



Memorandum from the Office of the Inspector General

September 22, 2020

John J. Bradley

**REQUEST FOR FINAL ACTION – AUDIT 2020-15706 – ECONOMIC DEVELOPMENT
LOAN PROGRAM**

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.

If you have any questions, please contact Michael C. Cook, Senior Auditor, at (423) 785-4816 or Rick C. Underwood, Director, Financial and Operational Audits, at (423) 785-4824. We appreciate the courtesy and cooperation received from your staff during the audit.

David P. Wheeler
Assistant Inspector General
(Audits and Evaluations)

MCC:FAJ

Attachment

cc (Attachment):

TVA Board of Directors
David B. Fountain
Jeffrey J. Lyash
Justin C. Maierhofer
Jill M. Matthews
Jeannette Mills
Sherry A. Quirk
Stephen D. Surles
OIG File No. 2020-15706



Office of the Inspector General

Audit Report

To the Senior Vice
President, Economic
Development

ECONOMIC DEVELOPMENT LOAN PROGRAM

Audit Team
Michael C. Cook
Robert L. Dixon

Audit 2020-15706
September 22, 2020

ABBREVIATIONS

CCI	Corporate Credit and Insurance
ED	Economic Development
EDLF	Economic Development Loan Fund
FY	Fiscal Year
LC	Loan Committee
SOC	Special Opportunities Counties
SPP	Standard Programs and Processes
SVP	Senior Vice President
TVA	Tennessee Valley Authority

TABLE OF CONTENTS

EXECUTIVE SUMMARY	i
BACKGROUND.....	1
OBJECTIVE, SCOPE, AND METHODOLOGY	4
FINDINGS	5
LOANS ORIGINATED SUBSEQUENT TO EXPIRATION PERIODS	5
LOAN PROGRAM GUIDANCE COULD BE IMPROVED	6
RECOMMENDATIONS.....	6

APPENDICES

- A. OBJECTIVE, SCOPE, AND METHODOLOGY
- B. MEMORANDUM DATED SEPTEMBER 15, 2020, FROM JOHN J. BRADLEY TO DAVID P. WHEELER



Audit 2020-15706 – Economic Development Loan Program

EXECUTIVE SUMMARY

Why the OIG Did This Audit

The Tennessee Valley Authority (TVA) Act of 1933 states that one of the purposes of TVA is “. . . to provide for the agricultural and industrial development” of the Valley. TVA’s primary economic development goals are to recruit companies to locate in the Tennessee Valley, encourage expansion of existing business and industry that provide quality jobs, and assist communities with economic growth opportunities. TVA’s Economic Development (ED) organization administers a loan program to stimulate or enhance local economic development efforts in the Tennessee Valley. We included an audit of TVA’s ED loan program in our annual audit plan due to risks identified during a 2007 inspection of the same loan programⁱ and a 2018 audit of TVA’s ED Grants.ⁱⁱ

Our audit objective was to determine if TVA ED loans were executed and administered in accordance with TVA policies and procedures. Our audit scope included 59 loans with outstanding balances of approximately \$47.5 million as of December 31, 2019.

What the OIG Found

We found that TVA ED loans were generally executed and administered in accordance with TVA policies and procedures. However, we found instances where loans were originated subsequent to the expiration date of (1) credit analyses and/or (2) loan commitment periods. We also found that loan program guidance could be improved by incorporating the ED loan program guidelines into TVA Standard Programs and Processes 24.015, *Economic Development Loan Programs*.

What the OIG Recommends

We recommend the Senior Vice President, ED, take the following actions:

1. Ensure credit analyses and/or loan commitments are current when new loans are issued.
2. Update TVA Standard Programs and Processes 24.015, *Economic Development Loan Programs* to include ED loan program guidelines.

ⁱ Inspection 2007-512I *Review of Tennessee Valley Authority’s Economic Development Loan Program*, August 16, 2007.

ⁱⁱ Audit 2017-15488 *TVA Economic Development Grants*, July 18, 2018.



Audit 2020-15706 – Economic Development Loan Program

EXECUTIVE SUMMARY

TVA Management's Comments

TVA management agreed with the facts, conclusions, and recommendations. See Appendix B for TVA management's complete response.

BACKGROUND

The Tennessee Valley Authority (TVA) Act of 1933 states that one of the purposes of TVA is “. . . to provide for the agricultural and industrial development” of the Valley. TVA’s primary economic development goals are to recruit companies to locate in the Tennessee Valley, encourage expansion of existing business and industry that provide quality jobs, and assist communities with economic growth opportunities. TVA’s Economic Development (ED) organization administers a loan program to stimulate or enhance local economic development efforts in the Tennessee Valley.

Primary guidance for the program is provided in TVA Standard Programs and Processes (SPP) 24.015, *Economic Development Loan Programs*, which states the purpose of the loan program is to provide impetus to qualifying projects that create and/or retain jobs, result in capital investment, and/or provide economic benefit to the TVA region. TVA established further ED loan program guidelines outside TVA-SPP-24.015, which are contained in marketing materials distributed to potential borrowers. While TVA-SPP-24.015 enumerates the ED loan program process, the ED loan program guidelines include more specific loan parameters that affect how much TVA will lend.

TVA-SPP-24.015 states that “TVA seeks to invest in projects where a loan either (1) makes a difference in whether a project happens or (2) helps project financing structure by providing below market, attractive loan terms that enhance the cash flow of the project.” As an economic development lender, TVA is prepared to take on somewhat higher risk than conventional lenders, particularly in economically distressed areas.

TVA has two categories for which it issues loans under the ED loan program:

- Economic Development Loan Fund (EDLF) – loans designed to stimulate capital investment and job creation in the TVA region.
- Special Opportunities Counties (SOC) Loan Fund – loans designed to enhance economic development opportunities for the most economically disadvantaged counties in the TVA power service area.

Loan program balances as of TVA’s fiscal years (FY)-end 2015 through 2019 and first quarter-end FY 2020 are shown in Figure 1 on the following page.

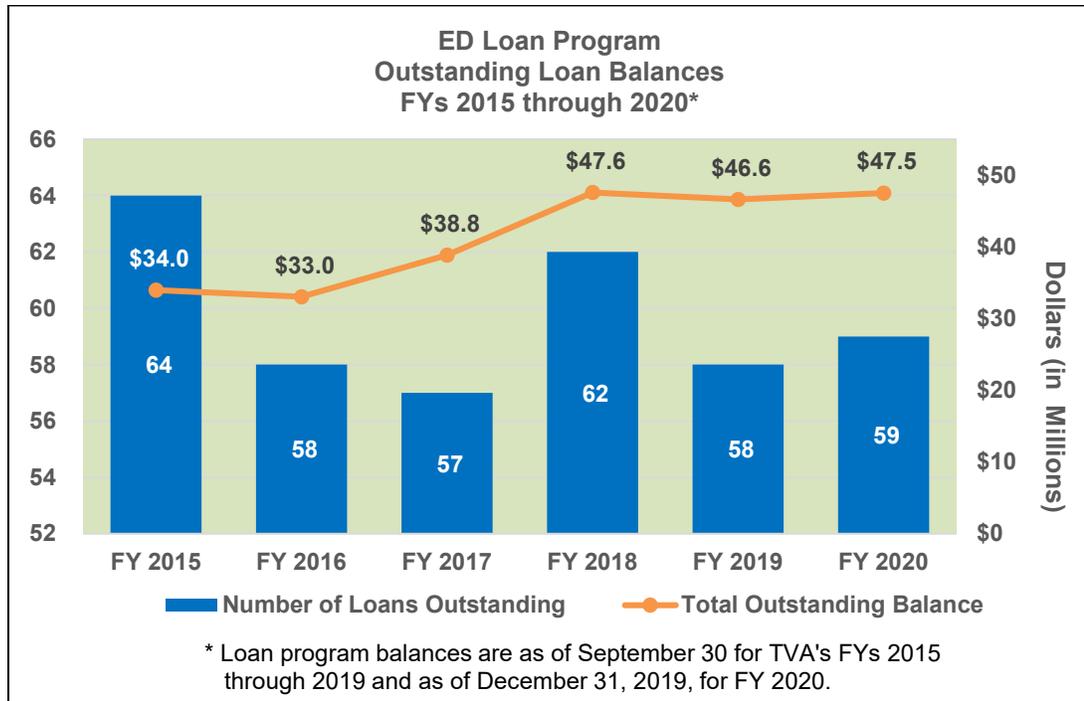


Figure 1

General Loan Terms

According to TVA's ED loan program guidelines, the maximum amounts for ED loans are (1) \$3 million for job-producing projects, (2) \$2 million for industrial land, and (3) \$1 million for speculative industrial buildings. TVA offers a fixed interest rate that is below prime, as well as a variable interest rate based upon TVA's average short-term cost of funds. TVA requires collateral to secure loans it makes to companies and economic development entities. The maximum loan period is dependent upon the type of security or collateral offered by the borrower.

EDLF Loan Program

ED loan program guidelines state EDLF loans seek ". . . to fill a funding gap or lower the funding costs of a project through below-market financing, thereby enhancing the opportunity for success. It is TVA's goal to partner with others in funding sound ED projects." Specific parameters for EDLF loans are set out below.

- According to ED loan program guidelines, loan amounts and terms are based primarily upon (1) jobs created and/or retained, (2) capital investment leveraged, (3) borrower's ability to repay the loan, (4) quality of collateral and other credit enhancements, and (5) perceived risk (financial condition, customer base, competition, etc.).
- TVA ED loan program guidelines state the typical loan size is \$500,000 to \$2,500,000, and the maximum loan amount for job-producing projects is \$3 million.

SOC Loan Program

According to ED loan program guidelines, SOC loans are typically used to either (1) help fill a gap that often occurs after traditional sources of financing are secured or (2) lower the cost of funds for the project or enhance the opportunity for success. Specific parameters for SOC loans are set out below.

- According to ED loan program guidelines, loan amounts and terms are based primarily upon (1) jobs created and/or retained, (2) capital investment leveraged, (3) borrower's ability to repay the loan, and (4) quality of collateral and other credit enhancements.
- The maximum loan amount under TVA ED loan program guidelines is \$1 million.

Loan Origination

According to TVA-SPP-24.015, TVA Corporate Credit and Insurance (CCI) personnel review project background and financial information and perform a credit analysis. This analysis has an expiration date, after which the analysis is no longer valid without a revision or extension by CCI. The ED Loan Committee¹ (LC) reviews all new loan requests and makes an approval recommendation to TVA's Senior Vice President (SVP), ED and the Treasurer and Chief Risk Officer, both of whom must approve new ED loans. Loans exceeding \$2 million must also be approved by TVA's Executive Vice President, External Relations. Once a loan has been approved, a commitment letter is sent to the counterparty outlining the terms and conditions of approval, the documentation and/or actions needed to close the loan, and a projected closing date. If the closing is not completed by this projected date, TVA performs additional reviews to determine if the closing date should be extended and the commitment reaffirmed. New loan activity for TVA's FYs 2015 through 2019 and first quarter FY 2020 are shown in Figure 2 on the following page.

¹ As of January 14, 2020, the ED LC is comprised of the Director, Treasury Management; Senior Program Manager, ED Strategy and Alignment; General Manager, ED Incentive Programs; Consultant, ED Product Development; and Director, CCI.

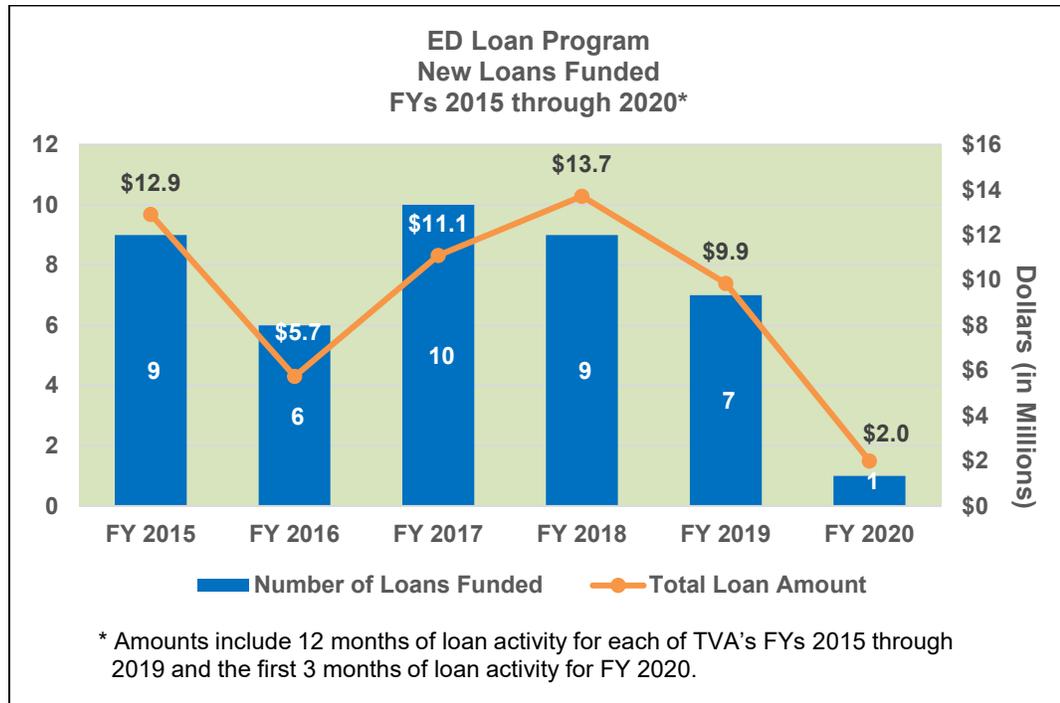


Figure 2

Allowance for Doubtful Accounts and Loan Write-offs

TVA conducts a review of the Allowance for Doubtful Accounts as needed based on analysis of the ED loan portfolio and an evaluation of the allowance balances to ensure that an appropriate level of funds are reserved for projected loan losses. During the period FYs 2015 through 2019, one loan with a remaining balance of \$62,745 was written off in FY 2015.

We included an audit of TVA's ED loan program in our annual audit plan due to risks identified during a 2007 inspection of the same loan program² and a 2018 audit of TVA's ED Grants.³

OBJECTIVE, SCOPE, AND METHODOLOGY

Our audit objective was to determine if TVA ED loans were executed and administered in accordance with TVA policies and procedures. Our audit scope included 59 loans with outstanding balances of approximately \$47.5 million as of December 31, 2019. A complete discussion of our audit objective, scope, and methodology is included in Appendix A.

² Inspection 2007-5121 *Review of Tennessee Valley Authority's Economic Development Loan Program*, August 16, 2007.

³ Audit 2017-15488 *TVA Economic Development Grants*, July 18, 2018.

FINDINGS

We found that TVA ED loans were generally executed and administered in accordance with TVA policies and procedures. However, we found instances where loans were originated subsequent to the expiration date of (1) credit analyses and/or (2) loan commitment periods. We also found that loan program guidance could be improved by incorporating the ED loan program guidelines into TVA-SPP-24.015. The following provides a detailed discussion of our findings.

LOANS ORIGINATED SUBSEQUENT TO EXPIRATION PERIODS

We selected a judgmental sample of 45 loans from a population of 59 active loans as of December 31, 2019. As shown in Table 1, we found 19 of 45 (42 percent) of the loans were issued after the expiration of the credit analysis, loan commitment, or both, taking into account any related extensions.

Loans Issued:	Number of Loans	Total Loan Amount
Prior to credit analysis and loan commitment expirations	26	\$32,263,439
Subsequent to:		
Credit analysis expiration	3	2,375,000
Loan commitment expiration	6	5,377,372
Both credit analysis and loan commitment expirations	<u>10</u>	<u>13,900,000</u>
Total Issued Subsequent to Expiration	<u>19</u>	<u>21,652,372</u>
Totals	45	\$53,915,811

Table 1

For those loans found to be issued after the expiration of the credit analysis or loan commitment, we reviewed and summarized the expiration periods, as shown in Table 2.

Loans Issued:	Number of Loans	Total Loan Amount
Subsequent to credit review expiration		
Expired by 10 days or less	9	\$11,750,000
Expired more than 10 days (33-186 days after expiration)	<u>4</u>	<u>4,525,000</u>
Total	13	\$16,275,000
Subsequent to loan commitment expiration		
Expired by 10 days or less	10	\$11,680,000
Expired more than 10 days (24-95 days after expiration)	<u>6</u>	<u>7,597,372</u>
Totals	16	\$19,277,372

Table 2

TVA ED personnel informed us that the majority of loans issued after expiration of the applicant credit analysis and/or loan commitments are attributable to the variable length of time required to complete loan closing. This involves coordination of all parties to provide documentation, review and approve contracts, execute documents, and finally, release loan funds to the borrower. While an attempt is

made to estimate the time needed to complete these activities, there are instances in which loan origination is completed after the approved expiration dates.

Issuing loans after credit analysis and loan commitment expirations could increase ED loan risk if the borrower's financial position or project characteristics have substantially changed since original credit review and approval.

LOAN PROGRAM GUIDANCE COULD BE IMPROVED

TVA's primary guidance for the ED loan program is provided in TVA-SPP-24.015 which states that:

The policies and guidelines contained in this document are utilized by Economic Development staff members and Economic Development Loan Committee members to evaluate and make recommendations for loan requests received by TVA for economic development projects.

However, TVA has also established ED loan program guidelines outside TVA-SPP-24.015, which are used for screening new loan applicants and determining individual loan terms. Currently, TVA incorporates the ED loan program guidelines into evaluation of all new loans funded.

Maintaining ED loan program guidelines outside TVA-SPP-24.015 could lead to inconsistent loan evaluation and approvals. For example, new or less experienced ED loan program personnel and LC members may incorrectly assume that TVA-SPP-24.015 includes all relevant program guidance. By incorporating all loan program guidance into one document, TVA would ensure that all loan parameters are readily available to all who need them. Further, by inclusion in TVA-SPP-24.015, this information would be subject to biannual review and update, which would help ensure program guidance consistency.

RECOMMENDATIONS

We recommend the SVP, ED take the following actions:

1. Ensure credit analyses and/or loan commitments are current when new loans are issued.

TVA Management's Comments – TVA management agreed with the recommendation and stated safeguards were built into the new loan tracking system (implemented June 2020) that will not allow the process to move past the expiration dates for credit analysis and loan commitments. See Appendix B for TVA management's complete response.

2. Update TVA-SPP-24.015, *Economic Development Loan Programs* to include ED loan program guidelines.

TVA Management's Comments – TVA management agreed with our recommendation and has begun updating TVA SPPs for the ED loan programs with loan guidelines and expects to complete this process by October 2021. See Appendix B for TVA management's complete response.

OBJECTIVE, SCOPE, AND METHODOLOGY

Our audit objective was to determine if the Tennessee Valley Authority's (TVA) Economic Development (ED) loans were executed and administered in accordance with TVA policies and procedures. Our audit scope included active ED loans with outstanding balances as of December 31, 2019.

To achieve our objectives, we:

- Reviewed TVA Standard Programs and Processes (SPP) 24.015, *Economic Development Loan Programs*, and other relevant program guidance to identify key requirements applicable to the execution and administration of ED loans.
- Interviewed ED, Treasury, and Office of the General Counsel personnel to gain an overall understanding of the loan program, including each department's administrative roles and responsibilities.
- Determined the significance of internal control to our audit objective and documented our understanding of the internal control environment relating to the ED loan program, including the primary controls in place, as well as our identification of the controls we determined are significant to the audit objective. The controls we determined to be significant to the audit objective include the following:
 - The Loan Committee approves new loans and is made up of members from different TVA groups, including Economic Development (ED), Treasury, and Corporate Credit and Insurance.
 - The Senior Vice President, ED and TVA's Treasurer and Chief Risk Officer provide approval for new loans.

We designed our testing to ensure we reviewed these controls to determine whether each was operating effectively.

- Obtained a listing of all 59 active ED loans with outstanding balances of \$47,526,418 as of December 31, 2019, as well as loan program summary information for TVA's fiscal years (FY) 2015 through 2019, and performed procedures to assess the reliability of the data.
- Selected a sample of 45 active loans with outstanding balances of \$43,417,115 as of December 31, 2019. Our sample included all loans issued since TVA-SPP-24.015 became effective on October 31, 2013. We reviewed available supporting documentation for each loan to determine (1) compliance with the requirements of TVA-SPP-24.015 and other relevant program guidance, and (2) whether internal controls deemed significant to the audit objective were operating effectively. Since this was a judgmental sample, the results of the sample cannot be projected to the population.
- Identified ED loans written off during TVA's FYs 2015 through 2019 and reviewed supporting documentation to verify appropriate TVA management approvals were obtained.

- Obtained the ED loan program allowance for doubtful accounts detail for TVA's FYs 2015 through 2019 and performed procedures to assess the reliability of the data.
- Performed a trend analysis of ED loan data as of FY-end for the past 5 FYs 2015 through 2019.
- Reviewed supporting documentation for loans included in the allowance for doubtful accounts balance as of September 30, 2019, including management's assessment of the collectability of these loans.
- Reviewed listing of active ED loans, as of December 31, 2019, to determine whether any active loans not included in the allowance for doubtful accounts should be considered for inclusion.

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.



Tennessee Valley Authority, 26 Century Boulevard, Nashville, Tennessee 37214

September 15, 2020

Dear Mr. Wheeler,

The Office of the Inspector General (OIG) performed an audit of Tennessee Valley Authority (TVA) Economic Development (ED) loan program in Fiscal Year 2020 to determine if TVA ED loans were executed and administered in accordance with TVA policies and procedures. Thank you for the opportunity to review and respond to this audit.

The OIG presented two recommendations in its draft audit report provided August 26, 2020. ED is in agreement with the facts, conclusions, and recommendations of the memorandum. Pursuant to the instructions included in the letter, below are the actions initiated and planned by ED on the recommendations in the report.

1. Ensure credit analysis and/or loan commitments are current when new loans are issued.
 - TVA ED built safeguards into our new loan CRM (CRM was fully implemented June 2020) that will not allow the process to move past the expiration dates for credit analysis and loan commitments.
2. Update TVA Standard Programs and Processes 24.015, *Economic Development Loan Programs* to include ED loan program guidelines.
 - ED has begun updating TVA Standard Programs and Processes for the Economic Development loan programs with loan guidelines and expects to complete this process by October 2021.

TVA ED is pleased with the overall results of the audit. Thank you for the opportunity to respond to the audit report and for the professionalism of your staff throughout the process.

Best Regards,

A handwritten signature in black ink that reads "John J. Bradley".

John J. Bradley
Senior Vice President
Economic Development