125444

~~20410~~

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

RESOURCES, COMMUNITY, AND ECONOMIC DEVELOPMENT DIVISION

RESTRICTED — Not to be released outside the General Accounting Office except on the basis of specific approval by the Office of Congressional Relations

SEPTEMBER 25, 1984

B-214712

RELEASED

125444

The Honorable John D. Dingell
Chairman, Subcommittee on Oversight
and Investigations
Committee on Energy and Commerce
House of Representatives

Dear Mr. Chairman:

Subject: Evaluation of the Department of Energy's Economic Regulatory Administration Office in Tulsa, Oklahoma (GAO/RCED-84-192)

In response to your March 7, 1983, request and agreements reached with your office, we reviewed the operations of the Economic Regulatory Administration's (ERA's) Office in Tulsa, Oklahoma. As your office requested, we reviewed (1) the change in the management of audit cases involving alleged oil pricing violations, (2) ERA's basis for changing its treatment of crude oil transactions between crude oil producers and affiliated crude oil resellers, and (3) the justification for employee performance awards.

We found that the change in the management of audit cases did not adversely impact the development and resolution of audit findings. We did not find any examples of audit findings being dropped or modified as a result of the change. We also found that ERA's basis for changing its treatment of crude oil transactions between crude oil producers and affiliated crude oil resellers was consistent with both the Department of Energy's (DOE's) regulations and a 1982 court decision involving similar transactions. Further, we found that employee performance awards were fully documented and made in accordance with DOE criteria for making such awards.

BACKGROUND

The Emergency Petroleum Allocation Act of 1973 (15 U.S.C. 751 *et seq.*) required DOE and its predecessor agencies, beginning

530134

(308563)

on August 19, 1973, to establish and enforce regulations controlling the allocation and pricing of crude oil and refined petroleum products. The Secretary of Energy delegated this authority to the Administrator, ERA, who enforced compliance with the regulations until January 28, 1981, when the President issued Executive Order 12287 lifting all price and allocation controls on refined petroleum products.

ERA is responsible for (1) identifying violations of petroleum pricing and allocation regulations that occurred between 1973 and 1981, (2) recovering overcharges, and (3) obtaining restitution for injured parties. Oil companies, including crude oil producers, refiners, resellers, and retailers, were subject to the pricing and allocation regulations. ERA considered companies to be in violation of the regulations if they (1) charged prices higher than the regulations permitted or (2) imposed terms or conditions not customarily imposed. Such violations included, but were not limited to, making use of inducements, premiums, or discounts; falsification of records; substitution of inferior commodities; or failure to provide the same service and equipment previously provided.

When ERA, through its audits of an oil company's financial records, alleges violations of the allocation and/or pricing regulations, it may negotiate a settlement with the oil company. If a settlement is achieved, a consent order is written to specify the actions ERA and the company agree will settle the alleged violations. When a settlement is not achieved, ERA initiates its administrative process which calls for issuing a proposed remedial order to the company that identifies the alleged violations and recommends the action necessary to resolve them. If the company does not agree with the proposed remedial order, ERA refers the matter to DOE's Office of Hearings and Appeals, which adjudicates the case. If the Office of Hearings and Appeals concludes that a violation existed, it issues a final remedial order to the company, which can then appeal the order to the Federal Energy Regulatory Commission (42 U.S.C. 7193(c)) and then to the district courts of the United States (42 U.S.C. 7192 (b)). The company can appeal further to the Temporary Emergency Court of Appeals.[1] At any time in this process, from when the

[1]This court has exclusive jurisdiction over all appeals from the district courts of the United States in cases involving federal control of the allocation and pricing of crude oil and refined petroleum products.

violations are alleged through the issuance of a final remedial order, ERA may also initiate legal action in a court of law to resolve the alleged violations.

As of July 16, 1984, ERA had five field offices which were generally responsible for auditing the oil companies in their regions, preparing proposed remedial orders, and settling the companies' alleged violations. The workload of ERA's Tulsa Office primarily involved crude oil resellers. Any firm that made a sale of crude oil after the first time it was sold into U.S. commerce was considered a reseller. The ERA Tulsa Office audited resellers to determine whether the prices they charged for reselling crude oil were within the maximum levels allowed by the regulations.

OBJECTIVES, SCOPE, AND METHODOLOGY

Our review of the management of the audit cases covered the period from January 1, 1982, through November 30, 1983, when we completed our audit work. We selected this period because the current Director assumed responsibility for the ERA Tulsa Office operations in December 1981 and shortly thereafter, in February 1982, changed the Office's approach to completing its audit cases. We wanted to determine whether this change adversely impacted the development of the Office's audit cases. On the basis of our discussions with the Tulsa Office auditors about how the audit cases were being managed, we arbitrarily selected 9 of the Office's 25 ongoing audit cases and 2 of the 28 closed audit cases for detailed review. We reviewed the workpapers and documents, such as audit reports, status reports, and proposed remedial orders, prepared during the course of these 11 audit cases. The purpose of our review was to determine whether any audit findings were suppressed or otherwise weakened by the ERA Tulsa Office's management of the audit cases. Therefore, we were looking for instances where an audit finding was dropped or significantly changed without adequate justification.

We reviewed the ERA Tulsa Office's case management procedures and discussed them with both Office management officials and 16 of the 18 auditors on board as of October 1983.[2] We did not determine whether the Tulsa Office management's approach was the best method for completing the audit cases. Rather, we focused on whether (1) management had supportable reasons for its

---

[2]Two of the auditors were on leave (one was on extended sick leave) when we interviewed the ERA Tulsa Office auditors.

approach and (2) the development and resolution of audit cases had been adversely affected by this approach.

In reviewing the ERA Tulsa Office's audit case files, we did not attempt to assess the quality of the audits. To do so, we would have had to retrace the various audit steps and determine whether the audit results were justified by the supporting documentation. This would have been a very staff-intensive effort, which we believe was not necessary because we focused on whether the management decisions on how to pursue the alleged violations had adversely affected audit cases, rather than the quality of the audit work performed by the auditors.

In our review of the audit cases, we also evaluated ERA's basis for changing its treatment of crude oil transactions between crude oil producers and affiliated resellers. We reviewed applicable legal decisions to determine whether ERA had an adequate basis for its change in interpretation of the regulations. We also discussed this change in interpretation with the Acting Assistant General Counsel for Enforcement in DOE and requested the basis for the change. By letter dated December 8, 1983, he presented his office's basis for advising the ERA Tulsa Office Director that such transactions should be considered first sales.

To determine whether the justifications for the employee performance awards were adequate to demonstrate that the employees' performances met the criteria established for awards, we examined the documentation on all 14 employee performance awards issued during the 2-year period ending November 1983. We did not attempt to determine whether the employees' actual performances matched those described in the written justifications. We also discussed the employee performance awards procedures with the 16 auditors we interviewed to obtain their opinions on them.

At the Subcommittee's request, we did not obtain agency comments on this report.

Except for the limitations discussed above, our review was conducted in accordance with generally accepted government auditing standards.

MANAGEMENT OF AUDIT CASES

When the current Director of the ERA Tulsa Office assumed his duties in December 1981, the ERA Administrator charged him with the task of completing all of the Tulsa Office's audit cases by September 1982. The Director decided that to meet the Administrator's objective he needed to know the specific status of the audit cases, including the quality and completeness of the audit work, and what remained to be done to adequately complete the audits.

In January 1982, the Director had the entire audit staff begin to review the active audit cases. The purpose of this review was to prepare a status report on each open audit case, including the additional tasks needed to complete each case, and to determine whether the support for the alleged violations was adequate.

In February 1982, the Director decided to expedite this review process by having his experienced auditors perform the reviews, with the remaining auditors forming a task group to accomplish the tasks identified by the review group. The review group was responsible for determining the status of each case and whether conclusions were properly supported and for identifying any additional work necessary before legal documents on the alleged violation cases could be issued. The primary reasons cited by the review group as to why audit cases needed additional work were lack of supporting documentation and incomplete development of alleged violations. For those cases requiring additional audit work, the review group specified the work to be done and followed up to see that it was accomplished.

The task group was responsible for doing the additional work, which involved file indexing, obtaining supporting data for recalculating violation amounts, and doing additional audit work to update each case for periods not covered in initial audits. The task group also assisted the legal staff in the revision of litigation documents.

This new audit management approach generally changed the auditors' responsibilities. In the past, the auditors were generally responsible for specific audit cases and were expected to conduct the overall audit and to prepare a summary, including a description of each alleged violation. Under the revised approach, the auditors generally were not responsible for specific cases, but rather were assigned to either the review group or the task group, which required them to switch from one case to another. As they completed an assignment, management switched them to another assignment.

The ERA Tulsa Office management had two reasons for changing the office's approach to completing audit cases. First, as discussed earlier, management wanted to know the specific status of each audit case. Second, the nature of the Tulsa Office's workload had changed. As of January 1, 1982, the Tulsa Office had completed audits of 61 (62 percent) of its 98 open audit cases. In addition, all but 6 of the other 37 audit cases had already been partially developed. Therefore, future work on these cases primarily would involve completing specific tasks, rather than initiating and developing an entire audit case. The Director of the ERA Tulsa Office said that giving the auditors responsibility for specific tasks rather than specific cases would be the best means of completing audit cases. (The change in the status of the 98 audit cases between January 1, 1982, and November 30, 1983, is shown in the enclosure.)

Four of the 16 auditors interviewed said that they did not fully understand the rationale for the revised operating procedures. (The other 12 auditors did not share this concern.) The four auditors said that they did not fully understand why the review and additional audit work were necessary and what their responsibilities were. In February 1982, one of these four auditors wrote a memorandum to management asking for clarification of the task group's duties and how it was to accomplish them.

We discussed this matter with the ERA Tulsa Office Director. He agreed that initially some of the audit staff did not know why they were required to perform certain tasks and that the review group could have better communicated to the task group the purpose of the tasks. In response to the auditor's February 25, 1982, memorandum, the Director provided written instructions to the audit staff in a memorandum dated March 5, 1982.

On the basis of our review of the eleven audit cases, which included the workpapers, audit reports, status reports, and enforcement documents such as the proposed remedial orders, we found no instances of the Tulsa Office suppressing, diluting, or dropping supportable audit findings. Rather, the Tulsa Office's review of its audit cases, which began in January 1982, identified those audit cases which needed additional supporting documentation and/or whose alleged violations were not properly calculated. Subsequently, the Tulsa Office auditors followed up on these audit cases to obtain the necessary documentation and/or properly calculate the alleged violations. Consequently, we believe that the audit cases were adequately managed.

REVISED INTERPRETATION OF REGULATIONS

In March 1982, the ERA Tulsa Office Director, after consulting with DOE's Office of General Counsel (OGC), issued guidance to his audit staff on how to treat crude oil transactions between a crude oil producer and a crude oil reseller both of which were part of the same firm, i.e., affiliated companies. This guidance changed the method of determining whether such crude oil resellers were in violation of ERA's crude oil pricing regulations.

DOE's oil pricing regulations at Subpart D of 10 C.F.R., Part 212, imposed price controls on first sales of domestic crude oil by producers. Subpart D defined first sale as follows:

> "'First sale' means the first transfer for value by the producer or royalty owner. With respect to transfers between affiliated entities, the 'first sale' shall be imputed to occur as if in arms-length transactions."

Sales of crude oil by resellers were controlled by subpart F or subpart L. Subpart F applied to each sale of a covered product (other than the first sale of crude petroleum) made by resellers prior to January 1, 1978. Subpart L controlled each sale of crude oil, other than the first sale, for resellers after January 1, 1978.

Prior to March 1982, the Tulsa Office did not consider transfers of crude oil between affiliated producers and resellers to be first sales under subpart D. Rather, they considered a first sale to occur only when the crude oil was sold to a third party. Therefore, the Tulsa Office applied the subpart D price controls to sales made by resellers to third parties where the reseller had previously received the oil from an affiliated producer (affiliated transfers). On March 5, 1982, after consultation with DOE's OGC, the Director of the Tulsa Office advised his staff that affiliated transfers should be treated as first sales under subpart D, and sales by resellers to third parties should be regulated by subparts F or L, as appropriate.

By letter dated December 8, 1983, DOE's Acting Assistant General Counsel for Enforcement stated that the Tulsa Office's earlier application of the price control regulations could not be justified. He explained that neither subpart D's definition of first sale nor the contemporaneous explanation of this definition in the Federal Register at the time the regulations were promulgated suggest that for affiliated transfers the first sale would not occur until the reseller level. DOE's predecessor agency, the Federal Energy Administration, explained in the Federal Register that internal or affiliated transfers were deemed to have economic value and that a sale was considered to have occurred for purposes of subpart D, even though money and goods were not actually exchanged. In addition, the Assistant General Counsel stated that the revised interpretation was supported by a recent court decision, Gulf Oil Corp. v. DOE, 671 F.2d 485 (Temp. Emer. Ct. App. 1982), which held that transfers of natural gas liquids by a gas processor to its affiliated marketer were first sales under the subpart K natural gas liquid price control regulations. He pointed out that two subsequent judicial decisions, Johnson Oil Co., Inc. v. DOE, 690 F.2d 191 (Temp. Emer. Ct. App. 1982) and United States v. Exxon, 561 F. Supp. 816 (D.D.C. 1983), appeal docketed on other grounds, No. DC-93 (Temp. Emer. Ct. App. July 6, 1983), supported the revised interpretation of the regulations.

For the reasons cited by DOE's Acting Assistant General Counsel for Enforcement, we agree with DOE's conclusion that affiliated transfers are first sales subject to subpart D regulations. We believe that DOE's reliance on the Gulf Oil decision to support this conclusion was appropriate. In March 1982, when DOE directed the Tulsa Office to change its application of the subpart D regulations, only the Gulf Oil decision was available to lend judicial support. In the Gulf Oil decision, the court decided that affiliated transfers of natural gas liquids are first sales under subpart K. Although this was an interpretation of regulations applicable to different petroleum products, it was sufficiently analagous to lend support to DOE's conclusion concerning affiliated transfers of crude oil. Both subparts D and K define first sale in a similar manner and in each instance in promulgating these definitions, the Federal Energy Administration indicated that the definition would inlcude affiliated transfers. Later, in United States v. Exxon, a federal district court used the Gulf Oil decision to support its conclusion that affiliated transfers of crude oil are to be considered first sales under subpart D.

This change in how affiliated transfers of crude oil were treated affected eight audit cases in ERA's Tulsa Office. In these cases, the ERA Tulsa Office auditors had originally considered the transfer of crude oil from a producer to its affiliated crude oil reseller and the subsequent sale to a non-affiliated third party as one transaction. As such, the auditors had compared the price paid by the third party with the maximum selling price allowed the producer under subpart D for the first sale of crude oil to determine whether the maximum allowable selling price had been exceeded. As a result of treating these transfers as one transaction, the ERA Tulsa Office auditors had alleged that the maximum allowable selling prices had been exceeded by a total of $1.9 million in these eight audit cases, with individual alleged violations ranging from $14,775 to $1,264,887.

As a result of changing the interpretation of when a first sale occurred under subpart D, the ERA Tulsa Office auditors began to reanalyze the transactions in these eight audit cases. In their reanalysis they treated these crude oil transfers from the producer to the affiliated reseller and the sale to the third party as two separate transactions. They treated the transfer from the producer to the reseller as a first sale under subpart D, and treated the sale by the reseller to the third party as a subsequent sale of crude oil regulated by other subparts of DOE's regulations.

As of November 7, 1983, the ERA Tulsa Office had completed its reanalysis of one of the eight cases. In that case, the auditors found that treating the transfers as two separate transactions meant that the maximum allowable selling price had been exceeded by $15,269, rather than the $107,597 alleged when the transfers were treated as one transaction. The reason for the amount of the alleged violation being less was that treating the transfers as two separate transactions increased the reseller's allowable costs, thus also increasing its maximum allowable selling price.

The ERA Tulsa Office auditors had not completed their reanalyses of the other seven reseller cases at the time we completed our audit work. However, based on their preliminary reanalyses of these seven cases, in which the ERA Tulsa Office auditors had originally alleged that the maximum allowable selling price had been exceeded by $1.8 million when the transactions were treated as transfers, it appeared that the alleged violations would be only about $24,820 less as a result of treating the transfers as two separate transactions.

PERFORMANCE AWARDS

During the 24-month period ending November 1983, 14 employees from the Tulsa Office were recommended for cash awards and all nominations were approved at DOE headquarters. The awards were supported by performance appraisals prepared by a supervisor and approved by the Director of the Tulsa Office. The appraisals contained a narrative description of the employees' level of performance and showed the factors and elements of performance that the supervisors considered worthy of an award. Also, the supervisors of the employees nominated for awards adhered to prescribed DOE guidance and certified that such employees exceeded normal job requirements.

Our discussions with the 16 ERA Tulsa Office auditors disclosed that the majority (10 of 16) believed that the awards were handled in a fair and equitable manner. Three auditors did not express an opinion on the awards process. The other three auditors said they believed the awards were not handled in a proper manner because, in their opinion, some auditors who were not meeting performance standards received awards because they were friendly with management.

Our interviews with the 16 ERA Tulsa Office auditors and our review of office records showed that the supervisors based their award recommendations on employees' performances which, in the supervisors' opinions, exceeded normal job requirements.

CONCLUSIONS

On the basis of our audit work, we believe that the ERA Tulsa Office adequately managed its audit cases. Our review of the Tulsa Office's operations covered a period during which its workload primarily consisted of finalizing previously developed audit cases. Given this type of workload and its need to know the exact status of each audit case, management initiated a different management approach than the one employed when the audit cases were first being initiated and developed. Our review of selected audit cases showed that this revised approach did not adversely affect the development and resolution of audit cases.

We believe that ERA's basis for changing its treatment of crude oil transactions between crude oil producers and affiliated crude oil resellers was consistent with both DOE's regulations and a 1982 court decision involving similar transactions.

Concerning the ERA Tulsa Office's employee performance awards, our review of the office records and discussions with the auditors showed that supervisors recommended the awards in accordance with prescribed DOE guidance, and certified that employees' performances exceeded normal job requirements.

- - - -

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of the report. At that time we will send copies to interested parties and make copies available to others upon request.

Sincerely yours,

J. Dexter Peach
Director

Enclosure

CHANGE IN STATUS OF ERA TULSA OFFICE
AUDIT CASES DURING PERIOD
JAN. 1, 1982, TO NOV. 30, 1983

		Number of cases
Caseload as of Jan. 1, 1982		98
Cases transferred in during the period		4[a]
Total		102
Cases disposed of during the period:		
Settled	24	
Closed with no violations	28	
Proposed remedial order issued	14	
Transferred to other ERA offices or DOE headquarters	11	
Total		77
Caseload as of Nov. 30, 1983		25[b]

[a]Of these cases, one was subsequently transferred to ERA headquarters and the other three were open cases as of Nov. 30, 1983.

[b]Does not include 79 cases relating to newly discovered crude oil, which were assigned by ERA headquarters to the ERA Tulsa Office in December 1982. Generally, newly discovered crude oil is domestic crude oil sold after May 31, 1979, which was produced from an area from which there was no production in calendar year 1978. We did not include these cases in the schedule because they represented a new audit area and we wanted the schedule to show the change in status of those types of cases assigned to the ERA Tulsa Office as of January 1, 1982. Of these 79 cases, 42 were still active as of November 30, 1983.