



Memorandum from the Office of the Inspector General

May 24, 2010

Janet C. Herrin, WT 10D-K

**REQUEST FOR FINAL ACTION – AUDIT 2009-12291-04 – REVIEW OF POSTPONED
AND CANCELLED CAPITAL PROJECTS – RIVER OPERATIONS**

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 within one year from the date of this memorandum when final action is complete.

If you have any questions, please contact Amy R. Rush, Senior Auditor, at (865) 633-7361 or Lisa H. Hammer, Director, Financial and Operational Audits, at (865) 633-7342. We appreciate the courtesy and cooperation received from your staff during the audit.

Robert E. Martin

Robert E. Martin
Assistant Inspector General
(Audits and Inspections)
ET 3C-K

ARR:JP
Attachment
cc (Attachment):

Peyton T. Hairston, Jr., WT 7B-K
Tom D. Kilgore, WT 7B-K
William R. McCollum, Jr., LP 6A-C
Richard W. Moore, ET 4C-K
Emily J. Reynolds, OCP 1L-NST
Scott D. Self, MR 6D-C
Joyce L. Shaffer, WT 9B-K
John M. Thomas III, MR 3S120
Robert B. Wells, WT 9B-K
OIG File No. 2009-12291-04



Office of the Inspector General

Audit Report

To the Senior Vice President,
River Operations

REVIEW OF POSTPONED AND CANCELLED CAPITAL PROJECTS – RIVER OPERATIONS

Audit Team
Amy R. Rush
Stephanie M. Broome
Jamie M. Wykle

Audit 2009-12291-04
May 24, 2010

SYNOPSIS

As part of our annual audit plan, we reviewed the process for postponing and cancelling capital projects. Our audit objectives were to determine whether fiscal years (FY) 2007 and 2008 project postponements and cancellations were properly approved, effectively communicated, and monitored to prevent inappropriate charges.

Our review specifically focused on the processes for the Nuclear Power Group, Power System Operations, Fossil Power Group, and River Operations (RO). Due to the unique aspects of each of these organizations, we will issue a separate report on each organization. This report addresses the process for the RO organization.

Based on our review, we determined all sampled cancelled capital projects reviewed were approved by the appropriate levels of authority and contained a capital classification designated by Fixed Asset Accounting (FAA). However, we noted that project documentation was not updated with changes in project status as required.

In addition, we determined that one project cancellation was not communicated to FAA; however, we noted that project costs related to the project were written off in a timely manner.

We recommended the Senior Vice President (VP), RO, in conjunction with other organizations:

- Establish a process for ensuring that project plans are updated with the project status as required by Standard Programs and Processes (SPP) 2.1.
- Develop and implement criteria related to project cancellations, including time requirements for communication of project cancellations to FAA and Business Services.

The Senior VP, RO, responded to a draft of this report and agreed with our recommendations. The Senior VP, RO, also provided planned actions in addressing those recommendations.

BACKGROUND

Each year, the Tennessee Valley Authority (TVA) initiates a wide variety of capital and operations and maintenance (O&M) projects. In that regard, TVA's project justification process is designed to ensure that such projects are aligned with TVA's vision, goals, and strategic plan objectives. As defined by TVA's

SPP-2.1: Project Justification Process,¹ the process consists of identifying project initiatives, coordinating and completing project reviews, receiving funding, approving projects, and executing projects which include project postponement, cancellation, and closure. Projects are initiated, owned, managed, and executed by the respective Strategic Business Unit (SBU).

According to TVA's Capitalization policy, projects are classified as capital if they result in the creation of new assets, the replacement of existing assets, or the removal of existing assets. Projects are considered O&M if they repair, restore, test, inspect, or assess existing assets. In addition, any capital project that is cancelled should be reclassified as an O&M project and project costs expensed. FAA personnel are responsible for determining the proper accounting classification for all projects under consideration for capitalization.

Capital projects greater than \$250,000 are required to be entered as stand-alone projects in the Project Justification System (PJS), which serves as the official database containing project data and project approval status. Depending on the cost and type of the project, there can be multiple levels of project approval. Projects less than or equal to \$250,000 are grouped together and entered into PJS as a "bucket." Projects are classified as one of three categories:

- Strategic – Projects initiated or sanctioned by the Board or management with costs greater than \$8 million.
- Base – Projects specific to an SBU to maintain its mission with costs less than or equal to \$8 million.
- Discretionary – Projects classified as Economic/Revenue, Capacity Growth, and Reimbursable.

Occasionally, projects may require a revision to change the project scope or priority and may need to be suspended, accelerated, or deferred.² When such a change occurs, the respective SBU must ensure the project change process is followed and adequately documented. Specifically, the SBU is required to (1) initiate a revised Project Justification (PJ) form with an explanation for the change and identification of the impacts on the project cost, schedule, scope, and/or benefits, (2) coordinate appropriate reviews for revisions to projects, and (3) update the Five-Year Project Plan.³

Depending on the project cost, projects are required to have various levels of approval. According to an interim policy, RO-SDP-9.17: Projects Process, RO has two project approval boards (PAB): a Pre-PAB and a PAB. The Pre-PAB

¹ During the review, SPP-2.1 was being revised to update the project authorization matrix. We used the latest approved revision for this testing.

² According to Chief Financial Officer personnel, project postponements or deferrals include projects where the in-service date (ISD) has been extended past the original planned ISD. During the period of postponement, costs may still be incurred, and work may still be performed on the project.

³ The Five-Year Project Plan is a "living" document comprising the current list of projects maintained as the SBU's funded and prioritized projects currently being implemented or planning to be implemented.

consists of a chairperson appointed by the RO SVP and the RO SVP's direct reports. The responsibilities of the Pre-PAB include evaluating projects greater than \$250,000. The PAB consists of a chairperson appointed by the RO SVP, direct reports to the RO SVP, and the RO SVP. The PAB is responsible for providing advice and objective critiques of new/revised projects requiring approval or concurrence by the RO SVP.

Once RO projects are approved, a project manager is responsible for developing, coordinating, monitoring, and ensuring completion of the project. A Project Control Specialist (PCS) is responsible for assisting the project manager with project documentation and tracking.

We determined there were a total of 589 postponed capital projects and 87 cancelled capital projects in FYs 2007 and 2008. Of those totals, RO had 32 postponed and 1 cancelled project (Table 1). As of FY 2008, RO projects deemed as postponed had a total requested budget and total expenditures of approximately \$326 million and \$93.7 million, respectively. RO-cancelled projects had a total requested budget of \$1.3 million and no total expenditures.⁴

	Postponed Projects	Cancelled Projects
Fossil Power Group	232 79	
Nuclear Power Group	80 3	
Power Supply Operations	233 4	
River Operations	32	1
Other	12 0	
Total	589	87

Table 1

OBJECTIVES, SCOPE, AND METHODOLOGY

As part of our annual audit plan, we reviewed the process for postponing and cancelling capital projects. Our audit objectives were to determine whether FYs 2007 and 2008 project postponements and cancellations were properly approved, effectively communicated, and monitored to prevent inappropriate charges. Our review specifically focused on the processes for the Nuclear Power Group, Power System Operations, Fossil Power Group, and RO. Due to the unique aspects of each of these organizations, we will issue a separate report on each organization. This report addresses the process for the RO organization.

⁴ Requested budget totals were obtained from PJS project documentation, and expenditures were obtained from FAA. These totals do not include "bucket" projects.

To achieve our objectives, we:

- Reviewed relevant policies and procedures governing the approval, communication, and monitoring of RO capital projects, including SPP-2.1: Project Justification Process, and RO-SDP-9.17: Projects Process.
- Interviewed RO project management, including PCS personnel, the Project Finance Specialist responsible for the PJS, RO Controller personnel, and FAA personnel.
- Identified 32 postponed and 1 cancelled project in FYs 2007 and 2008.
- Selected a statistical sample⁵ of four postponed projects and a judgmental sample of one cancelled project.
- Obtained and reviewed project documentation, including PJ forms, Five-Year Project Plans, Capital Reporting Summaries, and year-to-date cost information.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that 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 that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. 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.

FINDINGS AND RECOMMENDATIONS

Based on our review, we determined all sampled cancelled capital projects reviewed were approved by the appropriate levels of authority and contained a capital classification designated by FAA. However, we noted that project documentation was not updated with changes in project status as required.

In addition, we determined that one project cancellation was not communicated to FAA; however, we noted that project costs related to the project were written off in a timely manner.

APPROVAL OF PROJECTS

According to TVA's SPP-2.1: Project Justification Process, each SBU is required to obtain approval as defined in the Project Authorization Matrix for funded projects and project revisions meeting certain criteria. Project approval is required to be documented on the PJ form. We selected a sample of five projects, four postponed, and one cancelled and reviewed the PJS

⁵ For projects selected in the samples, we reviewed all revisions within scope for the project.

documentation for each project. We verified that all projects contained a capital classification designated by FAA and were approved by the appropriate groups/individuals in accordance with SPP-2.1.⁶

COMMUNICATION OF PROJECT STATUS

To facilitate project tracking, project status must be communicated by RO project management to FAA, Business Services, and internal project personnel. Specifically, projects having a cancelled status should be communicated to FAA and Business Services to ensure accuracy and timeliness of financial reporting. Cancelled projects as well as projects having a postponed status are required to be communicated within the organization to better facilitate project management. According to FAA process documentation and the Controller's Web site, communication of project status to FAA includes the submission of Form 4013, Capital Projects Completion/Cancellation Notice, for projects which are cancelled. Project cancellation status must also be submitted to Business Services since that organization is currently responsible for writing off project costs. Requirements for communicating this information to FAA and/or Business Services are not specified in SPP-2.1 or RO-SDP-9.17: Project Process. Communication of RO project status occurs during the Pre-PAB and PAB meetings as well as through project module notes which include project history. Communication for RO projects also occurs through the Five-Year Project Plan which is required by SPP-2.1 to be updated with changes in project status.

Communication to FAA and Business Services

We requested project communication from FAA for the sampled cancelled projects and determined that one cancelled project was not communicated to FAA; however, we noted the project costs were written off in a timely manner. According to FAA, Form 4013 is required to be submitted to FAA no later than ten business days after the cancellation date.

Communication Within RO

We obtained RO project module notes for the one cancelled and four postponed projects. In addition, we were provided RO Five-Year Project Plans. We reviewed the project plans and determined that of the five projects, the one cancelled project was not updated on the Five-Year Project Plan. Specifically, we noted that the project was included on the Five-Year Project Plan but was not marked as cancelled.

Based on discussions with project personnel and the review of project documentation, we determined that all sampled postponed projects had been postponed or cancelled for valid reasons. Reasons for postponing projects included scheduling issues and management request.

⁶ We did not test the accuracy of FAA's classification during this review. We relied on procedures performed in OIG Audit 2009-12429, where no exceptions were identified in our testing of FAA financial reporting controls related to the capital classification of projects.

MONITORING OF PROJECTS

According to TVA's Capitalization policy, FAA is responsible for determining the proper accounting classification for all projects under consideration for capitalization. According to FAA personnel, the project classification allows the SBU to charge appropriate costs related to the project as either capital or O&M, depending on the project classification. Specifically, if a project is designated as "capital" by FAA, it is the responsibility of the project manager to ensure only capital-type costs⁷ are capitalized. Similarly, only noncapital costs should be charged to O&M. Any capital project that is cancelled should be reclassified as an O&M project and project costs expensed.

We determined through interviews and policy reviews that a PCS assists the project manager with the cost control of projects. We reviewed a selection of capital costs for the sampled postponed RO projects and determined that costs appeared to be properly classified as capital costs. We also determined that project costs for the one cancelled project had been written off as of September 2008. During the review of project costs, we identified two RO projects in which travel costs were split among projects. According to RO project personnel, there is no policy governing the splitting of project costs. However, project management personnel stated that reviews, independent of the SBU, occur and that expenses were not material enough to affect the project budget.

RECOMMENDATIONS

We recommended the Senior VP, RO, in conjunction with other organizations:

- Establish a process for ensuring that project plans are updated with the project status as required by SPP-2.1.
- Develop and implement criteria related to project cancellations, including time requirements for communication of project cancellations to FAA and Business Services.

MANAGEMENT'S COMMENTS AND OUR EVALUATION

The Senior VP, RO, responded to our report on May 14, 2010 (please see the Appendix). Based on the response, the following actions will be taken by RO consistent with our recommendations:

- Procedure RO-SDP 9.17 will be revised to more explicitly state the requirements for updating project plans when appropriate.

⁷ Capital costs are costs incurred on the purchase of land, buildings, construction, and equipment needed to bring a project to a commercially operable status.

- Financial Shared Services (FSS) will develop a new procedure, FSS-SPP-13.11.1 (capitalization process), which will provide project cancellation criteria, including time requirements for communicating with FAA and Business Services.

We concur with RO management's planned actions.

May 14, 2010

Robert E. Martin
ET 3C-K

REQUEST FOR COMMENTS - DRAFT AUDIT 2009-12291-04 - REVIEW OF
POSTPONED AND CANCELLED CAPITAL PROJECTS - RIVER OPERATIONS

Thank you for the opportunity to review the subject draft audit. We offer the following comments on your recommendations.

1. Establish a process for ensuring that project plans are updated with the project status as required by SPP-2.1.

Response:

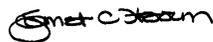
The requirements of TVA-SPP-2.1 are implemented by River Operations procedure RO-SDP 9.17. Procedure RO-SDP 9.17 will be revised to more explicitly state the requirements for updating project plans when appropriate. The procedure revision will be completed by June 30, 2010.

2. Develop and implement criteria related to project cancellation, including time requirements for communication of project cancellations to FAA (Fix Assets Accounting) and Business Services.

Response:

Financial Shared Services (FSS) is developing a new procedure, FSS-SPP-13.11.1 (capitalization process), which will provide project cancellation criteria, including time requirements for communicating with FAA and Business Services. FSS Accounting reports that this procedure is expected to be issued in June 2010. River Operations will follow this procedure.

Please let me know if you need any clarification.



Janet C. Herrin
Senior Vice President
River Operation
WT 10D-K

WLP:HL

cc: D. P. Cahill, LP 2P-C
R. J. Fisher, LP 6A-C
P. T. Hairston, WT 7B-K
D. A. Kearnaghan, LP 3D-C
R. E. Manning, MR 3H-C
W. R. McCollum, LP 6A-C

W. L. Poppe, LP 3D-C
R. C. Rupe, LP 6A-C
S. D. Self, MR 6D-C
J. L. Shaffer, WT 9B-K
P. D. Swafford, LP 3R-C
J. M. Thomas III, MR 3S-C
EDMS, WT CA-K