REPORT OF THE COMPTROLLER GENERAL OF THE UNITED STATES

Auditing Of Political Advertising By Electric Utilities And Gas And Oil Companies

Federal Power Commission
Internal Revenue Service

Political advertising by electric utilities and natural gas and oil companies can affect legislation and influence public opinion to the benefit of companies' owners.

The Federal Power Commission has regulations designed to make owners of companies under Commission jurisdiction, rather than the consumer, bear the cost of such advertisements. The Commission, however, could do more to insure that consumers are not required to pay for political advertisements.

The Internal Revenue Service also requires special treatment of political advertising costs by prohibiting inclusion of such costs as a normal operating expense for income tax purposes. GAO was unable to evaluate the method used by IRS to insure that such costs were properly treated because IRS refused access to its records.

EMD-76-2

JULY 16, 1976

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-178205

The Honorable Adlai E. Stevenson, III
United States Senate

Dear Senator Stevenson:

This report is a result of our review of auditing procedures relating to political advertising by energy producers. We made the review in accordance with your request of October 30, 1974, as modified by subsequent discussion with your staff. Since the Internal Revenue Service denied us access to the results of its audits, the report deals primarily with the auditing procedures of the Federal Power Commission. We did, however, summarize our position and the Internal Revenue Service's position on the matter of access to records.

This report contains recommendations to the Federal Power Commission which are set forth on page 17. As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the House and Senate Committees on Government Operations not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

Copies of this report will be sent to the Federal Power Commission so that the requirements of section 236 can be set in motion.

Sincerely yours,

Comptroller General
of the United States

Contents

ABBREVIATIONS

ECAP	Electric Companies Advertising Program
FPC	Federal Power Commission
GAO	General Accounting Office
IRS	Internal Revenue Service

COMPTROLLER GENERAL'S REPORT TO THE HONORABLE ADLAI E. STEVENSON, III UNITED STATES SENATE

AUDITING OF POLITICAL ADVERTISING BY ELECTRIC UTILITIES AND GAS AND OIL COMPANIES

Federal Power Commission
Internal Revenue Service

D I G E S T

Political advertising by electric utilities and natural gas and oil companies can affect legislation and influence public opinion to the benefit of the companies' owners. The Federal Power Commission has regulations designed to make utility owners, rather than customers, bear the cost of such advertisements. The Internal Revenue Service also requires special treatment of political advertising costs for tax purposes by prohibiting inclusion of such costs as a normal operating expense.

GAO initiated a review of the two agencies' audit procedures for insuring that their regulations are followed, but the Internal Revenue Service denied GAO access to needed records. IRS has consistently taken a position that matters involving the administration of the Internal Revenue laws are within the sole purview of the Joint Committee on Internal Revenue Taxation and outside the scope of GAO's responsibilities. GAO disagrees. (See pp. 19 to 21.)

Total advertising expenses of all types by the electric utilities and natural gas pipeline companies subject to Federal Power Commission jurisdiction amounted to about $74 million in 1973. These expenses, as a part of total operating expenses, were small in terms of their impact on the rates consumers paid. For example, only two-tenths of 1 percent of the revenue collected by the largest electric utilities and one-tenth of 1 percent of the revenue collected by the largest natural gas pipeline companies would cover the cost of all advertising.

Although advertising expenses are small, because they are sometimes used to influence public opinion on matters of a political

nature, the Commission has determined that the cost of political advertising should be separated from other advertising so that it may be highlighted for rate proceedings.

The Commission's rate jurisdiction extends only to sales for resale of electricity and natural gas in interstate commerce. The Commission feels that the wholesale market is not enhanced by promotional advertising and generally does not permit the cost of these advertisements to be used by utilities to justify higher rates. State regulatory commissions vary in the extent to which they permit utilities to use advertising costs to justify higher rates to their customers. (See ch. 2.)

Because both the Federal Power Commission and State regulatory commissions rely on the Uniform System of Accounts and Commission audits of utilities accounting records in their decisions in rate cases, the records should be complete and accurate.

Utility companies and Commission auditors, nevertheless, do not have adequate criteria for determining proper classification of advertising costs under the Uniform System of Accounts. Differences of opinion on cost classification have resulted from the inadequate criteria necessitating the Commission's judgment as to the proper classification of a particular advertisement. There is also a need for

--additional testing of utilities' advertising costs,

--clarification of inconsistencies in the audit coverage, and

--specific guidelines on how deficiencies found by Commission auditors are to be corrected.

GAO recommends that the Commission better define its regulations for the proper classification of advertising costs. In addition, GAO recommends that the Chairman of the Commission

improve current audit coverage of advertising expenses. (See p. 17.)

The Commission's Chairman agreed with the recommendations and advised GAO as to the actions taken or planned. (See p. 18.)

A description of several advertisements and the classification of them by the utilities are included in this report. (See p. 14.)

CHAPTER 1

INTRODUCTION

Political energy advertising by electric utilities and natural gas and oil companies can affect legislation and can influence public opinion. The Federal Power Commission (FPC) has promulgated regulations designed to make utility owners, rather than customers, bear the cost of such advertisements. The Internal Revenue Service (IRS) also requires special treatment of political advertising costs for tax purposes by prohibiting the inclusion of such costs in operating expenses.

Concerned that public utilities and oil companies are properly accounting for political advertising costs, on October 30, 1974, Senator Adlai E. Stevenson, III, requested that we review FPC and IRS audit procedures for political energy advertising. As a result of the request and a subsequent discussion with the Senator's office about matters relating to FPC, we are providing information on

--how utilities classify advertising expenses,

--the development of a comprehensive typology of the utilities' advertisements observed in our work to aid the Senator and his staff in making judgments as to whether particular advertisements should be classified as political or nonpolitical, and

--the adequacy of FPC's audit procedures with respect to advertising.

To provide a more complete background on advertising by companies subject to FPC regulation, we have also provided information on the extent to which

--advertising expenditures by utilities subject to FPC regulation affect the cost of services to ratepayers and

--FPC has control over the advertising costs which are passed on to ratepayers.

We were unable to review IRS's audit procedures, because the agency refused to grant us access to needed records. A discussion of our position and the IRS position on the matter of access to records is contained in chapter 4 of this report.

FPC'S AUTHORITY

The Federal Power Act (16 U.S.C. 824), as amended, and the Natural Gas Act (15 U.S.C. 717), as amended, require FPC to insure that wholesale rates charged by electric utilities and natural gas pipeline companies for sales in interstate commerce are just, reasonable, and nondiscriminatory. In general, FPC does not have the authority to regulate retail rates charged ultimate customers.

Accurate information on the cost of operations is essential for determining the reasonableness of electric and natural gas rates. One way FPC obtains such information is by prescribing accounting systems for electric utilities and natural gas pipeline companies, known as the Uniform System of Accounts.

Almost every privately owned company in the United States producing or selling electricity must keep accounting records in conformity with FPC's Uniform System of Accounts. In 1973, 210 of the 217 privately owned electric utility companies, with annual electric operating revenues of $1 million or more, were required to keep accounting records in conformity with the Uniform System of Accounts. On the basis of both assets and revenues, the 217 companies comprise nearly 100 percent of the privately owned sector of the electric light and power industry.

Natural gas pipeline companies with operating revenues of $1 million or more, which were required to keep accounting records in conformity with the Uniform System of Accounts, were limited to 80 companies in 1973. Natural gas producers, intrastate pipeline companies, and distribution companies do not sell natural gas in interstate commerce and, therefore, are not required to keep their accounting records as prescribed by FPC.

UTILITY COSTS PAID BY CUSTOMERS

Most costs of electric utilities and natural gas companies are recovered through revenues collected from customers. Expenses which can be included in customers rates are often referred to as above-the-line expenses. Costs which must be borne by stockholders are below the line. Naturally, utilities want all costs to be above the line, and they rarely spend money on things they can't charge to their customers. Citizens' groups often argue that ratepayers should not have to pay for certain expenses, such as promotional activities, charitable contributions, and advertising.

The Uniform System of Accounts plays an important role in regulating rates of electric utilities and interstate pipeline companies by providing a means of obtaining reliable, consistently developed cost determination information. To insure that costs are properly recorded, auditors of FPC's Division of Audits, Office of Accounting and Finance, audit the accounts of those public utilities required to maintain their accounting system according to the Uniform System of Accounts.

CHAPTER 2

UTILITY ADVERTISING UNDER FPC'S UNIFORM SYSTEM OF ACCOUNTS

Public utilities record advertising costs in one of three accounts as specified by the Uniform System of Accounts. Costs recorded in all three accounts amounted to about $73.6 million in 1973, which were the latest statistics available from the Federal Power Commission at the time of our review. These costs are small compared to total operating costs of $33 billion.

Including advertising costs in any of the three advertising accounts under the Uniform System of Accounts does not predetermine whether FPC or cognizant State regulatory commissions will permit such costs to be included in a utility's cost of service for determining future rates. In fact, FPC generally does not permit utilities to include any promotional advertising costs in their cost of service.

ACCOUNTING FOR ADVERTISING COSTS

Under FPC's Uniform System of Accounts, advertising costs are included in accounts 913, 930, or 426.4. Costs that are allowable deductions from operating revenue in arriving at net operating income are included under accounts 913 or 930. Costs that are not allowable are included under account 426.4. Advertising costs charged to this account, excluding payments to certain industry trade and politically oriented associations and public relations firms which also engaged in advertising, totaled only $22,717 for 1973.

Account 913, "advertising expenses," is to be used to record the cost of labor, materials used, and expenses incurred in advertising designed to promote or retain the use of utility service, except advertising the sale of merchandise by the utility.

Account 930, "miscellaneous general expenses," is a general account used to record the costs incurred in managing a utility not provided for elsewhere. Two specific items relating to advertising which are prescribed by the Uniform System of Accounts as includable in account 930 are (1) dues paid to industry associations, such as the Electric Companies Advertising Program (ECAP), and (2) institutional and goodwill advertising. Institutional and goodwill advertising promotes the image of the utility before its customers.

Account 426.4 is used to record the cost of certain civic, political, and related activities. Specifically, FPC has instructed that this account be used for:

> "* * * expenditures for the purpose of influencing public opinion with respect to the election or appointment of public officials, referenda, legislation, or ordinances (either with respect to the possible adoption of new referenda, legislation or ordinances or repeal or modifications of existing referenda, legislation or ordinances) or approval, modification, or revocation of franchises; or for the purpose of influencing the decisions of public officials, * * *"

IMPORTANCE OF ADVERTISING COSTS

Advertising costs make up a small percentage of total operating expenses by the companies subject to FPC regulation and, therefore, only a fraction of a percent of total revenue covers advertising costs.

Electric utilities

Sales by the 217 electric utilities were $33.2 billion in 1973. Of this amount, $31 billion, or about 93 percent, represented sales to ultimate consumers (retail) and thus the rate charged is under State regulation. The remaining $2.2 billion, or about 7 percent, represented sales for resale (wholesale), most of which were subject to FPC jurisidiction.

During 1973 these electric utilities charged about $64 million in advertising expenses to accounts 913 and 930. This $64 million represents only 0.24 percent of total operating expenses ($26.3 billion) during 1973 and only 0.19 percent of total revenues ($33.2 billion) for the same period.

Natural gas pipeline companies

The 80 largest natural gas pipeline companies subject to FPC regulation during 1973 had sales of $9.9 billion, of which $7.4 billion represented revenue from sales to wholesale customers, $1.9 billion represented revenue from sales to retail customers, and $0.6 billion represented revenue from other sources.

During 1973 these natural gas pipeline companies charged $9.3 million in advertising costs as an operating expense. This constitutes only 0.14 percent of total

operating expenses (6.7 billion) incurred by these utilities in 1973 and only 0.1 percent of total revenues (9.9 billion).

Therefore, even if all the cost of advertising by electric utilities and natural gas pipeline companies were included in the rates, the impact on the consumer would be small.

CONTROL OF RATES PAID BY THE ULTIMATE CONSUMER

FPC and State regulatory commissions are not bound by the Uniform System of Accounts to include advertising costs as part of the cost of service on which rates charged to customers are determined.

State commissions' regulation of rates

State commissions regulate almost all utility rates paid by ultimate consumers. About 93 percent of the sales of electricity in the United States by privately owned electric utilities are under State commission regulation.

State regulatory commissions rely on FPC's Uniform System of Accounts in varying degrees to insure that public utilities under their jurisdictions provide complete and accurate information on revenues and costs. However, State commissions must make decisions as to which costs will be included in the costs of service.

State regulatory commissions vary greatly in their treatment of advertising costs. Several State commissions, including Oklahoma, Iowa, Montana, and North Dakota, have ruled recently that institutional advertising in whole or in part is of questionable benefit to the ultimate consumer and therefore should not be part of the cost of service. In California, however, a utility successfully argued that institutional advertising was beneficial to the consumer because its informational content saved the cost of answering questions, an allowable cost included in the cost of service.

Similarly, the treatment of promotional advertising varies by State commission. For instance, the State commissions in Alabama and Hawaii have allowed promotional advertising in the cost of service of utilities where the promotional efforts were expanded to improve load factor. In Oklahoma, however, the State commission held that it would be in the public interest to prohibit public utilities and cooperative utility associations from making any type of promotional payments.

FPC's regulation of rates

FPC has jurisdiction over the wholesale sale of electricity and natural gas in interstate commerce. Wholesale sales for 1973 accounted for about 7 percent of total sales by the 217 electric utilities and for about 75 percent of total sales by the 80 natural gas pipeline companies.

According to FPC officials, except for advertisements that stress conservation of natural gas, all account 913 advertising expenses are routinely excluded in FPC ratemaking cases involving electric utilities and natural gas pipeline companies. FPC does not consider promotional advertising to be a legitimate cost of wholesale sales.

The 217 electric utilities and 80 natural gas pipeline companies charged $30.9 million and $6.0 million, respectively, to account 913 in 1973. FPC officials said that the $30.9 million charged by electric utilities was not a factor in ratemaking cases and that only that portion of the $6.0 million spent by natural gas pipeline companies for conservation advertising was an allocatable cost affecting the ratemaking process.

In 1973 charges for advertising to account 930 by the 217 electric utilities and 80 natural gas pipeline companies were $33.4 million and $3.3 million, respectively. Amounts classified to this account, which includes institutional advertising, are not routinely excluded for ratemaking purposes. Account classifications, according to FPC officials, are not detailed enough to prohibit the inclusion of institutional advertising in the allocation of miscellaneous general expenses in FPC ratemaking cases.

An FPC official said that, for ratemaking purposes, interstate natural gas pipeline companies were asked to provide an analysis of the expenses in account 930, but this was not always done. This analysis is not an FPC requirement but is requested by the FPC staff to help them analyze advertising costs. He also said that because of the limited time involved in approving rates, a complete audit of the entire account was not done. Another official of FPC's Section of Electric Rate Investigation said that, if electric utilities included political advertising in account 930, FPC's compliance audits should disclose it and should result in an appropriate disposition.

CONCLUSION

Costs included in accounts 913 and 930 totaled $73.6 million in 1973. Even if all such advertising costs

were included in the base for determining future rates, the effect would be relatively small considering that the total operating costs were $33 billion in 1973. FPC, however, generally does not allow account 913 costs to be included in the rate base and allows only a portion of account 930 costs. In addition, some State commissions do not allow costs of certain types of advertising to be included in the costs of service. The effect of advertising costs on rates paid by consumers appears, therefore, to be small.

CHAPTER 3

ADEQUACY OF FPC'S COMPLIANCE

AUDITS OF ADVERTISING EXPENSES

Audits of electric utilities' and natural gas pipeline companies' accounting records are usually made every 5 years. The purpose of these audits is to insure that the companies' accounting procedures are in accord with those prescribed by the Uniform System of Accounts.

Advertising costs hardly affect an individual's electric or gas bill; however, such costs are highly visible to the general public that is becoming skeptical about paying for advertisements that do not benefit the public. Because of this, we have identified some aspects of the Uniform System of Accounts and the Federal Power Commission's current auditing procedures for advertising costs that could be improved. They include (1) better defining FPC regulations on the proper classification of advertising costs under the Uniform System of Accounts to help eliminate differences of opinion between utility companies and FPC, (2) developing more definitive criteria, such as a list of advertising themes for its auditors to use in separating political advertising from other types of advertisements, and (3) insuring that auditors are following audit steps as required in their audit programs.

AUDITING ADVERTISING EXPENSES

At the start of our review, the FPC audit guidelines for electric utilities with regard to auditing advertising costs were different from the procedures for natural gas pipeline companies. The difference occurred because of a September 1974 revision to the guidelines for auditing electric utilities. An official of FPC's Office of Accounting and Finance said that it had an unwritten policy that, if it issued a change to one set of audit guidelines (electric or gas), the change would be applicable to both. At the time of our review, we were told that field auditors were using the revised electric utility audit guidelines for auditing the advertising expenses of natural gas pipeline companies, although they had no written instructions to do so. After our review, we were told that the audit program for natural gas pipeline companies has been changed to agree with the current audit guidelines for electric utilities.

FPC's September 1974 guidelines required auditors to:

--Determine, through discussions with company personnel, the company's (1) policy during the period under

audit with respect to promotional, goodwill, institutional, and conservation advertising and (2) criteria for separating political advertising from the above-mentioned advertising categories.

--Obtain the advertising department's log of advertisements placed during the latest year; watch for advertisements that may be politically oriented, such as advertisements criticizing the Clean Air Act, etc.; and obtain from the company a breakdown of the related cost of the advertisement.

--Obtain an analysis of trade association dues and contributions, such as Electric Utilities Advertising Program, and information on the nature of trade associations' activities, copies of advertisements placed, etc. If the company is not able to furnish the staff with necessary information to support the proper expense classification of these payments, the auditor should take exception to including these costs in operating expense accounts.

To evaluate the adequacy of FPC's audit guidelines for advertising expense, we reviewed the audit workpapers applicable to audits of 10 utility companies. The selection of the audits for review was based on a sampling of electric and gas pipeline companies relative to the size of the companies, their geographic locations, the amount spent on advertising, and the recency of the audits.

NEED FOR MORE DEFINITIVE CRITERIA FOR CLASSIFYING POLITICAL ADVERTISEMENTS

Utility companies do not have adequate criteria for properly classifying advertising costs under the Uniform System of Accounts. Also, FPC auditors reviewing the companies' accounting records for accuracy do not have adequate criteria for making proper judgments about such classifications.

An FPC official said that generally both utility companies and FPC auditors used the definitions of accounts 913, 930, and 426.4 as their criteria for classifying advertising costs. Because the definitions are not clear, differences of opinion have occurred between the utility companies and the auditors regarding cost classification.

For instance, FPC's audit staff found one advertisement entitled "Energy from the Sea--playing it safe" to be political in nature because it dealt with legislation pending in the Congress. The advertisement was sponsored by

16 utilities, 10 of which were subject to FPC jurisdiction The theme of the advertisement was that offshore drilling for natural gas on the outer continental shelf must begin as soon as possible to help meet the energy and environmental crises. The auditors advised these companies that the cost of the advertisement should be recorded in account 426.4. The companies did not accept the auditors' judgment and sought a reversal of their decision. When the companies found, however, that they were faced with the possibility of formal hearings, they agreed to reclassify the cost of the advertisements. An FPC official said that there are other instances in which the costs associated with particular advertisements have been appealed to the Commission because the utility companies did not accept the auditors' judgment.

Although FPC auditors are aware that the criteria for classification of advertising costs leaves room for differences of opinion, audit guidelines require them to determine, through discussion with company personnel, a company's advertising policies and criteria for separating the cost of political advertisements from the cost of other types of advertising. Workpapers prepared by the auditors for the 10 utility companies we reviewed indicated that this step was not done. An FPC official said the step may have been done and not documented because company officials sometimes respond that they use as a criterion the instructions pertaining to the advertising accounts under the Uniform System of Accounts.

The official said, however, that the audit step should be considered in the context of the overall audit approach to advertising expenses and that the step is just one way auditors can get some idea of a company's advertising policy. He said that if the company's advertising policy seemed to indicate it might be doing some political advertising and the company had no criteria for determining which costs were for political advertising, a closer look at its advertisements would be warranted.

Classifying advertising costs depends on clear criteria for utility companies to use in making judgments, such as a list of advertising themes FPC considers political. We believe that FPC auditors could more effectively insure that advertising costs are properly classified if criteria for classifying these costs were more definitive.

NEED FOR FPC TO CONSIDER REDEFINING THE SCOPE OF AUDIT COVERAGE

Audit guidelines for the prescribed scope of the audit coverage did not change with the revision of the guidelines in September 1974. Guidelines required that auditors review advertising expenses for the latest year. These guidelines were changed in May 1975, however, to require auditors to review advertising expenses for the last 2 years. This increased audit scope enhances FPC's ability to determine whether the companies' accounting procedures for advertising expenses are in accord with those prescribed by the Uniform System of Accounts.

However, since audits are conducted every 5 years, we believe FPC could further improve its audits by redefining the scope of audit coverage to include random testing of advertising expenses for the 3 years not currently reviewed. This extended coverage seems particularly applicable when questionable expenses are found during the period covered by the detailed review. Redefining the scope of audit coverage may also serve to eliminate some minor inconsistencies in the manner in which auditors review advertising expenses.

Inconsistencies in audit procedures occurred mainly in reviews of account 930. Workpapers for one electric utility company showed that the auditors did not review the nature of the advertising except to examine payment vouchers for a 2-month period. An FPC official said that the work was limited because the company was a subsidiary of a parent company and FPC did not do the same detailed audit at each subsidiary. The official also said that FPC had an understanding that any finding requiring correction at one subsidiary would be corrected at all subsidiaries and that, in the case of account 930, the detailed work had been done at another subsidiary.

FPC workpapers for four electric utility companies showed that FPC auditors had made an extensive review of account 930 for the latest year of the audit period.

Workpapers for two other electric utility companies showed that auditors did little audit work on account 930-type expenses except for examining vouchers and journal entries. One of the companies had made contributions to several organizations that had been known to do political advertising, but there was no evidence that the auditors attempted to ascertain the nature of the expenses.

We reviewed three natural gas pipeline company audits. One included little work on account 913 because the company had not used the account since 1971. At the other two companies, the auditors reviewed the account for the last year as required by the guidelines then in effect.

We reviewed workpapers on account 930 at three natural gas pipeline companies. At the first company, there was no indication that FPC auditors made a detailed analysis of the advertising costs charged except to determine if vouchers supported the amount reported. A detailed analysis of advertising costs was not made at the second company either. Work papers showed, however, that the auditors unsuccessfully tried to obtain information about the nature of advertising by trade associations to which the company belonged.

At the third company, auditors made a complete review of all company advertising for the year 1973, including a review of a large assortment of advertising clips.

NEED TO ENFORCE PROPER ACCOUNTING FOR ADVERTISING COSTS

In some instances where FPC auditors noted improper classification of advertising costs, they did not require the companies to reclassify the costs. In addition, the FPC audit staff has not been consistent in its treatment of companies that improperly classify advertising costs. As long as FPC continues this practice of allowing improper cost classifications, companies have no incentive to correctly classify costs.

In one instance FPC auditors disagreed with a company's charging the entire amount of a contribution to ECAP to account 930. They initially allowed the costs to remain as classified and recommended that in the future the company charge that portion of the contribution used for politically related advertisements to account 426.4.

After our review began and there was congressional concern about political advertising, including a number of ECAP advertisements, FPC reversed itself and has now ordered all the sponsoring companies to reclassify such costs to account 426.4. The companies have refused, and the FPC staff has set in motion procedures to obtain an FPC order to force the companies to reclassify the costs.

In another instance, we noted an ECAP advertisement which was clearly political according to a previous FPC decision. Nevertheless, FPC auditors did not make an audit

exception or require the company to reclassify the cost of the advertisement.

An FPC official said that FPC did not require reclassification because of the age of the advertisement (it had been run in 1972 and the audit was conducted in 1974) and because it represented the only example of advertising that FPC auditors found to be political. FPC workpapers did not contain the related cost of the advertisement but, on the basis of information we obtained about the cost of ECAP advertising, the company's related cost would be at least $3,000. FPC auditors, however, instructed another company to reclassify to account 426.4 the $1,136 it spent on a political advertisement.

Workpapers for a natural gas pipeline company showed that FPC auditors noted two questionable advertisements but made no audit exception, primarily due to the minimal amounts involved ($22,000 total cost of both advertisements). In addition, FPC auditors tried to obtain information about the company's participation in the American Gas Association but were unsuccessful.

In another instance the auditors did not review any advertisements under account 913 because only $11,217 had been charged to the account for the audit period.

In a third instance FPC auditors noted a company's membership in an organization which made expenditures of a political nature. The auditors made no audit exceptions because they felt the costs involved were minor.

TYPES OF ADVERTISING

We reviewed several types of advertisements included in FPC's workpapers supporting findings for audits of 10 companies. Generally utility companies use newspapers, magazines, television, radio, bill enclosures, and billboards to advertise. Utility companies also advertise indirectly through their participation in trade associations.

The following are general themes or recurring, unifying ideas found in the various advertisements reported under account 913.

1. Pleas for customer cooperation in overcoming problems a company was having in generating electricity because of inadequate rainfall which affects hydroelectric generation, increasing demand, and obstructions and delays in building powerplants.

2. Informing consumers of the problems faced by natural gas companies and informing them that financial incentives are needed before producers will accept the risks of deep drilling.

3. Informing consumers of the problems of natural gas companies which have created the need for higher rates on natural gas.

4. Informing the public of the need for continuing construction programs for nuclear powerplants to provide adequate energy supplies in the future.

5. Pleas for the customer's continued understanding and cooperation so the utility can provide energy today without overdrawing on the future.

6. Promoting the efforts of a company to make sure there is enough electric power to sustain the quality of life.

7. Customer tips on conserving electricity and gas.

8. Promoting use of more efficient lighting to save energy and reduce energy costs.

9. Promoting more lighting to make the home safer and more convenient.

10. Promoting homes with gas appliances.

11. Promoting all-electric apartments and condominiums.

12. Various advertisements on such things as safety tips for appliances, seasonal recreational ideas, how to label freezer meats, and recipes for food preparation.

The following are general themes found in various advertisements reported under account 930.

1. Consumer tips on conserving gas.

2. Promoting efficient use of appliances.

3. Displaying corporate names.

4. Supporting rate increases for utilities.

5. Advocating building nuclear powerplants to ease the energy crisis.

6. Promoting the safety record and describing the safety features of nuclear powerplants.

7. Alerting the public that Government-financed power systems are exempt from billions in taxes over the years which investor-owned electric light and power companies must pay.

8. Advocating offshore drilling for natural gas along the east coast.

Some themes under account 913 and 930 are similar. An FPC official said that this occurs because utilities interpreted differently to which accounts particular advertisements are to be charged according to FPC guidelines.

It is not economically feasible to determine the costs of the individual advertising themes detailed above. A major drawback of account 930 is that some advertisements were only partially paid for by the utilities because they may have been paid for through fees paid to trade associations by several utilities. In addition, when utilities sponsor trade associations, only part of the fee paid to the association may be used for advertising.

Several of these themes involve the advertisements questioned by FPC auditors as previously discussed. They are themes 2 and 3 under account 913 dealing with problems natural gas companies face in trying to provide adequate supplies of natural gas and themes 5 and 8 under account 930 dealing with the need to build nuclear powerplants and advocating offshore drilling for natural gas. Also, because of the similarities of themes between accounts 913 and 930, some advertisements that FPC questioned under 930 would also seem questionable under 913.

CONCLUSION

Although advertising costs are small compared to the total operating expenses of public utilities, they are nevertheless, highly visible to the general public and should be properly accounted for. We believe that some of FPC's current auditing procedures for advertising expenditures could be improved.

Utility companies and FPC auditors do not have adequate criteria for determining proper classification of advertising costs under the Uniform System of Accounts. Differences of opinions on cost classification have resulted from the inadequate criteria necessitating FPC's judgment as to the proper

classification of particular advertisements. More definitive criteria, such as a list of advertising themes for distinguishing between political and nonpolitical advertisements would help resolve the differences.

FPC usually audits utility companies once every 5 years. Before May 1975 auditors were required to review advertising expenses for the latest year; the May 1975 revision to the audit guidelines required a review for the latest 2 years. Although the 2-year coverage appears adequate from a detailed review standpoint, we believe that at least a random test should be made of advertising expenses for the other 3 years to further insure that such costs are being properly classified.

The questionable advertising expenses found by FPC auditors reviewing records for the latest 1-year period indicates that such additional testing is warranted. There is also a need to eliminate inconsistencies in audit coverage. These inconsistencies are made by auditors who fail to follow the audit steps as required in the audit program.

Workpapers showed that while some auditors reviewed all the advertisements placed by the company for the latest year under audit, other auditors only made a voucher analysis.

In some instances where auditors found improperly classified advertising costs, they were unsuccessful in getting the companies to reclassify the costs without instituting the lengthy process of obtaining an FPC order. In many instances the staff did not pursue the matter but merely recommended that the companies classify similar costs properly in the future. As long as FPC continues these practices, companies will have no incentive to classify correctly their costs.

RECOMMENDATIONS TO FPC

We recommend that the Commission better define its regulations on the proper classification of advertising costs under the Uniform System of Accounts. A better definition should eliminate differences of opinions between utility companies and FPC auditors as to the proper classification of such costs.

We recommend that, while awaiting Commission action, the Chairman, FPC, instruct the Office of Accounting and Finance to develop more definitive criteria, such as a listing of advertising themes for its auditors to use in separating political advertising from other types of advertisements.

We also recommend that the Chairman, FPC, instruct its Office of Accounting and Finance to (1) consider redefining the scope of the audits to include testing the classification of advertising expenditures for the 3 years not currently reviewed by auditors, (2) insure that auditors are following audit steps as required in the audit program, unless deviations are justified, and (3) establish specific guidelines for auditors to follow with regard to requiring utility companies to correct their accounting records when deficiencies are found.

AGENCY COMMENTS AND OUR EVALUATION

In a January 7, 1976, letter, the Chairman, FPC, agreed with our recommendations and described the actions that had been taken or were planned to implement them. (See app. I.)

The Chairman said that before receiving our draft report, the Office of Accounting and Finance was instructed to analyze the administrative problems associated with FPC's accounting regulations for advertising by jurisdictional companies and to make recommendations as to actions which might be taken, including changes in FPC's accounting regulations, to reduce or eliminate areas where differences of opinion or interpretation arise.

The Chairman said that the Office of Accounting and Finance had also been instructed to (1) adopt procedures to have field auditors promptly advised in writing of advertising themes as they emerge, with instructions to aid them in determining the appropriate classification of the related expenditures, and (2) take the necessary action to implement our recommendation with respect to FPC's auditing procedures.

Discussions with an FPC official in May 1976 disclosed that the Office of Accounting and Finance was in the process of changing its audit procedures consistent with our recommendations.

We believe that, if the Chairman's instructions are effectively implemented, FPC's accounting and auditing procedures governing advertising costs will be greatly improved.

CHAPTER 4

IRS'S REFUSAL TO GRANT ACCESS TO RECORDS OF AUDITS OF PUBLIC UTILITIES AND OIL COMPANIES

To enable us to review the adequacy of Internal Revenue Service audit procedures as they apply to political energy advertising, we requested IRS to furnish us with (1) its written procedures for auditing advertising expenses and (2) a listing of oil companies and public utilities that IRS had audited in the past 3 years. We told IRS we would then ask that audit reports and supporting workpapers for selected companies be made available for our review.

In its May 8, 1976, reply (see app. II), IRS furnished us with a copy of its audit technique handbook which contained instructions for auditing advertising expenses but refused to grant us access to its reports and workpapers on audits of oil companies and public utilities. Without these records, we were unable to test the adequacy of its audit procedures. We did note, however, that the instructions IRS furnished contained little guidance to aid auditors in making judgments about the political nature of advertisements. The instructions only tell the auditor to look for nondeductible expenditures claimed in connection with campaigns of political candidates or for the promotion or defeat of legislation.

Over the years, we have encountered consistent IRS refusal to grant us access to its records to review that agency's administration of the Internal Revenue laws.

IRS takes the position that matters involving the administration of the Internal Revenue laws are outside the scope of our responsibilities unless we are acting as the agent of the Joint Committee on Internal Revenue Taxation or of other congressional committees having oversight jurisdiction and authority to inspect tax returns. We disagree.

Our legal position and the position of IRS are essentially as follow.

IRS'S POSITION

IRS maintains that IRS regulations require that no matter involving the administration of the Internal Revenue laws, as distinguished from general housekeeping details and individual tax information related to an audit or investigation of activities of another department, can be "officially before" GAO. The bases for IRS's position are:

1. Administration and enforcement of the tax laws have been placed by law in IRS and, citing 26 U.S.C. 6406, the findings of fact and decisions of the Secretary or his delegate on the merits of any claim presented under the Internal Revenue laws or interest on credits or refunds shall not be subject to review by any other administrative or accounting officer, employee, or agent of the Government.

2. According to 26 U.S.C. 8022, the Congress has designated the Joint Committee on Internal Revenue Taxation, rather than GAO, responsible for supervisory review of the administration of the revenue laws.

3. GAO does not have authority to analyze management discretion in the collection of revenue.

OUR POSITION

We concede that we have no settlement authority over income tax claims and findings of fact relating to such claims. In auditing IRS, however, we would be exercising audit, not settlement, authority. Section 312 of the Budget and Accounting Act, 1921 (31 U.S.C. 53) and section 117a of the Budget and Accounting Procedures Act of 1950 (31 U.S.C. 67) clearly establish our authority to review all matters relating to the receipt, expenditure, and application of public funds, with the latter act giving the added authority to determine the principles and procedures to be used for such audits.

In addition, section 204(a) of the Legislative Reorganization Act of 1970, as amended, (31 U.S.C. 1154) provides that the Comptroller General shall review and evaluate the results of Government programs carried on under existing law. Finally, section 111(d) of the Budget and Accounting Procedures Act of 1950 (31 U.S.C. 65(d)) specifically provides that:

> "The auditing for the Government, conducted by the Comptroller General of the United States as an agent of the Congress be directed at determining the extent to which accounting and related financial reporting fulfill the purposes specified, financial transactions have been consummated in accordance with laws, regulations or other legal requirements, and adequate internal financial control over operations is exercised, and afford an effective basis for the settlement of accounts of accountable offices." (Underscoring supplied.)

The purpose of any GAO audit of IRS would be to ascertain and report to the Congress on IRS use of appropriated funds in its tax collection efforts. This would not involve review of tax claims and decisions with a view to set aside or change decisions that under the law are final when made by IRS. Similarly, such an audit of IRS would not entail any supervision of the procedures followed in making tax determinations. Of course, our audit reports would advise the Congress, if necessary, of weaknesses in IRS procedures. However, we would not actually supervise these procedures. Therefore, the authority of IRS over tax determinations under 26 U.S.C. 6406 does not in any way preclude audits of IRS under 31 U.S.C. 53 and 67.

IRS also contends that the Congress has given the Joint Committee on Internal Revenue Taxation, rather than GAO, the authority to conduct supervisory reviews of the administration of the revenue laws.

The Joint Committee was established by the Revenue Act of 1954 (26 U.S.C. 8001-8023), and its statutory functions include the investigation of the administration of taxes by IRS and the investigation of measures and methods looking forward toward the simplification of the tax law. We perceive no basis for the argument that the establishment of the Joint Committee preempted our review of IRS. Certainly the law does not specifically indicate such preemption; and parenthetically, it has never been argued that legislative oversight of the departments by the standing committees of the Congress precludes our review of the activities of such departments.

In regard to IRS's argument that GAO does not have authority to analyze the exercise of management discretion in the collection of revenue, the language of 31 U.S.C. 67 provides that "except as otherwise specifically provided by law," the financial transactions of the agencies shall be audited by GAO in accordance with such principles and procedures and under such rules and regulations as may be prescribed by the Comptroller General. It is our position, therefore, that except for the restrictions of 26 U.S.C. 6406, which make findings of fact and decisions on claims under revenue laws exempt from administrative review, we have the authority to audit IRS.

CHAPTER 5

SCOPE OF REVIEW

We made our review at Federal Power Commission headquarters offices in Washington, D.C. We reviewed legislation, regulations, policies, procedures, and reports on advertising and FPC's Uniform System of Accounts and reviewed workpapers associated with audits of electric utilities and natural gas pipline companies. We also reviewed IRS's written guidelines for auditing political advertising and attempted to gain access to IRS workpapers associated with audits of advertising expenses at electric utility, natural gas, and oil companies.

APPENDIX I

FEDERAL POWER COMMISSION
WASHINGTON, D.C. 20426

January 7, 1976

Henry Eschwege, Director
Resources and Economic Development
Division
United States General Accounting
Office
Washington, D. C. 20548

Dear Mr. Eschwege:

This letter is in response to the General Accounting Office's Draft Report titled "Advertising Expenditures by Utilities Subject to Federal Power Commission Regulation", which was submitted on November 28, 1975. On December 18, 1975, the staff discussed certain technical aspects of this report with representatives of your staff. The following comments are limited to replying to the recommendation contained in your draft report.

GAO RECOMMENDATION:

> "We recommend that the Commission better define its regulations relative to the proper classification of advertising costs under the Uniform System of Accounts. A better definition should eliminate differences of opinions between utility companies and FPC auditors as to the proper classification of such costs."

Prior to receipt of the subject draft report, and because of concern over the amount of administrative effort encountered by the Commission and its staff in regards to advertising expenditures, the Office of Accounting and Finance (OAF) was instructed to analyze the administrative problems associated with our accounting regulations for advertising by jurisdictional companies. OAF was requested to make recommendations as to action which might be taken including changes in our accounting regulations to reduce or eliminate areas where differences of opinion or interpretation arise concerning the classification of advertising expenditures.

Mr. Henry Eschwege

GAO RECOMMENDATION:

> "While awaiting Commission action, we recommend that the Chairman, FPC instruct the Office of Accounting and Finance to develop more definitive criteria such as a listing of advertising themes for its auditors to use in separating political advertising from other types of advertising."

Our Office of Accounting and Finance has endeavored to keep its field auditors abreast of types of advertising or advertising themes being sponsored by jurisdictional companies through both written correspondence and through training programs.

In recent years, the number of new themes introduced in advertising programs has increased so as to make it more difficult for field auditors to keep currently advised as to all new themes and obtain guidance as to the appropriate classification of advertising expenditures. OAF has now been instructed to adopt procedures to have field auditors promptly advised in writing, of advertising themes as they emerge with instructions to aid them in determining the appropriate classification of the related expenditures.

GAO RECOMMENDATION:

> "We also recommend that the Chairman, FPC instruct its Office of Accounting and Finance to (1) consider redefining the scope of the audits to include testing the classification of advertising expenditures for the 3 years not currently reviewed by auditors, (2) insure that auditors are following audit steps as required in the audit program, and (3) establish specific guidelines for auditors to follow with regard to requiring utility companies to correct their accounting records when deficiencies are found."

OAF has been appropriately advised to take the necessary action to implement this recommendation.

Sincerely yours,

Richard L. Dunham
Chairman

Department of the Treasury / **Internal Revenue Service** / Washington, D.C. 20224

Commissioner

MAY 8 1976

Honorable Elmer B. Staats
Comptroller General of the
United States
Washington, D. C. 20548

Dear Mr. Staats:

In re: B-178205

This is in further response to your letter of February 17, 1976, concerning your proposed review of the Internal Revenue audit procedures in conjunction with the administration of Section 162(e)(2) of the Internal Revenue Code as it applies to political energy advertising. We understand from your letter that Senator Adlai E. Stevenson III has requested the General Accounting Office to conduct such a review.

We are enclosing a copy of Internal Revenue Manual 4231, "Audit Technique Handbook for Internal Revenue Agents." Section 67(12) of this manual contains instructions for auditing advertising expenses and specific reference is made under item (1)(c) to expenditures claimed in connection with campaigns of political candidates or for the promotion or defeat of legislation.

In determining the deductibility of advertising expenses under Section 162(e)(2) of the Code, examiners use regular auditing techniques. This would include reviewing invoices and other documentary evidence as well as the text of the advertisements to determine the nature and purpose of the expenditures. If it is determined that the advertisements attempt to influence the public with respect to the desirability or undesirability of proposed legislation, the Service would disallow such expenses.

The Internal Revenue Service does not maintain a list of those oil companies and utilities whose income tax returns were audited in the last three years. Returns of corporations with assets of $250 million and above and utilities with assets of $1 billion and above are examined annually. Corporations, including oil companies and utilities, with assets below the amounts set forth above are audited as a part of our regular examination program. All returns are not selected for examination every year. Advertising expenses are reviewed as a normal part of every audit and are given close scrutiny during the audit of major firms.

APPENDIX II

Honorable Elmer B. Staats

Present law permits us to disclose tax return information to your office, for the purpose of reviewing the administration and enforcement of the Internal Revenue Code, only where the General Accounting Office is acting as the agent of the Joint Committee on Internal Revenue Taxation or other Congressional Committee having oversight jurisdiction and authority to inspect tax returns. However, as you know, the Internal Revenue Service supports the passage of H. R. 8948, 94th Congress, 2d Session, which would allow access to tax return data by the General Accounting Office for the purpose of evaluating the effectiveness, efficiency and economy of selected IRS operations and activities.

You may be interested to know that Senator Philip A. Hart, in his capacity as Chairman of the Subcommittee on the Environment, conducted a study regarding the political energy advertising of the major oil companies, major electric and natural gas utilities and other energy related firms. This study was conducted in 1974 and dealt specifically with the deductibility of such expenses under Section 162(e)(2) of the Internal Revenue Code.

We hope this information will be of assistance to you in your consideration of Senator Stevenson's request.

With kind regards,

Sincerely,

Commissioner

Enclosure

GAO note: Enclosure omitted because pertinent information is included in report.

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