and increasingly challenging marketplace. As stated in the message from the TVA President and Chief Executive Officer (CEO), "The Strategic Plan captures the opportunities to leverage and realign TVA's strengths and to address the customer, financial, operational, and organizational initiatives necessary for future growth and success."

The 2007 Strategic Plan states, "In developing the new strategic plan, the Board determined that the TVA's current business structure best enables TVA to carry out its integrated mission. The Strategic Plan proposes to largely preserve the current structure but adapt it to today's competitive environment. Key components of the business structure are:

1. Continued focus on a three-part integrated mission in energy, the environment, and economic development.
2. All aspects of the business area will continue to be funded from power revenues and financings.
3. Generation and transmission services will continue to be provided as part of a “bundled” package.
4. Demand for power will be met through a careful balance of self-reliance and partnership with others, limiting dependence on the market to keep costs competitive and reduce risk associated with short-term market volatility.
5. Financing obligations will be appropriate to the value of the assets.”

We also noted that the 2007 Strategic Plan states that while leveraging existing strengths, TVA has a renewed focus on:

- Customers
- Variable length contracts with distributors
- Prices that reflect product cost
- Acquiring or partnering for supply
- Long-term financial strength
- Risk management and communication
- Performance goals set by industry benchmarks

We further noted that the RM External Contractual Services' program does not directly align with the mission, long-term goals, strategic objectives, and performance indicators described in the *TVA Government Performance and Results Act (GPRA) Annual Performance Plan For FY 2008*.

TVA Benefits and Program Risks

RM has cited that the RM External Contractual Services' program provides financial and other benefits to TVA, including revenue; economic development; training for TVA employees at no (or low) cost; no additional TVA labor costs; and retention (without cost to TVA) of knowledge and expertise critical to TVA operations.⁷ We believe, however, that the program subjects TVA to increased monetary, reputational, and environmental risk. Not only could the monetary impact of a large-scale event be substantial for the work being performed, but also such an event related to the work could cause TVA negative publicity and reputational damage.

⁷ RM provided a listing showing over [Redacted] employees who have transferred from RM to TVA core operations since program inception.

The magnitude and type of work being performed increases TVA's risks. For example, RM had 28 projects with the DOD that were active during FY 2006 with a total contract ceiling of approximately [Redacted]. It appears that 15 DOD contracts potentially contained scopes of work related to chemical demilitarization and decontamination of hazardous materials. The 15 contracts made up a total contract ceiling of [Redacted].⁸ In addition:

- TVA could be viewed as competing for private sector business. According to a Senior Manager, RM will not attempt to enter into an agreement to perform work if the scope of work has already been competed. While RM cited that no competitive bidding is allowed, they perform cold calls; attend trade shows; and advertise. According to a RM senior manager, the marketing activities are for federal business. However, we noted that RM screening criteria states that, "If for a competitive bid, who are potential primes, & how do they add value from client's viewpoint?" It also states, "What features(s) can RM offer client that competition cannot?"
- Disposing of hazardous wastes under TVA's disposal contracts could increase TVA's clean-up costs in the event of a Superfund Site determination.
- The program is revenue (i.e., volume) driven since Winning Performance goals are tied to the RM External Contractual Services' contribution to corporate overhead. This could increase perceptions about program competition with private companies.

Risk Mitigation Activities

RM stated they continue to improve the risk profile for the RM External Contractual Services' program through completion of high-risk projects, their strategy on the nature of future work, and their actions and processes to mitigate financial risks. RM cites that risk is managed by (1) entering into MOUs, where applicable; (2) transition of external commitments away from "hands-on" Trades and Labor chemical agent project to work that more closely mirrors TVA skill needs; (3) managing projects in a safe and professional manner; (4) incorporating written indemnity clauses into certain contracts in order to shift responsibilities to other parties; and (5) reducing TVA risk elsewhere by helping TVA maintain an intellectual capital base for unique TVA work needs. Insurance is also purchased to cover

⁸ In discussions with RM, RM stated that many of the higher risk projects have been completed or are coming to completion. The scope of work on future projects will involve more project management and technical assistance type activities.

(a) errors and omissions, (b) general liability, and (c) automobile collision. RM carries four different types of insurance to manage their risk.

- Pollution and Professional Liability – provides professional liability coverage for environmental consulting revenue contracts. The estimated annual premium was [Redacted].
 - RM has up to [Redacted] of coverage, per event, with a [Redacted] deductible for nonfederal work ([Redacted] annual aggregate).
 - RM has up to [Redacted] of coverage, per event, for other federal agency work with a [Redacted] deductible ([Redacted] annual aggregate).
- General Liability – provides general liability coverage to TVA Service Groups: Central Labs, Heavy Equipment Division (HED), Power Service Shop (PSS), RM, and Energy Services Company groups for their external contracts. This policy provides [Redacted] coverage with a [Redacted] deductible. TVA also maintains excess coverage for up to [Redacted] per [Redacted] occurrence with a [Redacted] self-insured retention, per occurrence, that has to be paid by TVA. The estimated premium for RM's portion was [Redacted].
- Commercial Auto – provides liability insurance for RM projects. RM has a [Redacted] primary and [Redacted] excess coverage. The estimated combined annual premium was [Redacted].
- Special Crime Coverage – provides coverage for RM's international consulting work. RM pays approximately [Redacted] annually for a three-year prepaid policy with [Redacted] coverage.

While we agree that the purchase of insurance does mitigate some of the risks, the cost of a large-scale event cannot be estimated, and there is no insurance to mitigate reputational risk/damage. For example, the environmental clean-up costs of two “mega-sites” have averaged about \$140 million for each site.⁹ In summary, the purchase of insurance demonstrates that the RSO&E External Contractual Services' program increases TVA's risks.

RM provided additional information to support its assertion that risk is adequately mitigated. Specifically, RM provided documentation showing that in updating the TVA Enterprise Risk Map:

⁹ Study Pegs Superfund's Cost at \$14-\$16 Billion Through 2009, Industry Headlines, The McGraw-Hill Companies, by Tom Ichniowski.

- TVA, Secondary Business Activities Risk, had a low Likelihood and low Severity¹⁰ rating.
- TVA Risk Management and Economic Analysis recommended reducing the severity number to the total insurance deductibles (approximately [Redacted]).
- The new severity number does not meet the threshold of an “enterprise risk” for dollar severity and could drop the services business off the TVA Enterprise Risk Map. RM advised, however, that the reputational risk is enough to keep this program on the map.

PROJECT DOCUMENTATION

Our review of 14 selected contracts/projects found instances where (1) no contract could be provided for the project, (2) there is no supporting documentation and/or justifications supporting key decisions/evaluations required by RM policies and procedures, and/or (3) documentation was incomplete. Specifically:

- Procurement could not locate the contract files for five of the projects we selected. The combined contract ceilings for the five contracts totaled approximately \$14.5 million.
- RM could not provide a statement of work/scope of work or IWPs for two projects. The combined contract ceilings for the two contracts totaled approximately \$6.2 million.
- RM could not provide a proof of funding or Military Interdepartmental Purchase Requests (MIPR) for two projects. Total contract ceiling for these contracts was approximately \$447,000.
- No documentation was maintained to support key business decisions and evaluations. Some of the key processes and decisions required by RSO&E—SPP—19.1 that were not documented include:
 - A series of tests against established criteria must be used to disclose the advantages and disadvantages of each project opportunity.
 - A general set of questions must be answered to decide whether to assign a particular project to a project manager or a technical lead.

¹⁰ Severity is defined as the potential impact to cash flow.

- The draft proposal must be reviewed by the Technical Review Team for technical adequacy and modification.
- The Management Review Team must review the polished bid and proposal with the project manager and make the final recommendation on commitment of resources.
- The Business Capture Team must review the Management Review Team's analysis and make a “Go or No-Go” decision.
- Once published, the bid and proposal must receive final approval, commitment, and sign-off by the assigned Project Manager and the Senior Manager of RM. The bid and proposal is then appropriately transmitted to the potential client.

RECOMMENDATIONS

We recommend that the President and CEO:

- Eliminate chemical agent work once current contractual commitments expire.
- Direct RM officials to maintain adequate supporting documentation of projects and decisions made in regards to RSO&E—SPP—19.1, including maintaining contracts and proof of funding or Military Interdepartmental Purchase Requests.

Management's Response – The President and CEO provided comments on a draft of this report. In response to our findings, management plans to:

- Eliminate the chemical agent work which carries the greatest risk potential for TVA once current contractual commitments with the DOD expire.
- Conduct further review of the risks associated with the program and update the TVA risk assessment to reflect any changes.
- Improve program documentation as TVA implements its new business management software in FY 2008.

(The complete text of the President and CEO's comments is provided in Appendix A.)

Auditor's Comments – While we recommended the RM External Contractual Services' program be terminated, RM plans to continue work for (1) DOD that is deemed consistent with TVA's Strategic Plan core responsibilities related to energy and environment and (2) the

Electric Power Research Institute, the Department of Energy, and distributors of TVA power related to energy, water, and environmental tasks. We agree that management actions to eliminate chemical agent work will eliminate the greatest risk potential within the RSO&E External Contractual Services program. Also, the other planned actions will strengthen the program. Therefore, we revised our recommendation accordingly and take no exceptions to management's comments.

December 5, 2007

Robert E. Martin, ET 3C-K

RESPONSE TO DRAFT INSPECTION REPORT – INSPECTION 2007-5101 – REVIEW OF RESOURCE MANAGEMENT EXTERNAL CONTRACTUAL SERVICES

We reviewed the draft inspection report on the Review of Resource Management External Contractual Services (RM) and are pleased that the program was found to be in compliance with the Economy Act and that costs and overheads were properly recovered. We offer the following comments on the remaining findings:

The work performed is not a TVA core business and does not appear to align directly with TVA's Strategic Plan.

RM intends to exit chemical agent work once current contractual commitments with the Department of Defense (DOD) expire. Other work currently being performed for DOD, including environmental science and engineering; geographic information, engineering, and mapping; research and development; and project management related to Base Realignment and Closure (BRAC) may continue consistent with TVA's Strategic Plan core responsibilities related to energy and environment.

We also intend to continue work currently performed for and with the Electric Power Research Institute (EPRI), the Department of Energy (DOE), and distributors of TVA power related to energy, water, and environmental tasks.

The work being performed increases TVA's monetary, reputational, and environmental risks.

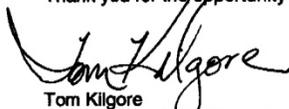
We believe the chemical agent work carries the greatest risk potential for TVA and, as noted above, intend to discontinue that work as soon as current contract requirements allow. The remaining work performed by RM utilizes core skills and expertise consistent with TVA's strategic direction and should not increase TVA's risk exposure. The current Risk Map (October 2007) characterizes this risk as "under development" rather than including it on the risk map as referenced in the report (page 12). Further review of the risks associated with these programs is scheduled soon and the risk assessment will be updated to reflect any changes.

For five of the 14 projects reviewed, a contract could not be provided. In addition, key decisions required by RM policies and procedures were not documented, or documentation was incomplete.

We will address these findings by improving documentation as TVA implements its new business management software in fiscal year 2008.

We plan to continue reviewing all aspects of RM work to ensure consistency with TVA's goals and strategic direction. We would appreciate the safeguarding of all sensitive information included or referenced in the report, including revenue, headcount, and insurance information.

Thank you for the opportunity to comment on the draft report.



Tom Kilgore
President and Chief Executive Officer
WT 7B-K

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