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REPORT TO THE SUBCOMMITTEE ON REORGANIZATION, RESEARCH, AND INTERNATIONAL ORGANIZATIONS COMMITTEE ON GOVERNMENT OPERATIONS UNITED STATES SENATE

Problems In The Federal Energy Administration's Compliance And Enforcement Effort

B-178205

Federal Energy Administration

UNITED STATES GENERAL ACCOUNTING OFFICE

12/6/74

DEC 6, 1974

OSP-75-7

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

B-178205

The Honorable Abraham A. Ribicoff
Chairman, Subcommittee on Reorganization,
Research and International Organizations
Committee on Government Operations
United States Senate

Dear Mr. Chairman:

This report is in response to your letter of February 8, 1974, asking that we continuously monitor the operations of the Federal Energy Administration (FEA). On July 23, 1974, we sent you a report on "Problems in the Federal Energy Office's Implementation of Emergency Petroleum Allocation Programs at Regional and State Levels", (B-178205). The report pointed out that FEA's enforcement and compliance effort was rather limited and may have been misdirected and stated that we would examine the effectiveness of the compliance and enforcement program in more depth. This report summarizes the information presented at a September 30, 1974, briefing with staff members of your Subcommittee on the results of our work.

In developing this report, we (1) visited 4 of FEA's 10 regional offices--Atlanta, Chicago, Dallas, and San Francisco, (2) examined FEA audit reports and, in some cases, supporting documentation, and (3) held discussions with FEA auditors, investigators, and program officials.

Price regulations involve all elements of the petroleum industry from production of crude oil to the retail sale of petroleum products. All crude oil producers, refiners of petroleum products, wholesalers, and retailers come under price regulations. To illustrate the magnitude of the enforcement effort, there are about,

--19,000 producers of crude oil,
--200 companies with a total of about 250 refineries,
--25,000 wholesalers, and
--200,000 retail gasoline stations.

The vertical integration and multinational character of the major petroleum companies increases the complexity of enforcing petroleum pricing regulations.

FEA's reluctance to allow us full access to information relating to the refinery audit impeded our evaluation. FEA provided us with information on their completed refinery audits, but would not provide any information on uncompleted audits. FEA officials said uncompleted audits involved unresolved issues which might result in court cases against the companies and they believed that court cases might be jeopardized by providing us with information. Since many of the problems FEA uncovered were considered unresolved issues at the time of our audit, our ability to completely evaluate the extent of the problems as well as the adequacy of FEA's efforts to resolve them was limited.

We believe the language of the Federal Energy Administration Act of 1974 (88 Stat. 96) is clear regarding GAO's access to FEA records. Section 12(a) of the act requires GAO to both monitor and evaluate the operations of the Administration and provides that the Comptroller General

> "* * * shall have access to such data within the possession or control of the Administration from any public or private source whatever, notwithstanding the provisions of any other law, as are necessary to carry out his responsibilities under the Act * * *."

Section 12(f) further requires that GAO carry out its responsibilities in a manner which will preserve the confidentiality of proprietary data of private companies as defined by 18 U.S.C. 1905. The act makes no distinctions or exceptions for records relating to uncompleted audits or matters under investigation.

We have continued to discuss with FEA officials their reluctance to allow us full access to information relating to refinery audits in view of the broad access authority contained in the FEA Act. On December 4, 1974, the Administrator, FEA, in a letter to the Comptroller General agreed that the FEA Act contains no explicit limitations exempting certain classes of data in FEA's possession from access by GAO when such information is necessary for GAO to carry out its statutory responsibilities. He also stated that FEA does not intend to contest further GAO's view that the FEA Act allows it "plenary access" to all such data. The Administrator expressed FEA's concern that methods can be developed whereby GAO will be able to carry out its statutory responsibilities without impairing FEA's compliance activities, particularly where investigations have reached the point that FEA is seeking administrative sanctions for violations of its regulations or litigation is involved where the United States is a party. A copy of the Administrator's letter is enclosed as Appendix I.

We believe the Administrator's letter reflects his agreement on a workable framework for GAO access to the information it requires to fulfill its responsibilities under the FEA Act.

The information furnished us on completed audits revealed significant problems in FEA compliance activities at all four levels of industry operations in that:

--There was almost no direct audit of crude oil producer operations which provide the basis for the cost of crude oil processed in refineries.

--FEA concentrated its audits at the retail level and found numerous violations, however, there was evidence of large violations at the wholesale level where little audit effort had been directed.

--The audits of refiner operations were not completed.

--Substantive issues relating to the adequacy of regulations remain unresolved.

--Organizational disputes within FEA hindered the refinery audit effort.

Assuming petroleum products remain under price control, we believe FEA will have to substantially strengthen its compliance and enforcement program at all levels if it is to have adequate assurance that firms are in substantial compliance with pricing regulations.

On November 12 and 13, 1974, we met with FEA officials to discuss their comments on a draft of this report. They indicated general agreement with our findings and advised us of substantive changes designed to improve the compliance and enforcement program. More detailed information on our findings and conclusions and FEA actions follow.

LEGISLATIVE BACKGROUND

The Emergency Petroleum Allocation Act of November 1973 (87 Stat. 627) was designed to minimize the adverse impacts of short-term petroleum shortages. This goal was to be achieved through equitable restrictions on supply, cost, and profit. The act is the basic legislative authorization for continued control of petroleum product prices and, unless extended, its provisions expire on February 28, 1975.

The Federal Energy Administration Act of May 7, 1974, (88 Stat. 96) provided for a reorganization of governmental functions, on an interim basis, to deal with energy shortages. FEA was given the tasks of (1) inventorying energy resources, (2) developing a comprehensive national energy policy, and (3) insuring that energy programs are designed and implemented in a fair and efficient manner.

The act stated that FEA was to,

--promote stability in energy prices to the consumer,

--promote free and open competition, and

--prevent unreasonable profits.

FEA REGULATIONS

To bring about the legislated energy goals, FEA and the predecessor Federal Energy Office established a series of regulations governing the allocation and price of crude petroleum and refined products. Allocation regulations have evolved from a strict proration at 1972 supply levels during the Arab oil embargo to a more liberal proration at 1973 supply levels, or even higher in recent months. Price regulations have remained relatively constant.

Production of crude petroleum is subject to three basic price rules. First, monthly production up to the level of 1972 is controlled at a price of about $5.25 per barrel. Crude petroleum determined under this rule is termed "Old Oil."

Secondly, production over the level of 1972, termed "New Oil", and production from wells yielding 10 barrels or less a day, termed "Stripper Well Oil", are not price controlled and can be sold at the existing market price--about $10 a barrel.

Thirdly, for each barrel of new oil that is produced in a given month, a like amount of the old oil production for the month is released from price controls.

The refiner, wholesaler, and retailer of petroleum products are subject to the general rule that they may not exceed a base period profit margin. The base period is determined by averaging the highest annual profits for any 2 years ending after August 15, 1968. Within that general rule, firms may generally charge the prices in effect on May 15, 1973, increased dollar-for-dollar for any product costs incurred subsequent to that date. Further, when the firms can substantiate increases in non-product costs, such as labor or overhead, they are allowed additional price increases.

COMPLIANCE AND ENFORCEMENT ACTIVITIES

Originally, FEA regional offices were responsible for program direction of compliance and enforcement activities, except for certain audits of major oil refiners which FEA headquarters directed. Because of an early need for trained auditors, actual compliance and enforcement work was performed by Internal Revenue Service (IRS) employees in accordance with a Memorandum of Understanding between FEA and IRS. Under

the Memorandum of Understanding, dated January 11, 1974, FEA transferred compliance and enforcement responsibilities for allocations and pricing to IRS through June 30, 1974. IRS immediately assigned 300 investigators to this work and agreed to hire and train additional energy investigators who would be transferred to FEA on July 1, 1974, at which time program operations would be returned to FEA.

On July 1, 1974, FEA, using about 850 investigators hired and trained by IRS, assumed control of the compliance and enforcement effort. In our previous report, we pointed out that IRS concentrated its compliance efforts at the retail level. The following table shows how the original 300 auditors were used by IRS.

Assigned to	
Producer audit	0
Retail-wholesale	236
Refinery audit	64
Total	300

During the period January to June 1974, IRS hired additional auditors who were assigned to FEA compliance and enforcement activities after training. The following table shows how FEA assigned compliance and enforcement manpower after July 1, 1974.

Assigned to	
Producer audit	0
Retail-wholesale	762
Refinery audit	88
	850

FEA's efforts in each of these assigned areas are discussed below.

Producers

As shown by the preceding tables, neither IRS nor FEA assigned any of the compliance and enforcement staff to producer audits. FEA officials told us, however, that in some instances producer records were looked at either as part of a refinery audit or on a selected basis.

Audits of producer operations are important because it is the point of production that the type--new, old, stripper or release--and consequent price of crude oil used in refineries is determined. Since the cost differences between old and other types of crude oil are substantial, an adequate program of verification at that level is needed to insure that crude purchasers and ultimately consumers are not overcharged.

Specific steps for review of crude production were added to the refinery audit guidelines on July 24, 1974; however, as of mid-November 1974, FEA was still in the process of developing its first full-scale review of producer operations.

The five States covered by FEA's Dallas region account for over 70 percent of the crude production in the United States. This region planned to audit 20 percent of the independent producers if its staff of auditors could be increased from 50 to 70.

Wholesalers and retailers

FEA's enforcement and compliance effort has identified substantial violations at both the retail and wholesale level As previously described, IRS and FEA concentrated their effort at the retail level. According to FEA officials, auditors concentrated on violations at the retail level because the consuming public was more sensitive to these violations and because they could be investigated faster than wholesale violations.

According to FEA records, FEA and IRS investigated 80,137 wholesale and retail firms as of September 27, 1974. These investigations uncovered 18,034 price violations and resulted in refunds of $51.2 million to the marketplace.

We could not determine from FEA records the total number of investigations or violations at the wholesale level as opposed to the retail level, because IRS did not provide FEA with such a breakdown. However, we found that one FEA region had 679 investigations in process on June 3, 1974. Of the 679 investigations, 615 were identified as retail firms and 33 as wholesale firms.

Regional compliance and enforcement personnel estimated that about 6,900 retail gasoline firms were in violation from 3 to 10 cents a gallon. If this estimate was valid, the potential value of these violations was as much as $16.7 million.

The manager of a compliance and enforcement group in another region advised us that all retail gasoline firms investigated during a 2-week period were found to be in violation. In the period May 1, 1974, to July 30, 1974, violations amounting to $345,000 were found in 132 retail gasoline outlets. Four wholesale firms were also found in violation in the amount of $513,000.

While there appeared to have been many violations at the retail level, the individual violations were in relatively small amounts. On the other

hand, wholesaler investigators found much larger violations. For example, in January 1974, FEA initiated "Project Speculator" to investigate wholesale firms dealing in propane. As of October 3, 1974, FEA determined that 75 companies were in violation or probable violation of FEA regulations and had overcharged customers by $55 million. We recognize that the propane situation was somewhat unique but believe that Project Speculator illustrates the magnitude of potential violations at the wholesale level.

FEA officials acknowledged that the auditors had concentrated their efforts at the retail level, but told us that they will redirect their enforcement efforts to concentrate on investigations at the wholesale level. In order to accomplish this, they plan to curtail retail investigations to the point where only customer complaints will be investigated.

Refiners

One hundred and twenty-five firms were required to submit monthly reports to FEA which outlined the capacity of the firm's refineries, the expected supply of crude oil for the refineries, and various cost information. Of the 125 firms, 31 were classified as large refiners and 94 were classified as small refiners. The monthly report was used by the refining firms to compute adjustments for cost increases since the base month of May 1973. Under the Refinery Audit Program, FEA and previously IRS were to validate the information shown on the monthly report to insure that price adjustments were made only for allowable cost increases. To determine whether prices charged were appropriate, FEA developed a comprehensive audit program which was designed to determine that:

--Only allowable costs were passed on to customers.

--Profit margin limitations were not exceeded.

--There was uniformity of price increases.

--Historic and consistent business practices were maintained.

--The intent of the FEA regulations was not subverted.

Before July 1, 1974, IRS audited the 31 large firms to determine their costs and prices for the period May 1973 through January 31, 1974. IRS used 64 auditors to investigate these 31 firms--many of which operated more than one refinery--and, according to its agreement with FEA, the auditors were to complete their work by May 31, 1974. FEA then planned to use its own investigators to audit firms' costs and prices for the period February 1, 1974, through June 30, 1974. The latter work was to be completed by September 30, 1974.

Appendix II shows the 31 large refiners. For 17 of the large firms, we examined the audit reports issued by IRS, reviewed the documentation supporting those reports, and discussed the audits with the auditors who performed the work.

Neither IRS nor FEA completed its assignments. FEA compliance and enforcement officials provided us with varying estimates of the extent to which IRS completed its audit work; however, they stated that there were problems with each of the estimates. In any event, FEA officials said that as of October 31, 1974, the audit work that was to be completed by IRS and the audit work that FEA was to complete by September 30, 1974, was not completed.

Four of the important objectives of the Refinery Audit Program were to (1) determine the validity and accuracy of quantity and cost of domestic crude purchases, (2) substantiate imported crude costs to insure that additional profits did not result from transactions with affiliated foreign entities, (3) review selling prices to insure that cost increases had been passed on uniformly to the various types of customers and verify that consistent pricing practices had been maintained, and (4) determine the magnitude of profits, return on investment, and dividend distribution.

Appendix III shows the manner in which the auditors carried out these 4 important objectives in 3 of the 17 audits we reviewed.

In summary, we found that:

--The scope of work performed was limited. In a number of cases, the auditors agreed with us that the work was not adequate.

--Limited and, in some cases, no verification or tracing of pertinent cost or other information to basic source documents was accomplished.

--In many instances where problems or discrepancies were noted, followup or expanded audit effort was not undertaken.

Failure to accomplish the entire scope of the audit program and the lack of followup where discrepancies were noted can be directly related to the limited level of audit effort at the refiner level. The basic staffing pattern for IRS audits of refiner operations, as continued by FEA since July 1, 1974, was to assign two auditors to each of the refiners under audit.

Considering that many of the refiners are billion dollar corporations with numerous subsidiaries and multinational operations, it is not surprising that the auditors fell short in completing an ambitious audit program. For example, FEA officials said it took some auditors 4 to 8 weeks just to gain familiarity with the operations of the companies.

ADMINISTRATIVE SANCTIONS

FEA regulations provided various administrative sanctions for violations of the regulations. When FEA believed a provision of the price regulations had been violated, the first step taken was an attempt to obtain a voluntary price rollback and a refund of overcharges. Where specific customers were identified, refunds were to be made directly to them. If the customers could not be identified, overcharges were to be returned to the marketplace through price reductions.

If voluntary compliance could not be achieved, FEA may have issued a Notice of Probable Violation (NOPV) or a Remedial Order (RO). The course selected was dependent upon the degree of certainty of FEA's position. NOPV was used to initiate proceedings when FEA believed that a violation had occurred or was about to occur. RO was used to initiate the proceedings when FEA was certain the violation had occurred or when the alleged violation appeared blatent or repetitive. If the company complied with the NOPV or RO, both were rescinded.

FEA's administrative procedure allowed 10 days for response to an NOPV; failure to respond was considered an admission of the alleged violation. If the firm's response to the NOPV did not disprove the alleged violation and/or if the firm did not voluntarily undertake corrective action, FEA issued a RO.

FEA allowed 30 days for appeal of a RO. If FEA denied the appeal, the firm could appeal further through the judicial system.

As of September 30, 1974, FEA records showed that the Refinery Audit Program had uncovered overcharges by 13 refining companies amounting to $194.3 million. The following table shows the type of administrative sanctions, the number of companies involved, and the dollar value of the overcharges.

	Number of companies	Value (millions)
Voluntary rollback or refund	5	$ 35.4
NOPV	4	90.7
RO	6	68.2
Total		$194.3

In cases of voluntary action, FEA auditors were to verify from the company records that the rollbacks or refunds had been made. The following table shows the amount involved, the date issued, and the disposition of NOPVs and ROs as of September 30, 1974.

	Sanction used	Amount (millions)	Date issued	Disposition
Company A	NOPV	$15.0	3-19-74	Resolved 5-16-74
Company B	NOPV	46.6	5-08-74	Open
Company C	NOPV	12.1	6-26-74	Company signed agreement to rollback prices; FEA audit to be completed before resolving
Company D	NOPV	17.0	7-12-74	Open
Company E	NOPV	(a)	8-12-74	Open
Company F	NOPV	(a)	8-09-74	Open
Company G	RO	8.0	2-12-74	FEA plans to resolve orders in mid-November; awaiting confirmation from auditors of compliance
	RO	1.9	5-13-74	
Company H	RO	21.5	3-09-74	Resolved 6-21-74
Company I	RO	11.0	3-12-74	Resolved 5-01-74
Company J	RO	15.8	4-12-74	Resolved 6-24-74
Company K	RO	10.0	9-20-74	Under appeal

[a]Unknown

One (Company B) of the four NOPVs, which was not resolved, involves transfer pricing, which is the manner in which the firms record the cost of crude obtained from a foreign affiliate. FEA believes that a proposed regulatory change will stop such occurrences in the future and provide for some rollbacks for past violations. However, the change is still under study and the NOPV was not resolved. Two unresolved NOPVs (Companies E and F), which involve competitive discounts, will be resolved after a policy decision is made with regard to such practices. The other unresolved NOPV (Company D) involves class of purchaser discrimination and errors in base-price computations. FEA is awaiting additional information from the company.

In the RO involving Company H, FEA stated that the firm had increased its prices to recover increased costs in the month incurred rather than in the month subsequent to the cost increase, as required by FEA regulations. As a result, the firm obtained additional revenues in the month in which the costs were passed through as increased prices. On April 30, 1974, FEA accepted the firm's proposal to reduce the April and May passthrough

by $21.5 million. The corrective action consisted largely of a writeoff against paper-cost increases accumulated under a cost carryover provision of the price regulations. This provision allows refiners to "bank" cost increases which the firm feels cannot be immediately passed on in the marketplace. The firms have the option of recovering these costs through future price increases. According to FEA, the carryover provision was intended to be a method whereby price increases could be smoothed out. They cited as an example the instance where a one-half cent increase could be withheld until further cost increases would justify a one cent increase--presumably an easier adjustment than a fractional one.

What has happened, however, is that large accumulations, or banks, of these unrecovered costs have been made. A number of companies have banks which represent over 50 percent of the additional costs they claim to have incurred since October 1973. The trend has been towards increasing the size of the banks which could, under FEA regulations, be added to existing prices at any time.

During the period of short supply, most costs were immediately passed through as higher prices. At the end of March 1974, the 125 companies reporting to FEA had a collective bank of $386 million, which had been accumulating since October 1973 and representing about 16 percent of the increased costs incurred. At June 30, however, when supplies had improved, this collective bank had increased to over $1.3 billion, or 39 percent of the increased costs incurred. FEA officials told us that as of September 30, 1974, the collective bank totaled about $2 billion.

FEA officials told us they became concerned with the sizes of these banks and on November 6, 1974, FEA limited the amount of banked costs which could be added to consumer prices to 10 percent of a company's total bank a month. In addition, FEA officials believe their transfer-pricing regulation of October 31, 1974, will eventually result in a reduction of these banked costs.

The other ROs and the voluntary [illegible] concerned technical violations which have been or will be corrected. [illegible] cases, corrective action consisted, at least in part, of adjust[illegible] against those banks of largely unverified costs. As a result, many violations may not result in actual refunds or price rollbacks.

UNRESOLVED ISSUES

On August 28, 1974, the Director of the Refinery Audit Program, in a final report preceding his leaving FEA, indicated that there were several regulatory issues pending before FEA awaiting clarification, interpretation, or ruling. He stated that the issues included (1) treatment of propane,

refiner fuel costs, natural gas liquids and gas plants, import tickets, and domestic pipeline charges; (2) computation of cost recoveries; (3) discrimination among different types of customers; (4) allocation of increased costs of crude to other covered products; and (5) treatment of cost passthroughs resulting from mandatory crude sales.

The last issue relates to the recently publicized allegations of "double dipping" or "double recovery" by certain oil companies. The problem arose because of a certain provision of FEA price regulations which involved refiners who were in an excess crude supply situation, and who were required to sell a certain portion of their excess crude to refiners who had insufficient supplies. Certain refiners interpreted the price regulation to mean that they could claim the cost of the crude they had purchased and subsequently sold to deficient refiners without deducting the price paid to them by the purchasing refiner from their original cost.

In the case of the double-dip issue--as well as some of the other issues enumerated above--FEA has issued rulings or regulations which should preclude such practices in the future. However, several issues are still not resolved. In addition, FEA has not determined the amount of the alleged past overcharges nor sustained the legality of their positions. In any event, substantial amounts of time elapsed since FEA auditors surfaced potential violators and FEA took final positions.

In our opinion, most of the unresolved issues resulted from FEA regulations, which were either silent or ambiguous regarding certain oil industry practices. The developing problems with FEA regulations are somewhat understandable considering the haste with which FEA had to prepare them.

We were unable to determine the extent of the problems--how widespread or the potential dollar value of the violations--because FEA declined to furnish us pertinent information or refused to discuss the cases with us on the basis that such disclosure or discussion might compromise its position in potential cases. FEA refinery audit officials estimated, however, that the magnitude of refineries' potential violations could be between $1 and $2 billion and that some of the individual violations were so large that if sustained by FEA administrative sanctions, could "wipe out" the previously mentioned company banks of some companies and thereby result in price reductions.

ORGANIZATIONAL PROBLEMS

In addition to matters discussed above, organizational changes and disputes were factors which undoubtedly inhibited sustained program direction and effort.

When IRS was performing compliance and enforcement activities, FEA's direction of IRS personnel was hampered due to the lack of key regional personnel. For example, as of June 1974, some FEA regions did not have a permanent director for compliance and enforcement for the retail and wholesale level. Also, FEA's assessment of the effectiveness of IRS efforts was limited because of the limited amount of information being furnished FEA by IRS.

When FEA assumed full responsibility for compliance and enforcement activities in July 1974, a dispute arose as to whether headquarters or the regional offices were responsible for the activities of the refinery auditors. While FEA headquarters is responsible for program direction of the audits of major refiners, the field auditors are assigned to FEA's regional offices. In some cases, the lack of clear responsibility for the auditors' activities has hindered the effectiveness of the refinery audit program.

CONCLUSION

The future of petroleum product price controls is uncertain. In recent weeks, various Executive Branch officials have commented on the need to relax such controls. Existing legislative authority for petroleum product price controls is scheduled to expire on February 28, 1975, although bills are currently pending in the Congress to extend the authority through August 1975.

In any event, our work has shown that if such controls are to be continued, FEA will have to substantially strengthen its compliance and enforcement program at all levels if it is to have adequate assurance that firms are in substantial compliance with pricing regulations.

Specifically, FEA will need to devote considerable attention to audits of producers and wholesalers in view of the potential impact of pricing violations at each of those levels. In the case of refiners, FEA should consider the following alternatives to improving the effectiveness of its audits:

--Increase the size of assigned staff.

--Use a "strike force" approach where a team of auditors would visit selected firms and review key facets of the operations. Such an approach would provide opportunity to develop auditors specialized in a particular aspect of FEA regulations or refinery operations. Further, if FEA wished to maintain a continuous presence at each refinery operation, one auditor could be permanently assigned for the purpose of identifying problem areas which may necessitate more detailed attention by a "strike force."

Further, we believe that FEA should centralize the control and direction of the auditors assigned to review refineries.

FEA COMMENTS

On November 12 and 13, we met with officials of FEA's Office of Operations, Regulations, and Compliance to discuss our report and obtain their comments. The FEA officials stated that they agreed with our report and its findings and had initiated substantial changes to improve their compliance and enforcement program. They stated that the major changes were a revised organization, clarification of lines of authority, and finalization of agency position on many of the unresolved issues we had noted.

On October 16, 1974, FEA approved a revised staffing plan to initiate audits of crude producers, increase the audit attention at the wholesale level, increase the audit attention at the refinery level, and decrease the audit attention at the retail level. The following table shows how FEA intends the enforcement and compliance manpower to be directed by December 31, 1974.

Assigned to	
Producer audit	143
Wholesalers	263
Retailers	100
Refiners	188
Propane investigation	90
Total	784

In addition to this revised staffing plan, operating procedures between headquarters and regional offices for compliance activities were finalized on November 5, 1974, in order to insure more uniform treatment of violations and to coordinate actions among the regions and the national office. Also, a revised audit program for refinery audits was issued in October 1974. FEA officials said that these guidelines are the result of the experience they have gained in their previous audits and will result in a more effective review of refinery operations.

FEA officials stated that many unresolved issues had been resolved by new interpretations of regulations or rulings. They said that the major issues yet to be resolved included whether refinery fuel costs should be considered product or nonproduct costs, whether natural gas liquids from company-owned wells should be entitled to a mark-up, and

whether FEA regulations requiring maintenance of company discount policies should be applied in certain cases.

FEA's officials also stated that planned improvements in FEA's reports and data gathering procedures should enhance the ability of FEA to identify patterns of suspicious activity or companies in violation of FEA regulations through its review of reported information. The officials stated that a task force recently has been appointed to develop programs integrating forms designs, data programming, and compliance activities.

We do not plan to distribute this report further unless you agree or publicly announce its contents.

Sincerely yours,

Phillip S. Hughes
Assistant Comptroller General

FEDERAL ENERGY ADMINISTRATION
WASHINGTON, D.C. 20461

DEC 4 1974

OFFICE OF THE ADMINISTRATOR

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

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Dear Mr. Comptroller General:

Thank you for your letter of November 26, 1974 in which you acknowledged my letter of November 8, which discussed our position on GAO access to certain FFA data and records under section 12 of the Federal Energy Administration Act of 1974.

I appreciate your advice that, contrary to my previous understanding, we arrived at no agreement at our meeting of June 28, 1974 with respect to any limitations on access by the General Accounting Office to audit data associated with pending compliance actions.

Since my letter of November 8 and Mr. Gorman Smith's correspondence of November 27, we have had an opportunity to consider further the broad statutory responsibilities imposed upon the General Accounting Office by the Federal Energy Administration Act of 1974, and have met with Messrs. Hughes and Canfield of your staff with a view to resolving the difficulties which GAO feels it has encountered in carrying out its oversight responsibilities.

Having carefully reviewed the matter, I would agree that the language of section 12 of the Federal Energy Administration Act contains no explicit limitation exempting certain classes of data in FEA's possession from access by GAO when such information is necessary for GAO to carry out its statutory responsibilities. While my letter of November 8 suggested limitations in application of the literal language of section 12 in order to reconcile that access with other legal and practical considerations, we do not intend to contest further GAO's view that section 12 affords the GAO plenary access to audit data in the custody of FEA.

Notwithstanding GAO's legal capacity to obtain access to all such information, however, we are very much concerned that the methods by which GAO carries out its statutory responsibilities will not compromise FEA's ability to meet its statutory responsibilities by impairing the integrity or efficacy of its compliance activities -- both those pending administratively and those involving litigation in which the United States is a party. Accordingly, I believe it is crucial that the manner in which our staffs work together to carry out our respective responsibilities be cooperative and complementary, and be so designed to assure that GAO requests for access to compliance related data be handled with a full awareness by both our staffs of their extreme sensitivity.

I have therefore directed my staff to assure that GAO's requests for access to da a necessary to carry out its statutory responsibilities will be promptly and completely honored. At the same time, I have asked my staff to work closely with yours to develop procedures whereby GAO will be kept apprised of the sensitivity of particular data requests from the enforcement standpoint at the time they are made. This will enable GAO to take appropriate steps to assure that FEA's statutory responsibilities are not impaired.

I hope you will understand that neither my letter of November 8 nor Mr. Smith's letter of November 27 was intended to suggest arbitrary limitations on the statutory authority of the General Accounting Office, and that despite the reservations as to some issues expressed in that correspondence I recognize the necessity that GAO be afforded the broadest possible access to data in FEA's custody. I am confident that on every occasion in which GAO's statutory responsibilities require access to such information it will be provided promptly and in such a manner as to meet GAO's requirements. I am also confident that your staff is sensitive to the importance of avoiding any action that would impinge upon the integrity of the regulatory or judicial process, and that by cooperating we can assure that application of the principle of plenary access by GAO will not have consequences which would be inimical to the public interest.

Sincerely,

John C. Sawhill
Administrator

REFINERS AUDITED BY IRS/FEA[a]

Major	Smaller
Exxon	Tenneco
Texaco	Kerr Mc-Gee
Gulf	Koch
Mobil	Charter
Standard-California	Champlin
Standard-Indiana	Murphy
Shell	Crown Central
Atlantic Richfield	Coastal States
Phillips	Clark
Continental	Pace
Sun	Delta
Union-California	
Cities Services	
Getty	
Skelly	
Standard-Ohio	
Marathon	
Amerada Hess	
American Petrofina	
Ashland	

[a]For the companies underlined, we examined the audit reports issued by IRS, reviewed the documentation supporting those reports, and discussed the audits with the auditors assigned to the companies.

EXAMPLES OF PORTIONS OF THREE REFINERY AUDITS

The following describes four important objectives of the Refinery Audit Program and how IRS carried out these objectives in its audits of three companies. The majority of IRS audit work was completed by May 31, 1974, and our audit work in this area included information available through August 19, 1974.

DOMESTIC CRUDE

The auditors were to determine the validity and accuracy of quantity and cost of domestic crude purchases reported on the firms' monthly reports. Verification was to encompass the base month of May 1973 and each month subsequent to August 1973. It also consisted of tracing representative quantity and cost data to supply and payment documents.

Company X

One of the company's geographical regions, accounting for 57 percent of the company purchases of domestic crude during May 1973, was selected for audit. Further, five different types of crude, comprising 54 percent of this region's domestic crude purchases were traced to production documents. The resultant test represented less than 1 percent of the company's crude supplies.

From this limited sample, the auditors determined that the domestic crude cost at one refinery--with a capacity of about 45,000 barrels a day--was overstated by $0.16 per barrel during May 1973. Despite this, the auditors recommended that additional work on May purchases receive a low priority because they had a limited amount of time to complete the remainder of the audit work on this company.

Company Y

The auditors did not determine the total quantity or cost of domestic crude purchased in May 1973, nor any subsequent month. Data for one refinery was obtained and production from a limited number of the company's properties was traced to computerized production statements. A few of the transactions on the production statements were traced to supporting documents.

The auditors stated that they did not believe that a sufficient number of transactions had been tested, and accordingly, they could not comment on the validity or accuracy of quantities and cost of even this one refinery.

Company Z

One refinery was selected for audit. The average acquisition cost of domestic crude at that refinery was computed. A 5-percent sample of the acquisitions of one type of crude during May 1973 was made. From this sample, a further sample of producers of that type of crude was traced to May posted prices.

The audit report stated that the sample was inadequate to evaluate the domestic crude purchases. FEA auditors stated that the May 1973 verification would have to be redone. Transactions from August 1973 through May 1974 were only traced to the company's ledgers.

FOREIGN CRUDE

The auditors were to substantiate imported crude costs to assure that additional profits did not result from transactions with affiliated foreign entities. In addition to performing the type of verification required for domestic crude, the validity of transfer prices of equity crude was to be determined. Review of transfer prices is important to determine whether foreign operators are selling to third parties at the same p 'ces they are charging affiliated companies.

Company X

Procedures for determining purchase price from affiliated and nonaffiliated suppliers were examined. Data from the monthly report for May 1973 and the months of August 1973 through February 1974 were traced to company schedules. Verification to supporting documents was substantially incomplete. No evidence of tests of transfer prices could be found in the audit documentation.

The auditors stated that company schedules showing curde landings were not received until May 6, 1974, when the auditors were preparing their final report. They said that these schedules did not show tax-paid costs or production cost of equity crude.

Company Y

This company purchases most of its foreign crude from nonaffiliated entities. Auditors verified a selected number of May 1973 and August 1973 transactions. May costs were found to be understated by $600,000, but no further action was taken.

Company Z

Procedures used to determine the cost of foreign crude were examined. January 1974 costs, except for transportation, were verified by source documents. Verification for all other months was substantially incomplete.

SELLING PRICE

The auditors were to determine how the company classified its customers, e.g. , affiliated, associated, or independent and recompute the average sales price to each class on May 15, 1973. They were then to reconcile monthly report data and related price increases to insure that cost increases had been passed through uniformly to each class of purchaser. The auditors were to also verify that consistant business practices, such as discounts and incentives had been maintained.

Company X

Company procedures for determining class of purchaser were reviewed. Pricing complaints from the company's customers were investigated. No other audit work was performed.

Investigation of customer complaints showed that the company had improperly increased rents on retail gasoline facilities. Refunds of $36,000 were made and the company was instructed to review all rental transactions.

The auditors also found that the company had discontinued certain discounts. However, no formal position was taken on this matter pending the results of a similar issue in another company.

Company Y

Company procedures for determining class of purchasers were reviewed. A small sample of company computed base prices were test checked. Price increases reported on the monthly reports were not reconciled to price increases implemented.

Company Z

Company procedures for determining class of purchasers were reviewed. No other audit work was performed.

PROFITS

The auditors were to determine the magnitude of profits, return on investment, and dividend distribution. They were to analyze the absolute and relative contribution of each consolidated entity to corporate

earnings during current and prior periods. This portion of the refinery audit was cited as a priority item.

Company X

Profit margin reports were obtained from the company; however, no verification or analysis was performed.

Company Y

Breakouts of foreign and domestic earnings were obtained. It was found that corporate overhead had not been allocated to foreign and domestic operations. Analysis showed that domestic earnings had increased 32.5 percent in 1973 while foreign earnings had increased 72.1 percent. The auditors determined that foreign earnings had increased from $26 million in the quarter ending December 31, 1973, to $62 million in the quarter ending March 31, 1974. No further action was taken.

Company Z

The company had not provided earnings data that the auditors requested.