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Address by Elmer B. Staats
Comptroller General of the United States
and
Chairman of the Cost Accounting Standards Board
before the
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Accounting Conference
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IMPORTANCE OF FINANCIAL DATA IN EVALUATING FEDERAL ENERGY PROGRAMS

I appreciate your invitation to address this conference sponsored by
DLG 00791 the American Gas Association and Edison Electric Institute. *DLG 00792* In my capacity
as Comptroller General of the United States and Chairman of the Cost
Accounting Standards Board, I have a great deal of interest in the subjects
on the agenda.

Legislation enacted over the past several years has shown that the
Congress is interested in using accounting in carrying out national policies.
For example, the absence of any authoritative body of cost accounting
principles applied in negotiated defense contracts led the Congress to create
the Cost Accounting Standards Board in 1970.

More recently, the Energy Policy and Conservation Act, passed last
December, requires the Securities and Exchange Commission, in consultation
with the General Accounting Office, to establish accounting standards for
mandatory use by companies that produce crude oil and natural gas. In
both instances, the Congress recognized that groups in both the private
and the public sectors were concerned with improved information needed
for public purposes.

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As I observed the energy scene, the question of the availability of adequate and credible energy data--financial and otherwise--is recurrent and deep-seated. Much of what I am discussing today is drawn from our efforts at GAO to provide the Congress with factual information and the issues and options with which the Congress must grapple in arriving at energy decisions. As you may know, GAO is an independent agency of the legislative branch and has traditionally been called the Congress' "watchdog" because of its role in evaluating executive branch programs. This role has focused on assisting the Congress in its legislative and oversight responsibilities. Increasingly, we are providing the Congress with critical analyses of Government options, alternative policies, and legislative proposals.

Before discussing GAO's work in the energy area, let me first describe briefly the work of the Cost Accounting Standards Board in which you have expressed a special interest.

COST ACCOUNTING STANDARDS BOARD

The Board is now well into its sixth year of operation. During that time, I believe we have made good progress in developing standards--to further the objectives of the authorizing statute--which are reasonable and equitable for both contractors and the Government agencies affected by them.

The Comptroller General heads the five-member Board. He appoints the other four members for 4-year terms. In addition to myself, the current members of the board are:

--Mr. Herman W. Bevis, retired senior partner, Price-Waterhouse of New York.

--Mr. Terence E. McClary, Assistant Secretary of Defense (Comptroller, Department of Defense.

--Mr. Robert K. Mautz, Partner, Ernst & Ernst of Cleveland.

--Mr. John M. Walker, Vice President and Corporate Treasurer, Texas Instruments, Inc., of Dallas.

The Board has two principal purposes: first, to require that, as a condition of entering into negotiated defense contracts, cost accounting practices be disclosed and to follow such practices consistently and, second, to publish cost accounting standards to achieve greater consistency in the cost accounting practices of defense contractors and subcontractors.

The board has issued 12 standards which have become effective. One, "Allocation of Business Unit General and Administrative Expenses to Final Cost Objectives," will establish for the first time an input base for costing negotiated contracts.

Another standard, "Cost of Money as an Element of the Cost of Facilities Capital," should be acted on at the Board's meeting in early May.

The promulgated standards cover many areas of cost accounting, and we believe they are by and large usable by companies having process cost accounting systems. The board has begun investigating the possibility of a cost accounting standard designed specifically for use by firms in the petroleum industry. We have received the welcome cooperation of the American Petroleum Institute, which has formed a committee to provide comments on board proposals.

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In addition, the board's staff has been instructed to research some 15 additional subjects which presumably will result in additional standards.

All contractors whose awards amounted in any fiscal year since 1971 to \$10 million or more of negotiated defense prime contracts of the kind covered by the board's requirements must, as a condition of negotiating a contract, file with the contracting Government agency a Disclosure statement, issued by the board. Beginning with fiscal year 1976, the board has required that the volume of both covered prime and subcontract awards be calculated to determine if the \$10 million threshold is met.

The Disclosure Statement requires the contractor to provide general information about himself and the kind of business he does with the Government. It then requires him to make a disclosure concerning

- direct costs,
- the categorization of costs that is, which cost will be charged directly or indirectly to contracts,
- the method by which indirect costs will be allocated to contracts,
- his procedures for capitalizing and depreciating assets,
- his treatment of other contract costs and credits, and
- his treatment of deferred compensation and insurance costs, including pension plans, stock options, and the like.

Finally, a contractor which operates under a home office or group office must submit a statement concerning corporate or group expenses. Some of the required information about cost accounting practices does not apply to many petroleum companies. In such cases, the board has asked only that the companies disclose the costing or pricing practices they do have and explain why the required information is not applicable to their operations.

In summary, the Disclosure Statement seeks to provide for knowledge, in advance of contracting, of the cost accounting practices which the contractor will actually use, not necessarily to obtain answers to every question posed.

The board seeks the best guidance available from all sources and in each step of its work. The board maintains close liaison with the Financial Accounting Standards Board and professional groups such as the American Institute of Certified Public Accountants; the Financial Executives Institute; the National Association of Accountants; and the American Accounting Association; as well as other Government agencies involved, particularly the Securities and Exchange Commission.

A primary objective of the board is to achieve consistency, to the extent practical, in cost accounting under covered Government contracts. We do not seek consistency for its own sake but to improve understanding and communication of cost accounting and allocation of costs in the negotiation and administration of Government contracts.

Most of you here are as familiar as I am with the complexities involved in an effort of the magnitude of that contemplated in the charter of our board--a fact made all the more sobering when we recognize that

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most companies doing business with Government are affected by cost accounting standards.

The board recognizes that the standards may well be adopted by State and local governments and Federal regulatory agencies as well.

Matters such as depreciation allowances and allocation of pension costs and vacation pay, as well as issues such as the cost of capital and accounting for inflation, are old problems--yet unsolved problems--which the board has recognized it must tackle if it is to carry out its statutory charter.

It is not surprising that there has been criticism on both sides. The board has felt that at times company management "has been fighting the problem" rather than helping to seek solutions. At the same time, contractors have felt that some standards are overly rigid and represent additional red tape in dealing with the Government and that the cost in relation to benefits has not been adequately supported in determining whether a standard is needed in the first place.

From my point of view, this dilemma cannot be answered without an attitude of support and cooperation on both sides. It will especially take the continuing support of large numbers of accounting professionals who, according to Price Waterhouse & Company in a recent statement on the subject, "take the time to study proposed standards and through their firms and professional organizations provide the CASB with their insights." Price Waterhouse then calls upon companies subject to standards to "become knowledgeable in this ever expanding and increasingly significant area."

Let me now turn to GAO's work in the energy area. As I mentioned, our role in the past has focused heavily on assisting the Congress with oversight responsibilities; but, increasingly, GAO is providing the Congress with critical analyses of Government options, policies, and proposals to assist it in considering new legislation.

THE ENERGY POLICY AND CONSERVATION ACT

Last December, 2 years after the Organization of Petroleum Exporting Countries (OPEC) oil embargo, the Congress passed and the President approved a "comprehensive energy bill," the Energy Policy and Conservation Act. This act, among other things, will establish a strategic petroleum reserve, set a ceiling price for domestic crude oil, and mandate auto efficiency standards. Some feel the law is a step in the right direction. Others, largely because of the crude oil price rollback, feel it is a step backward. Regardless of whether you feel that the act is positive, negative, or merely harmless, it greatly affects GAO's oversight work at the Federal Energy Administration (FEA) and confers upon GAO a large new responsibility.

The act substantially increases FEA's responsibility. By way of illustration, it authorizes FEA to

- expand programs to convert powerplants from oil and gas to coal,
- develop a strategic petroleum reserve of 1 billion barrels of oil,
- provide incentives to develop underground coal mines,
- develop standby plans for rationing and mandatory conservation,
- administer a program of grants to States to promote conservation programs,

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- establish industrial energy conservation programs,
- prescribe standards for U.S. petroleum companies necessary for participation in the International Energy Program, and
- prescribe energy efficiency standards for consumer appliances.

The Federal Energy Administration Act requires that GAO monitor and evaluate FEA. With the expanded FEA programs under the new act, GAO's work will be considerably expanded.

Section V of the act states that GAO may use its authority to inspect the books and records of private persons and companies under the following conditions.

1. If a company is legally required to submit energy information to FEA, the Federal Power Commission (FPC), or the Department of the Interior.
2. If a company is engaged in the energy business, other than at the retail level, and
 - a. furnishes energy information directly or indirectly to any Federal agency, excluding the Internal Revenue Service, and
 - b. GAO determines that the Federal agency uses this information in carrying out its official functions.
3. If the energy information is financial in nature and pertains to a vertically integrated petroleum company.

Although GAO is authorized to make these verification examinations on its own initiative, it is required to make such examinations, if requested to do so by a congressional committee having jurisdiction over energy matters administered by FEA, FPC, or the Department of the Interior.

GAO may be called upon to provide answers to the many questions punctuating current congressional energy debates. Some requests have already been made.

One request concerns the costs of transporting crude oil and products from overseas locations to the United States; another concerns the relationship between the multinational oil companies and the OPEC governments.

As long as the Government continues to control oil and gas prices and the energy industry continues to oppose these controls, the Congress will probably ask GAO to attempt to answer such questions as these:

--Are companies failing to develop reserves or "shutting in" reserves in anticipation of higher prices?

--Are companies accurately reporting oil production to FEA?

--Are price increases allowed by FEA and FPC justified on the basis of actual costs incurred by the energy companies?

--Are the acquisition costs of imported oil being accurately reported to FEA?

--Are current prices leading to "windfall" profits?

While industry argues for higher prices to spur additional oil and gas production, others argue that higher prices will not yield additional production. GAO may be requested by the Congress to evaluate previously confidential company information to determine the adequacy of U.S. oil and gas reserves and the industry's ability to convert resources into reserves.

As you know many Members of Congress favor breaking up the big oil companies. GAO may be called on to determine how much money the oil companies make on their integrated operations, such as producing, refining, distributing, and marketing.

GAO is called upon to help the Securities and Exchange Commission develop accounting practices for crude oil and natural gas producers. GAO has already begun to work closely with the Commission in fulfilling this consulting role.

The law authorizes the Commission to rely upon standards developed by the Financial Accounting Standards Board. The board's recommendations may be accepted if the Commission is assured that the practice will be observed by persons engaged in producing crude oil or natural gas to the same extent as it would be observed if the Securities and Exchange Commission had prescribed such practices.

As you may know, the Financial Accounting Standards Board has underway a task force project which focuses on accounting issues that are unique to the extractive industries, including the oil and gas industry. The Commission plans to use the task force project to help meet its responsibilities under the law and it and GAO, among others, observe the task force.

As my opening remarks indicated, because of the differing missions and objectives of bodies in both the private and public sector, approaches to the same issues will vary. GAO's role as we see it--and I'm sure others share this interest--is to insure that the accounting practices in the oil and gas industry will, to the extent practicable, permit a reliable energy data base to be compiled for public purposes, as provided by law.

With this new authority and a continuation of our ongoing efforts, we in GAO hope to provide information to the Congress and the executive branch which will help in choosing the best options available for the Nation's energy future. We will need your cooperation and your help to achieve this important objective.

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OTHER GAO ENERGY WORK

Our work in energy goes further. We have about 90 studies underway or planned. Of these, 27 were initiated as a result of congressional requests--the remainder were undertaken on our own initiative.

To give you an idea of these projects, I would like to briefly mention a few which relate to both energy supply and demand:

- A review of FEA's efforts to decrease the use of oil and gas in powerplants and fuel burning installations. We are examining FEA's implementation of section 2 of the Energy Supply and Environmental Coordination Act, which authorizes FEA to require powerplants to burn coal instead of oil and gas.
- A survey of Federal efforts to develop and introduce emerging alternate fuel sources (with emphasis on alcohol fuels). The survey evaluates the ability of the Federal sector to respond to the increasing need for analysis, development, and promotion of emerging alternate fuel sources.
- A review of effectiveness of Federal voluntary energy conservation programs in which GAO will seek to determine

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(1) whether voluntary energy conservation programs are working, (2) what further incentives or requirements are needed for the various sectors of the economy to effectively conserve energy, and (3) what the Federal role should be in establishing energy conservation policies and priorities.

--Review of Interior's Outer Continental Shelf leasing program.

Last spring, GAO reported on the implications of Interior's accelerated Outer Continental Shelf leasing program and, subsequently, on the processes by which decisions are made on which tracks to lease and at what dollar value.

--A report issued in April 1976 examines Interior's coal leasing program in light of the President's declaration of a goal to double the Nation's annual coal output by 1985.

GAO is giving special attention to the question of increasing energy supplies, particularly since our future energy demand has received so much attention during the past several years. If we continue increasing our energy demand at 3 or 4 percent per year, our energy supplies must more than double by the year 2000. The unanswered question which GAO feels compelled to ask again and again is, "Can we get there from here?"

Our efforts to address this question were underscored with a review of the Liquid Metal Fast Breeder Reactor Program. Since the breeder reactor future is uncertain, the Nation need not make a definite commitment to this energy source for another 7 to 10 years.

A study GAO completed in January on the implications of natural gas deregulation was our second major effort in this area. And, a

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third study now being made will examine trends in coal leasing, production, and marketing and the future of coal in our energy supply picture.

IMPLICATIONS OF DEREGULATING THE PRICE OF NATURAL GAS

I will refer very briefly to our natural gas study. Last August, the Chairman, House Government Operations Committee, asked GAO to assess: (1) the social, economic, and environmental consequences that would result during the past winter from natural gas curtailments and (2) the natural resource, economic, environmental, and social impacts that would result if the price of interstate natural gas were deregulated. The report on the first part of the request was issued in October, while the second report was issued in conjunction with our testimony before the House Interstate and Foreign Commerce Committee on January 14, 1976.

Energy effects

People generally agreed on the amount of annual additions to natural gas reserves necessary to maintain a particular level of natural gas production. Using this consensus, GAO developed three supply scenarios.

- The low supply case assumes continued regulation with pricing patterns similar to that occurring in recent years.
- The medium case assumes deregulation and new gas finds equal to the best 10-year period experienced in the history of U.S. natural gas exploration.
- The high case assumes deregulation and new finds larger than previously experienced.

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While the high case seems to place an upper limit on likely gas supplies under deregulation, it would probably be unrealistic.

The medium case was optimistic but attainable. It would result in increased natural gas supplies in 1985 of 1.5 trillion cubic feet--about 9 percent--over projected supply under the low case, which assumes continued regulation.

However, when compared to natural gas supplies in 1975, the medium case would result in a 13-percent decline in supply by 1985 as compared to a 20-percent decline under the low case, which would continue regulation.

While the projected decline in natural gas supplies is likely to be replaced by increased amounts of imported oil, an additional 1.5 trillion cubic feet of natural gas each year could reduce oil imports by 750,000 barrels per day.

Economic and social effects

Using the Wharton economic simulation model, GAO compared continued regulation with deregulation, assuming the average deregulation price reached \$2.10, city-gate price in 1980 or 1985. In all cases, the gross national product, the rate of inflation, and the rate of unemployment were virtually the same, indicating that deregulation would not likely have discernible consequences for the Nation's economy.

Consumer effects

Under deregulation additional costs to consumers of natural gas would peak at \$13 billion in 1980, decreasing to \$4.2 billion in 1985. The cumulative additional costs of deregulation under GAO assumptions for the 10 years ending in 1985 are estimated at \$75 billion, or an increase of 22 percent over the costs with continued regulation.

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Costs to consumers under continued regulation would continue to increase because of price rises within the regulatory framework and because consumers who could no longer buy natural gas would purchase substitute fuels at higher prices.

Industry effects

Additional industrial fuel costs resulting from deregulation of natural gas or the use of alternative fuels should not be significant over the long run, since total industry expenditures for natural gas in 1974 represented less than 1 percent of the monetary value of industrial output.

Some industries, however, could be severely affected by decontrol. They include

- industries for which natural gas costs represent a major portion of their selling price, such as the cement industry, and
- industries, such as the fertilizer, plastics, certain textile, and baking industries which depend upon natural gas for its unique material or quality heating value rather than for its energy value and for which no practical substitute exists.

Because FPC regulations give priority to residential customers in times of shortages, most interstate residential customers would continue to receive supplies under continued regulation. Therefore, deregulation would primarily affect those residential consumers in the form of increased prices. Prices would continue to increase under regulation--but more slowly.

Conclusions

Even with deregulation, natural gas production is likely to continue its decline. Deregulation could, however, slow, and possibly arrest, the rate of decline. Without it, production would decline even more steeply. The National will not likely achieve production again in the amounts currently being produced.

Even with continued regulation, the price of natural gas will increase, but with deregulation the increase would be more rapid. The additional supplies of gas likely to result from deregulation must be weighed against the additional costs to consumers. The undesirable implications of continuing a regulatory framework which creates separate interstate and intrastate markets also must be faced.

Deregulation must be carefully weighed against other alternatives which include continuing regulation, but at higher prices, and bringing intrastate supplies under Federal regulation. The implications of deregulating natural gas and allowing its price to rise to the equivalent price of imported oil--which is not established in a free and competitive market--also must be carefully considered.

In the final analysis, deregulation requires a political judgment based on a careful weighing of the economic tradeoffs involved in alternative courses of action.

GAO'S VIEWS ON SENATE BILL 2872

The Senate Committee on Government Operations is considering Senate Bill 2872 which would continue the Federal Energy Administration Act of 1974 from June 30, 1976 to September 30, 1979. I would like to

briefly summarize for you my testimony presented 2 days ago related to (1) possible organizational changes in FEA, specifically addressed to FEA's energy policy and regulatory roles, (2) the energy data issue with emphasis on the need for credibility and objectivity in Federal energy data efforts, and (3) mandatory reporting requirements in the area of national energy conservation.

While GAO supports the extension of FEA as a temporary agency, the best long-term organizational approach to the solution of energy problems would be to establish a Department of Energy and Natural Resources, which GAO has consistently supported. Pending the establishment of a full Department, however, the Congress should mandate organizational changes in the executive branch which begin to move in the direction of creating such a department.

A desirable division of FEA's responsibilities, would be to separate FEA's policy responsibilities from its regulatory responsibilities and combine the two functions with the related functions of other energy agencies.

Specifically, I proposed combining FEA's permanent energy policy responsibilities with the Energy Research and Development Administration's energy research and development policy responsibilities into a new agency called the National Energy Administration.

While FEA's regulatory responsibilities could be dealt with in several ways, perhaps the simplest would be to transfer the responsibilities to the Federal Power Commission.

The issue of energy data has long interested GAO. GAO work shows that new energy data collection efforts for the most part have been piled on top of old efforts, and efforts for improved coordination have yet to show much success. Again, the establishing of a Department of Energy and Natural Resources with an independent data collection component will offer the best long-term organizational solution to energy problems, including energy data problems. In the interim, I suggested that, with proper legislative safeguards, FEA be strengthened to make it a more credible and objective focal point for Federal energy data efforts.

Finally, I recommended that energy conservation be accorded a higher priority in our national energy policy. FEA's current responsibility to actively function as the Government's central coordinating and fact gathering agency in energy conservation would be strengthened and enhanced if FEA were required to annually report to the Congress on current national energy conservation activities and Federal plans and needs in the conservation area for the upcoming year. This reporting requirement should be mandatory for a period of 5 years or until FEA's authority expires, whichever comes first.

The reporting requirement that I recommend will give a centralized picture of the Government's overall conservation efforts, enable more accurate judgments of its effectiveness, identify conservation plans for the upcoming year, and provide a basis for assessing the merits of further voluntary efforts and the need for mandatory efforts. More

significantly, it will provide the Congress with a base of information upon which to take future legislative actions, such as the establishing of mandatory automobile mileage standards, which is included in the Energy Policy and Conservation Act.

Thank you.

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