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Transportation Charges for Imported Crude Oil: An Assessment of Company Practices and Government Regulation. EMD-76-105; B-178205. October 27, 1977. Released November 4, 1977. 40 pp. + 2 appendices (7 pp.).

Report to Rep. Harley O. Staggers, Chairman, House Committee on Interstate and Foreign Commerce; by Robert F. Keller, Acting Comptroller General.

Issue Area: Energy: Energy Pricing (1606); Energy: Effect of Federal Financial Incentives, Tax Policies, and Regulatory Policies on Energy Supply (1610).
Contact: Energy and Minerals Div.
Budget Function: Natural Resources, Environment, and Energy: Energy (305); Commerce and Transportation: Water Transportation (406).
Organization Concerned: Department of the Treasury; Federal Energy Administration.
Congressional Relevance: House Committee on Interstate and Foreign Commerce.
Authority: Emergency Petroleum Allocation Act of 1973 (P.L. 93-159). Economic Stabilization Act of 1970 (P.L. 91-379). Federal Energy Administration Act of 1974 (P.L. 93-275). Energy Policy and Conservation Act of 1975 (P.L. 94-163).

Transportation cost is a significant element in the cost of imported crude oil. Together with other costs, it is used to support price increases for regulated petroleum products. Findings/Conclusions: Review of the tanker transportation charges reported by seven large oil companies showed that: the Federal Energy Administration's (FEA's) transportation regulations were inadequate in preventing companies receiving payments greater than their actual costs; the overall reliability of the FEA's transportation data was questionable due to inconsistencies and incompatibilities in the reporting systems and inadequate audits; and companies reported about $26 million in transportation charges which seemed questionable or were considered as overcharges. Recommendations: The Secretary of the Department of Energy should take the following actions with regard to regulatory compliance, administration, and systems support: (1) verify that the oil companies have reported cost adjustments for uncovered overcharges; (2) assure proper implementation of new transportation regulations; (3) assure that all companies applying for exceptions to standard transportation accounting methods demonstrate that the company method results in costs no greater than those resulting from the use of the published Average Freight Rate Assessment as commonly applied; (4) insure that reviews of imported crude oil transportation charges are of sufficient scope to assure continued compliance with applicable regulations; (5) evaluate the Average Freight Rate Assessment

periodically to assure the continued integrity of the system; (6) eliminate, to the greatest extent practical, problems which arise from Department of Energy report period time frames which are incompatible with the timespan in which the reported events take place; and (7) require respondent companies to use uniform reporting procedures which identify clear and discrete transportation data. (Author/SC)

4289

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040004

REPORT OF THE COMPTROLLER GENERAL OF THE UNITED STATES

Transportation Charges For Imported Crude Oil--An Assessment Of Company Practices And Government Regulation

Transportation cost is a significant element in the cost of imported crude oil. Along with other costs, it is used to support price increases for regulated petroleum products. GAO reviewed tanker transportation charges reported by seven large oil companies and found that:

- The Federal Energy Administration's transportation regulations were inadequate in preventing companies receiving payments greater than their actual costs.

- Companies reported about $26 million in transportation charges which GAO questioned or considered overcharges.

- The overall reliability of the Federal Energy Administration's transportation cost data is questionable because of inconsistencies and incompatibilities in the reporting systems and inadequate audits.

EMD-76-105

OCTOBER 27, 1977

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

B-178205

The Honorable Harley O. Staggers
Chairman, Committee on Interstate and
Foreign Commerce
House of Representatives

Dear Mr. Chairman:

In response to your February 11, 1976, request, we reviewed the Federal Energy Administration's regulations and company practices regarding transportation charges for imported crude oil.

The Federal Energy Administration reviewed a draft of our report. Its comments are included as appendix II. We also provided the Internal Revenue Service with a draft of our report and the seven companies included in our review with pertinent report extracts.

Our report contains recommendations to the Secretary, Department of Energy, on page 36. As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the House Committee on Government Operations and the Senate Committee on Governmental Affairs not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

Sincerely yours,

R. F. Keller

ACTING Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE COMMITTEE ON
INTERSTATE AND FOREIGN
COMMERCE
HOUSE OF REPRESENTATIVES

TRANSPORTATION CHARGES FOR IMPORTED CRUDE OIL--AN ASSESSMENT OF COMPANY PRACTICES AND GOVERNMENT REGULATION

DIGEST

Transportation cost is a significant element in the cost of imported crude oil. During the 27-month period of October 1973 through December 1975, crude oil transporation charges of nearly $3 billion--a little over $1 for each barrel imported--were reported to the Federal Energy Administration. 1/ These charges, along with others reported by oil companies, are used to support price increases for certain regulated petroleum products.

This report, prepared at the request of the Chairman, House Committee on Interstate and Foreign Commerce, discusses the

--effectiveness of the Federal Energy Administration's transportation regulations,

--allowability of transportation charges claimed by seven selected companies importing crude oil,

--quality and reliability of the transportation charges reported, and

--compliance and enforcement efforts of the Federal Energy Administration with regard to transportation charges.

Using the authority to make energy verification audits of the books and records of private companies, stated under title V of the Energy Policy and Conservation Act, GAO

1/The Federal Energy Administration is one of the agencies consolidated under the Department of Energy as of October 1, 1977.

Tear Sheet. Upon removal, the report cover date should be noted hereon.

EMD-76-105

examined company information supporting about $293 million in imported crude oil transportation charges reported by seven oil companies for the period October 1973 through December 1975. (See p. 6.)

STUDY RESULTS

GAO found:

--Federal Energy Administration regulations for computing and reporting crude oil transportation charges in effect during GAO's period of review were inadequate, therefore giving companies the opportunity to collect more than actual costs. (See p. 13.)

--In one case GAO found an apparent violation of the FEA regulations existing at that time. (See p. 24.) In all instances, no evidence of intent to misstate transportation charges was found. (See p. 10.)

--Companies were using a variety of computational methods and reporting widely varying charges for similar shipments. (See p. 13.)

--Companies used a variety of transportation practices that appeared reasonable under the circumstances and the related charges were supported by company documentation. (See p. 27.)

--Individual company computations of transportation charges were generally accurate, but the overall reliability of the Federal Energy Administration's transportation cost statistics is questionable, because of inconsistencies among companies computed and reported transportation charges. (See pp. 10 and 11.)

--The Federal Energy Administration had assigned low-priority audit status to imported crude oil transportation charges. Because of factors, such as a limited number of auditors and the complexity and interpretive nature of the Federal Energy Administration's regulations, much of the data reported was not verified. However, the accomplished audit work varied in quality and detected problems were not vigorously pursued. (See p. 14.)

Effectiveness of transportation charge regulations

Federal Energy Administration regulations for imported crude oil transportation were ineffective during GAO's period of review because they left undefined the accounting method to be used to compute transportation charges for transactions between companies and their affiliates. This allowed refiners the opportunity to recover more than actual costs. (See p. 13.) The Federal Energy Administration issued new regulations effective January 1, 1977, which define the accounting methods to be used. GAO believes the Average Freight Rate Assessment method provided for in the regulations is a reasonable measure of transportation costs for affiliates' transactions if consistently applied over the long term. (See p. 17.)

Allowability of reported charges

GAO identified over $26 million in reported transportation charges which were overcharges or questioned charges. The overcharges totaling about $1 million resulted from unintentional errors by five of the seven companies in accounting for and reporting transportation charges. (See p. 10.) Of the questioned charges, $24 million represented charges by three companies which were not supported by application of an industrywide measure for computing transportation charges, or by actual cost data which the companies gave GAO. (See p. 20.) An additional $900,000 in questioned charges involved an unusually high fee by one company for moving crude oil from the Carribbean to U.S. ports. The company involved did not support to GAO's satisfaction that the fees represented actual costs. (See p. 30.)

The seven companies engaged in a variety of transportation practices that are specific cost items included in total transportation charges. Where these transportation practices occurred and could be identified with shipments in the GAO sample, the charges generally were reasonable and were supported by documentation provided by the companies.

The overcharges and questioned charges were used in oil company computations to support price increases for certain regulated petroleum products. GAO could not determine, however, the impact, if any, on consumers because the complex regulatory formulas and pricing practices disguised the impact which transportation charges had on price increases relative to all other cost factors. (See p. 3.)

Reliability of transportation cost information

In preparing monthly computations of transportation charges for reporting to the Federal Energy Administration, companies found it necessary to estimate costs for which they had not yet been billed. Also, in some instances they corrected previously reported data which they found to be erroneous or incomplete. The manner in which companies adjusted reported information when previously reported data was updated varied among the companies, both in frequency and the Federal Energy Administration forms on which they were reported. (See pp. 8 and 11.) For example, adjustments might apply to a prior month or months and might be reported a year after the original reporting to the Federal Energy Administration. Also, depending on the form used for making the adjustments, cost data was aggregated with other reported costs and at times was not picked up in the transportation charge data base. (See p. 11.) Because of such factors, GAO believes that the Federal Energy Administration's transportation costs statistics for imported crude oil are of questionable reliability.

Federal Energy Administration compliance and enforcement efforts

Generally, the Federal Energy Administration has assigned a low priority to the audit of transportation charges. It has attempted to verify the accuracy of certain data but because of limited personnel and the complexity and interpretive nature of their regulations, much of the data reported has not been verified. Additionally, GAO noticed instances where Federal Energy Administration auditors were not aware of the issues, believed that no problem existed, or did not vigorously pursue problems identified. (See p. 14.)

RECOMMENDATIONS

GAO recommends that the Secretary, Deparment of Energy, take the following actions with regard to regulatory compliance, administration, and systems support.

Compliance

--Verify that the companies have reported cost adjustments for the overcharges discussed in this report.

--Determine if the charges GAO questioned represent recoveries greater than cost and, if so, require companies to make appropriate adjustments.

--Assure proper implementation of new transportation regulations.

--Assure that all companies applying for exceptions to standard transportation accounting methods demonstrate that the company method results in costs no greater than those resulting from the use of the published Average Freight Rate Assessment as commonly applied. It is important that data offered by companies in support of exceptions receive indepth audit.

Administration

--Insure that reviews of imported crude oil transportation charges are of sufficient scope to assure continued compliance with applicable regulations.

--Evaluate the Average Freight Rate Assessment periodically to assure the continued integrity of the system. This will be especially important if either the status of the tanker market changes significantly or if the Average Freight Rate Assessment's specifications should change.

Systems support

--Eliminate, to the greatest extent practical, problems which arise from Department of Energy report period timeframes which are incompatible with the timespan in which the reported events take place.

--Require respondent companies to use uniform reporting procedures which identify clear and discrete transportation data.

AGENCY AND COMPANY COMMENTS AND UNRESOLVED ISSUES

Federal Energy Administration's comments on the report are contained in a June 30, 1977, letter. (See app. I.) The Federal Energy Administration considered the report's conclusions and recommendations to be reasonable and stated that in each case action had been initiated or would be taken to implement them.

Four of the companies--Gulf, Shell, SOCAL, and Texaco--which submitted comments on the draft report did not have any substantive comments regarding the report material. EXXON, Getty, and Mobil took issue with certain report statements and made substantial comments. The full text of company comments are available from GAO upon request. Where warranted, GAO made appropriate changes to report data and statements, but there remain residual differences of opinion concerning the interpretation of certain charges and computation methods. Transportation charges which were overcharges or charges questioned by GAO remain at about $26 million.

Contents

ABBREVIATIONS

AFRA	Average Freight Rate Assessment
DOE	Department of Energy
DWT	deadweight ton(s)
EPAA	Emergency Petroleum Allocation Act
FEA	Federal Energy Administration
GAO	General Accounting Office
IRS	Internal Revenue Service
VLCC	very large crude carrier

GLOSSARY OF TERMS

AFRA (average freight rate assessment)	The weighted average cost of chartered tonnage as employed in the international transport of oil (see London Tanker Broker's Panel).
arms-length transaction	The consummation of a business transaction between unrelated parties in a free marketplace.
backhaul	The practice of an oil tanker loading another cargo, such as grain, coal, oil, or ore, for transport to some overseas location after discharging crude oil at a U.S. port.
bank	The accumulation of allowable product cost increases which were not passed through to the purchaser in the form of higher prices.
barrel	The standard unit of volume for oil measurement, equivalent to 42 gallons (U.S.) at 60 F.
bunker fuel	A grade of residual fuel oil used to power ships.
charter	
bareboat or demise charter	An agreement under which a vessel is operated by the charterer who bears all costs other than capital costs typically for 10 to 20 years or for the vessel's useful life.
contract of affreightment	An agreement under which the ship owner delivers a specific quantity of oil during a specific period but does not

state the frequency of shipments, the amount in each shipment, or the vessels that are to be used. The owner is responsible for all costs.

single voyage or spot charter — Hire of a vessel for one voyage between any two ports. All expenses are for the account of the owner.

time charter — Hire of a vessel for any agreed period for voyages between any ports selected by the charterer. All capital and fixed operating costs are borne by the owner, but variable costs, such as fuel, canal tolls, and port charges, are borne by the charterer.

cost passthrough — The increase in the allowable selling price of a petroleum product as a result of an increase in costs of production. The increased costs of production must be those permitted to be passed on to the buyer by FEA regulations.

deadfreight or light loading — A charge by the vessel owner or operator to the importer for cargo carrying capacity not used.

DWT (deadweight tons) — Total carrying capacity of a ship expressed in long tons of 2,240 lbs.

demurrage — The charge paid to a vessel owner or operator by the vessel charterer for detention of a vessel at the port(s) beyond the time allowed, usually 72 hours, for loading and unloading.

lightering — The practice of unloading part of the crude from a tanker onto a smaller vessel, usually a barge, in order that the partially loaded tanker may enter a port. Lightering costs, called lighterage, are the fees paid for the use of the small vessel.

landing — The unloading of a petroleum cargo at its final port of destination.

London Tanker Brokers' Panel — A London-based panel which publishes AFRA rates on a monthly basis. The panel is made up of representatives from six leading London tanker brokerage firms.

slow steaming — Reducing vessel cruising speed to extend voyage time and/or absorb excess tanker capacity.

transshipment — A method of ocean transportation whereby ships dock at a deepwater terminal and offload the oil cargo to temporary storage tanks or to one or more smaller tankers, which then transport the oil to a market destination that has only shallow water port facilities.

vertically integrated oil company — A company engaged in all phases of the oil business; i.e., production, transportation, refining, and marketing; a company which handles its own oil from wellhead to gasoline pump.

voyage	Usually the movement of a vessel from loading port to discharge port and return. A portion of a voyage; e.g., from loading port to discharge port, is called a leg of a voyage.
Worldscale	A worldwide schedule of nominal freight rates stated in dollars per long ton for crude oil carried between numerous ports. It is intended solely as a standard of reference for comparing rates for all voyages and market levels.

CHAPTER 1

IMPORTED CRUDE OIL TRANSPORTATION

In 1976 crude oil imports averaged 6 million barrels per day and supplied 44 percent of the United States energy demand. Recent industry estimates indicate that by 1980, crude oil imports could increase to over 12 million barrels per day. Transportation cost to the United States is a significant element in the cost of imported crude oil.

During the period October 1973 through 1975, reported transportation charges totaled over $2.8 billion for over 2.7 billion barrels of imported crude oil. Under Federal Energy Administration (FEA) 1/ regulations, increased transportation costs related to imports may be ultimately passed on to consumers as price increases. The Chairman, House Committee on Interstate and Foreign Commerce, requested that, using the authorities quoted under title V of the Energy Policy and Conservation Act, we make an assessment of the administration and enforcement of FEA regulations pertaining to the accounting for transportation costs.

The level of assurance that imported crude oil transportation charges reported to FEA are a reasonable approximation of actual costs, and thereby adequate for Federal price control, is dependent on the following factors:

--The degree to which Federal regulation provides an enforceable standard for the evaluation of cost identification and reporting procedures.

--The effectiveness of Federal agency efforts to verify that reported transportation charges are, in fact, a valid representation of actual costs.

--The integrity and manageability of the Federal information systems used to formulate and communicate the reported transportation charge data.

In the course of our work we focused on four principal issues:

--The effectiveness of FEA's transportation regulations and compliance and enforcement efforts in supporting the Emergency Petroleum Allocation Act (EPAA) of 1973 (Public Law 93-159) which calls for a dollar-for-dollar passthrough of crude cost increases.

1/FEA is one of the agencies consolidated under the Department of Energy (DOE) as of October 1, 1977.

--The reasonableness of published rate scales and shipping rate averages used for calculating imported crude oil transportation charges reported to FEA.

--The accuracy and reliability of transportation costs claimed by companies importing crude oil under FEA regulations.

--The frequency, nature, and impact on transportation cost of shipping practices ancillary to crude oil importation.

FEA REGULATION

Origins of price controls

While there has been Federal regulation of the petroleum industry since the 1930s, price control of the petroleum industry was initiated in August 1971 with a 90-day price freeze imposed by the President under the authority of the Economic Stabilization Act of 1970 (Public Law 91-379). Subsequently, oil companies were placed under a control system in which ceiling prices established during the freeze period became base prices that could not be exceeded unless (1) the increases were cost justified and (2) yearly profit margins did not exceed the base period profit margin.

The regulation on petroleum prices continued in effect until they were re-issued relatively intact by the Federal Energy Office under EPAA, passed as a result of the Arab oil embargo. EPAA stated that in specifying prices the President shall promulgate regulations providing for a dollar-for-dollar passthrough of net increases in the cost of crude oil, residual fuel oil, and refined petroleum products to all marketers or distributors at the retail level.

To bring about the legislated energy goals, the President created the Federal Energy Office on December 4, 1973. Then on May 7, 1974, the Federal Energy Administration Act of 1974 (Public Law 93-275) was enacted which provided for a reorganization of governmental functions to deal with energy shortages. EPAA was amended by the Energy Policy and Conservation Act of 1975 (Public Law 94-163), extending controls over crude oil prices into 1979, with standby authority until 1981.

Consumer impacts of controls are uncertain

The price consumers pay for petroleum products are determined by the application of complex regulatory formulas to cost factors and by cost increases which refiners feel can be recovered in the marketplace. Because of supply and demand market forces, prices charged are frequently less than the ceiling amount allowable under the regulatory formulas. FEA has allowed refiners to carry forward as unrecovered costs those increases which were not immediately added to selling prices. This carry forward has been described as "banks," and has at times represented over 50 percent of the additional costs that refiners claim to have incurred since May 1973. In December 1975 the combined banks of the 30 largest refiners were about $1.5 billion. FEA has also allowed refiners to offset against the banks the value of most overcharges resulting from violations of the regulations. Frequently it can't be determined whether given charges or cost adjustments actually result in product price increases. This is due in part to the fact that not all cost increases are passed through, and in part to the cost and adjustment absorbing nature of the banks.

Revision of landed cost regulations

During the period covered by our review, October 1973 through December 1975, FEA regulation allowed refiners to recoup through increased product prices the crude oil cost increases incurred since May 1973. For imported crude FEA defined landed costs as the purchase price plus transportation to the United States and import fees and duties incurred. Much of the foreign crude imported by major integrated U.S. oil companies is transported on vessels owned or controlled by the oil companies' foreign affiliates.

FEA regulations required that where transportation was obtained through an arms-length transaction, the importing oil company must report the actual transportation cost as the transportation charge. This is a cost in the strict sense and meets the dollar-for-dollar criterion. However, in a transaction between affiliates, the transportation charge was to be computed using whatever generally acceptable accounting procedures the importing refiner had historically used. These regulations, applicable to the period of our review, were issued January 15, 1974, and remained relatively unchanged until a new regulation was issued effective January 1, 1977.

Because the accounting methods used to compute imported crude transportation costs were undefined by the regulation, varying charges resulted for similar shipments. As a result, in March, and again in September 1976, FEA issued two different proposals to revise the regulation. It held hearings and invited public comments and issued a revised regulation effective January 1, 1977, on the basis of industry comments to the proposals and its own considerations.

Within 30 days of the regulation's effective date, companies may request approval to use their customary accounting procedures if they can demonstrate that resultant transportation charges are not materially greater than those charges which would result from prescribed procedures.

ACCOUNTING AND SHIPPING PRACTICES

Worldscale

Charter rates reflect the mutual views of owners and charterers on present and future tanker purchase and operating costs and present and anticipated tanker demand and supply balances. Frequently, charter rates are listed in Worldscale--a worldwide schedule of nominal freight rates stated in dollars per long ton for crude oil carried between numerous ports, prepared jointly by the International Tanker Freight Scale Association of London and the Association of Ship Brokers and Agents of New York. The schedule was originally issued, effective September 15, 1969, to provide a standard of reference that could be used for all voyages and market levels. It replaced separate freight schedules previously published by the associations. Worldscale rates are revised annually and published near the end of each year.

Average Freight Rate Assessment

An integrated company faces the problem of apportioning shipping costs plus a reasonable profit for the shipping affiliate among the various refining and marketing affiliates. Because companies generally do not dedicate specific ships to specific routes, shipping costs, such as depreciation, crew expenses, and repairs, are difficult to allocate to individual voyages. The use of Average Freight Rate Assessments (AFRA) applied to Worldscale is a common industry practice which is one alternative to accounting for costs on a voyage-by-voyage basis.

AFRA was first calculated on April 1, 1954, and has been published regularly since that date. Each month the London Tanker Brokers' Panel publishes, in terms of

Worldscale, the weighted average charter rate for five size categories of tankers operating commercially during the previous month. For example, the AFRA rate for a 25,000-44,999 deadweight ton (DWT) class of ship, for a given month, may be expressed as W165.5. This tells the AFRA user that the transportation charge per ton of petroleum carried on any tanker in that size range over a certain route may be computed by multiplying the appropriate Worldscale rate for that route by 165.5 percent. The assessment period runs from the 16th day of a month to the 15th day of the following month, and during this period the London Tanker Brokers' Panel analyzes and evaluates all the information supplied by the oil companies direct, the individual Panel members, and other sources. Most major integrated oil companies cooperate with the Panel in furnishing information regarding their executed contracts. The six Panel members have each accepted responsibility for maintaining day-to-day records for a section of the world tanker fleet. The Panel believes it secures data relating to at least 90 percent of the tankers included in AFRA.

Federal interest in accounting and shipping practices

Transportation charges computed using AFRA were not required by FEA to be supported by actual cost data. Also, the various methods individual refiners use when applying AFRA rates may produce differing transportation charges given essentially the same facts. It was the variety of methods for using AFRA which led FEA in April 1976 to question the use of AFRA and Worldscale and to propose revisions to the transportation regulations. FEA held hearings, reviewed industry and public comments, and made further revisions to the proposed regulation later that year.

FEA concluded that AFRA and Worldscale as published are an industrywide measure and should lead to close agreement over the long term between allowed and actual crude oil transportation costs. With certain limitations, other costs not included in published AFRA or Worldscale rates are also allowed.

An alternative to AFRA is the net-cost method, a technique for calculating the approximate actual transportation costs for each voyage. The regulation allows a firm using an actual cost method to request permission to make a one-time-only change to the AFRA method.

In addition to AFRA there are certain practices which are intrinsic to tanker transportation of crude oil. Most U.S. ports are not capable of handling vessels over 80,000

DWTs without light-loading or lightering (see glossary). As a result, imported crude oil transportation costs include costs ancillary to the basic shipping charge. These costs include lighterage, deadfreight, demurrage, and transshipping fees. In addition, backhauling and slow steaming are practices which may affect transportation charges. While these are normal and acceptable industry practices, the methods used to calculate the costs of several of these practices could result in increased transportation charges.

SCOPE

From October 1973 through December 1975, the seven major U.S. oil companies included in our review accounted for 45 percent of all foreign crude oil imports, about 1,222 million barrels, at a reported total cost of about $14.8 billion. Of this amount, about $1.4 billion or 9.7 percent was transportation costs. Our review of the seven companies covered 693 randomly selected shipments which accounted for 241 million barrels or about 20 percent of their imports of foreign crude oil during the 27-month period. Reported costs of sampled transportation charges were about $293 million. Due to inconsistent reporting practices, the total population of landings and associated transportation charges from which our sample was taken could not be determined from the data within the scope of our review.

The seven companies were:

--Exxon Corporation, U.S.A.	(EXXON)
--Getty Oil Company	(Getty)
--Gulf Oil Corporation	(Gulf)
--Mobil Oil Corporation	(Mobil)
--Standard Oil Company/of California	(SOCAL)
--Shell Oil Company	(Shell)
--Texaco Incorporated	(Texaco)

We reviewed laws and FEA regulations affecting transportation charges. We evaluated the oil companies' use of diverse accounting and shipping practices relative to reported transportation charges and discussed them with oil company officials.

To preclude unnecessary duplication of efforts or more than a minimum imposition of burden on the companies, we sought to acquire as much pertinent information as possible already in the possession of Federal agencies. We had meetings and discussions with technical staff at the U.S. Maritime Administration, the Military Sealift Command, the Internal Revenue Service, and the Congressional Research Service. In addition, we had discussions with officials at FEA headquarters and field locations to determine the scope of auditing devoted to imported crude oil transportation charges reported by the seven companies.

CHAPTER 2

TRANSPORTATION REGULATIONS COMPLIANCE

AND DATA RELIABILITY

For the period October 1973 through 1975, the seven companies we reviewed generally compli[illegible] [illegible]th applicable FEA transportation regulations and related [illegible]rting requirements. Also, companies were reasonably accurate in determining the transportation charges they reported to FEA. However, overall, the transportation information reported by the companies and associated FEA reporting systems cannot be considered reliable for price control because neither was accomplished in a consistent nor determinant manner. In addition, FEA's landed cost regulations were ineffective in supporting the objectives of EPAA because they allowed refiners the opportunity to recover more than their actual costs.

One standard method for computing transportation charges specified under the revised transportation regulations issued by FEA in December 1976 and effective January 1, 1977, is the use of AFRA. Because AFRA is not controlled by the agency specifying its use, it is important that the Federal Government be assured that AFRA is an appropriate measure of transportation costs. (See ch. 3 for our assessment of the appropriateness of AFRA.)

Additionally, some shipping practices, which are ancillary to the transportation of crude oil, are quite costly. Such practices are important in assessing transportation charges reported to the Federal Government; they are examined and evaluated in chapter 4.

COMPANY COMPLIANCE WITH FEA REGULATIONS AND THE QUALITY OF DATA REPORTED

FEA reporting systems

Basically, FEA's petroleum price control system permits refiner cost increases for crude oil, purchased refined products, and certain nonproduct costs experienced in a month to be applied to the price of products sold in the following month. For the period covered in our review, refiners accomplished this through the preparation of the Monthly Cost Allocation Report, Form FEO-96 (form-96). Increased costs would be passed through during the month in which the report was submitted; e.g., May 1975 costs would be reported by June 10, 1975, with any increased costs to be added to product prices in June 1975.

The regulations applicable to the refiner segment of the industry recognized transportation to the United States as a cost element in the total crude cost or the "landed cost" (crude oil purchase price plus transportation plus import fees and duties). In determining landed cost, FEA required that transportation cost be determined in one of two ways:

--If the transportation was obtained pursuant to an arms-length transaction, the actual transportation cost was to be used.

--If the transportation was obtained pursuant to a transaction between affiliated entities, the cost was to be computed by using generally accepted accounting procedures consistently and historically applied by the firm concerned.

Before February 1975 transportation charges were not reported separately; they were incorporated in the total imported crude oil cost reported on form-96.

In February 1975 FEA required refiners which imported at least 500,000 barrels of crude per month and refiners which imported crude from affiliates to submit a Transfer Pricing Report, Form FEA-F701-M-O (form-701). Among other data, the refiner was required to report by month, retroactive to October 1973, and also for the month of May 1973, the transportation cost per barrel for each crude oil landing.

As a price monitoring form, the principal use of form-701 by FEA is to determine, using nonaffiliated crude oil import transaction data, an average price for certain types of crude oil. This average or "representative price," exclusive of transportation costs, is applied as a ceiling against a company's reported average price per barrel of similar crude oil purchased from affiliates. The second purpose is to provide the data necessary for FEA to monitor changes in price and cost for crude oil in both the U.S. and worldwide markets.

Form-96 was superseded in January 1976 by the "Refiners' Monthly Cost Allocation Report," Form FEA-P-110. The new form reflects the regulatory changes made to pricing computations and requires only summary data be reported to FEA in lieu of the actual computation. Detailed supporting data must be maintained by the companies for FEA audit purposes. Form-701 continues to be used essentially unchanged from the period of our review.

Reported data was generally accurate

Because form-96 lacked discrete transportation cost data, we chose form-701 as the basis of our review. Our sample consisted of 693 reported shipments from schedule B of form-701.

Although the companies' computations of transportation charges were generally accurate, we found specific overcharges related to imported crude transportation costs at five of the seven companies. The overcharges resulted from a variety of activities, but mostly from errors made in accounting for and reporting of transportation costs on forms 701 and/or -96.

We carefully examined the nature of each of these errors and found neither a pattern nor evidence of the intent to misstate the subject transportation costs. Examples of the errors that caused overcharges included the application of the wrong AFRA category; application of AFRA pertinent to the wrong month; use of the wrong Worldscale rate; accounting errors, such as duplicate charges; and errors in the exchange rate used to convert foreign currency to U.S. currency.

We believe these errors and resulting overcharges were unintentional and the companies involved were trying to comply with the regulations. In each case the companies agreed to correct the overcharges by adjusting their monthly reported cost. As noted below, errors were found which also resulted in undercharges or cost understatements.

Erroneous transportation charges from the sample transactions verified at each company are shown below.

Company	Undercharges	Overcharges	Net reported undercharge or overcharge
Gulf	$ -	$ 551,917	$551,917
EXXON	10,512	25,744	15,232
Getty	-	-	-
SOCAL	-	-	-
Mobil	67,616	111,414	43,798
Shell	52,781	94,714	41,933
Texaco	215,924	541,580	325,656
Total	$346,833	$1,325,369	$978,536

Reliability of data is questionable because of inconsistency in reporting

In preparing the monthly computations, the manner in which data was extracted and compiled from their financial accounting systems varied among refiners, according to the individual practice of each company. We found instances where data reported to FEA by the several oil companies were erroneous or incomplete but later adjusted. The major causes for these problems are

--the incompatibility of FEA reporting requirements with the company's corporate procedures and

--the FEA requirements to retroactively report data nearly 2 years old.

Because the time period from loading to unloading cargo is often longer than the reporting period (monthly), many costs had to be estimated. In many cases transportation charges included cost estimates of demurrage and lightering, which were then billed to the refiner in months subsequent to the reporting period. These problems were handled differently by individual refiners with solutions ranging from lump-sum reporting to nonreporting. We found in some companies that invoices for various transportation charges were filed in the chronological order in which they were processed--an order which met the internal needs of the company but which made it difficult to locate all costs associated with particular shipments for purposes of reporting to FEA. Invoice revisions, adjustments, and reversals were sometimes captured at different physical locations. Under these circumstances the retrieval of support data can be very difficult, time consuming, and uncertain as to completeness.

When actual or corrected cost data became available, the refiner would make an adjustment for transportation charges on subsequent reports, usually as prior period unrecovered costs. These adjustments might refer to the previous month or a series of previous months and might be submitted a year or more after the original shipment report. Frequently, the adjustments were an aggregation of lesser individual adjustments. As a result, the ability to identify transportation data relating to a given month, let alone a specific shipment, was lost.

Compounding this, the manner varied in which companies made adjustments to form-701 data:

--All adjustments were routinely made via form-96.

--Form-701 data adjustments were made via that form only if the item was "material"--at least $50,000.

--Form-701 data was always adjusted to that form.

Because of the masking effect of adjustments, especially for form-96, and because the reporting cycles for forms-96 and -701 are different and not compatible, we found that reported costs could not be reconciled between them. As a result, effects on costs' passthrough adjustments for any given month are indeterminant.

Conclusions

Seven major U.S. oil companies importing crude oil for the period October 1973 through 1975 reported to FEA transportation charges which were generally accurate. Although we found overcharges, we encountered no evidence indicating an intent to overcharge.

We could not determine the impact of the overcharge on petroleum product prices due to

--the complex regulatory formulas,

--prior prices which did not reflect total cost increases,

--the banking of these costs for future recovery, and

--the inability of the reporting mechanisms to trace data relating to specific accounting and shipping activity.

The conflicting timings of reports and events should have no material effect on reported charges over long periods, if existing reporting practices for transportation cost are historically and consistently applied. However, when the data resulting from such practices are used for short-term decisionmaking, the significance of existing timing conflicts and reporting practices is more pronounced. As long as the exigencies of Federal reporting systems remain incompatible with the physical occurrence of reported activities and with industry accounting practices; and until there are reasonably uniform reporting practices; the timeliness, accuracy, and utility of the reported data will probably be unreliable and of uncertain accuracy.

ADEQUACY OF FEA'S REGULATIONS AND COMPLIANCE AND ENFORCEMENT EFFORTS

Transportation regulations were permissive

FEA regulations applicable to the refiner segment of the industry recognized transportation to the United States as a cost element in the total crude cost, but left undefined the accounting methods to be used to compute imported crude transportation charges. While the regulations stipulated the use of actual cost data for third-party transactions, they restricted affiliated transactions only to "generally accepted accounting practices consistently and historically applied." No further direction or constraints were provided by the regulations.

This lack of regulatory specificity raised questions about the data being reported to FEA as transportation costs and the possible effects it could have:

--In reference to transactions between affiliates, where the profits from transportation charges fall to the foreign shipping affiliate, the question arises of whether oil companies using affiliate company's ships have recovered more than transportation costs.

--The Federal Government's lack of regulatory standards for the costing of imported crude oil transportation resulted in inconsistent reporting and the inability to evaluate both the data and accounting methods. (See ch. 3 for its effects.)

We found that among the seven companies were four distinct methods of accounting for transportation costs. Also, three of the companies modified an industry "standard" accounting practice. Charges for similar shipping practices varied and many transportation charges were not demonstrated to reasonably approximate actual costs.

The interim regulation issued in December 1976 and effective January 1, 1977, addresses the problems of lack of criteria to judge appropriateness of accounting practices and cost representiveness of reported transportation charges. The substance of this new regulation deals with the specification and application of AFRA and an optional "net cost" method. (See ch. 3.)

FEA review of transportation charges

Generally, FEA has assigned a low-priority audit status to imported crude oil transportation charges. Regardless of priority, FEA did not vigorously pursue detected problems, and audit work was varied in quality.

FEA did attempt to verify the accuracy of the costs reported on the form-96. Because of the limited number of auditors, the complexity of FEA's regulations, and the degree to which the regulations were subject to interpretation, much of the data reported had not been verified. Our findings are consistent with our earlier observations on FEA's compliance and enforcement. (See our report "Problems in the Federal Energy Administration's Compliance and Enforcement Effort," December 6, 1974.) While the situation has been partially mitigated by the new regulations, the basic problems identified in that report still remain.

In recent testimony before the Subcommittee on Energy and Power, House Committee on Interstate and Foreign Commerce, on FEA Compliance Activities, we summarized FEA's difficulties with regulatory compliance and enforcement activities.

> "Some of the problems are caused by the unresolved regulatory issues and inappropriate regulatory reporting requirements discussed earlier. Other factors, which our previous work has shown, and which may have contributed to the existing situation, are the number of special programs such as the propane and fuel oil supplier audits which took auditors away from other review programs, interregional disputes over jurisdiction and support roles, attrition of personnel, and uncertainties over the future of the regulatory program."

Practices went undetected

We noticed certain instances at the companies where FEA auditors were either not aware of the issues involved or they believed no violation of FEA regulations had resulted. FEA auditors assumed that if a company used AFRA for calculating transportation charges, and if the application was consistent and historical, generally, the company was in compliance with FEA regulations, regardless of how the company chose to apply AFRA.

In the case of one company, FEA auditors had done no work in the area of imported crude oil transportation charges. The auditors appeared unaware of the company's modification of the AFRA system as well as the effect of the modification on transportation charges. (See p. 21.)

In another case, FEA auditors had been aware that the AFRA categories were revised, but they believed that the company had consistently and historically revised the categories and, therefore, no violation of the regulations had occurred. However, after inquiries in early 1976 by staff of the House Subcommittee on Energy and Power, FEA audited certain transportation charges reported by that company. FEA auditors found that the company had changed accounting methods and was not consistent in its use of modified AFRA. The auditors recommended to FEA regional and headquarters officials that the company be required to follow AFRA without any deviations as this would more truly reflect a proper measurement of costs. (See p. 23.)

In a third case, FEA auditors did some work in the area of transportation charges, including those reported in January and February of 1974. They did not discover the use of a questionable bunker surcharge which occurred during that time. FEA's explanation for this was that the time limitations did not allow for an indepth investigation. (See p. 24.)

FEA officials told us that they have recently begun to closely review the facts in the second case we cited.

Conclusions

For the period of our review, October 1973 through 1975, FEA regulations governing the calculation of imported crude oil transportation charges were not effective because they allowed refiners the opportunity to recover more than cost. Importing refiners were using a variety of computational methods and, as a result, reported widely varying charges for similar shipments. Thus, Federal regulations did not provide an enforceable standard for the identification and reporting of dollar-for-dollar costs passthrough as required under EPAA. FEA issued new regulations effective January 1, 1977, which, if properly implemented, will eliminate future problems of the nature described in this report.

Transportation costs are less significant than are crude oil costs, and the scope of the review did not permit us to assess the propriety of FEA's assignment of a lower priority to the audit of transportation costs. However, FEA has not adequately fulfilled its responsibilities of assuring compliance with transportation cost regulations. In addition, because FEA's reporting requirements included estimates and combined adjustments, we could not be assured of complete and accurate transportation cost data. In our opinion, the information reported to FEA was not reliable for assuring price control. Similarly, the effectiveness of the new transportation regulations may be neutralized without more effective data reporting requirements.

The change in accounting methods cited in the second example of FEA audit oversights appears to violate the FEA regulation requiring the use of customary accounting procedures consistently and historically applied.

CHAPTER 3

ACCEPTANCE AND APPLICATION OF AFRA FOR REGULATORY PURPOSES

To determine how charges derived from applying AFRA and Worldscale compare to actual transportation costs, we examined two accounting systems which were structured to provide actual cost data on a voyage-by-voyage basis, referred to as voyage cost accounting. In addition, we obtained profit and loss data and other financial information relevant to tanker transportation from several companies that did not practice voyage cost accounting.

Our examination of AFRA, supported by work accomplished during our review, has shown that published AFRA/Worldscale can be an appropriate measure of transportation costs. Generally, for the period of our review, we found that transportation charges computed using AFRA were lower than actual transportation costs for long-term chartered vessels and greater than short-term charter costs. Although, for any given period of time, a company's actual fleet costs could be above or below those computed using AFRA, the relation of AFRA to costs reflected the status of the tanker market during most of the period of our review.

Fluctuations in costs are a function of (1) industry response to anticipated shipping and cargo market changes, (2) the resultant mix of long- and short-term contract arrangements, and (3) the actual behavior of the particular markets themselves. In times of surplus tanker capacity and declining charter rates, AFRA is usually above short-term charter rates. On the other hand, in times of high market rates, AFRA will be below short-term charter rates.

ACCEPTANCE OF AFRA

EPAA provided for a dollar-for-dollar passthrough of net increases in the cost of crude oil. Transportation charges based on actual cost meet the EPA requirement. However, because companies sometimes use AFRA to compute transportation charges reported under FEA regulations, we found it necessary to determine whether AFRA, both as it is published and used, satisfies the requirements of relevent legislation and regulation.

We addressed two principal questions:

--Can AFRA be applied in a manner which provides an acceptable level of assurance that AFRA-based transportation charges are a reasonable approximation of actual costs?

--Which applications of AFRA, if any, raise questions about the cost representativeness of their resultant transportation charges?

Acceptance of AFRA by industry and U.S. Government

For many years integrated oil companies have used AFRA to price crude oil transportation between affiliates. Today industry continues to strongly affirm its use as an arms-length rate, essentially reflecting the open chartering market. This is because AFRA represents the average cost of all competitively chartered tankers in world trade. Tankers owned and operated by the oil companies to transport company crude oil are not effectively included in AFRA. The cost of each charter currently in effect is weighted into the AFRA calculation, which results in the average cost of the world's tanker fleet, and expressed in terms of Worldscale. At any point in time the cost of an individual vessel may be above or below AFRA. Because long-term, short-term, and spot charters are weighted, AFRA reflects the steadying effects of the longer term period charters which dampen the typically violent fluctuations of the very short-term spot charter market, and, in this sense, AFRA represents more stable costs.

However, the use of AFRA has raised some concerns. The published AFRA rate schedule is divided into five distinct categories on the basis of vessel size. Due to economies of scale, the AFRA rate decreases as vessel size increases. There is concern that, by revising the categories so that larger vessels are included in a smaller vessel category, or by disregarding the actual size of vessel used in transporting the crude oil, the effective AFRA rate could be higher.

Tankers may, on occasion, load another cargo for transport to some overseas location after discharging crude oil at a U.S. port. This practice is known as backhauling. Potential backhauls include such products as grain, coal, and ore. AFRA values are based on a roundtrip voyage--a loaded leg and a ballast (empty) leg. This raises the question of whether a refiner should receive a credit against the crude oil transportation charge for any revenue received by virtue of the backhaul.

As indicated in the preceding chapter, in the September 1976 proposed regulations, FEA concluded that

"* * * the specification of AFRA and Worldscale, based on the class of vessels and transportation routes actually used, should lead to close agreement over the long term between allowed and actual crude oil transportation costs."

In December 1976 FEA published its revised regulations which incorporated AFRA/Worldscale as the acceptable nominal freight rate to be used between affiliates.

Also, the Internal Revenue Service (IRS) has accepted AFRA as a measure of arms-length shipping charges for tax audits through the 1972 tax year. Until recently, however, IRS had not made firsthand verification of the actual economic validity or systemic integrity of AFRA. It did study AFRA in 1970 and concluded that it could accept AFRA/Worldscale as a measure of intercompany charges for transportation of crude oil and oil products.

Although IRS noted some defects, it believed that they were not serious enough to bar the acceptance of AFRA. In 1976 IRS, in conjunction with the United Kingdom Inland Revenue, undertook a detailed analysis of the AFRA system operated by the London Tanker Brokers' Panel. The general conclusion was that the methodology and procedures as practiced by the Panel are the same as the published methods and procedures, and that AFRA provides an accurate statistical index of the average cost of chartered tanker tonnage on a month-by-month basis.

We discussed objectives and scope of work of the analysis with IRS and Inland Revenue personnel who accomplished it. We also reviewed the analysis work plan and findings, and we are satisfied that the scope of the review was sufficient to assess the accuracy and integrity of the AFRA system.

Our assessment of AFRA

For the two companies with voyage cost accounting systems, comparative analysis illustrates the relationship of AFRA to actual costs for company-owned and long-term chartered vessels and to voyage costs for spot (short-term) chartered vessels. 1/

1/"Long term" refers to leased, bare boat chartered, and time chartered vessels. "Short term" refers to voyage chartered and contract of affreightment vessels.

When comparing the companies' actual costs to AFRA, we found that

--if the companies were constrained by ownership or long-term shipping agreements, each experienced a loss of about $1 million and

--if the companies were able to take advantage of the fluctuations of the short-term market, each experienced a gain of nearly three-quarters of a million dollars.

The overall net loss during 2 years for each of the companies was over a quarter of a million dollars. However, as stated earlier, a company's actual costs could be higher or lower than AFRA's for a period of time.

Whether a shipping affiliate paid at AFRA rates will remain profitable under similar circumstances depends on a number of factors. Making the right decisions, such as when to build, lease, charter, and scrap vessels, at the right time is important. For example, a shipper who could have foreseen the current tanker surplus and correspondingly low rate spot charter market and sold or scrapped uneconomical vessels would thus be in a position to charter-in vessels at low spot charter rates to meet current transportation requirements.

Conclusion

The use of actual transportation costs meets the requirements of EPAA, but published AFRA/Worldscale consistently applied over the long term is also an appropriate measure of transportation costs. The use of AFRA meets the need for determining reasonable charges between affiliates for the transportation of crude oil.

AFRA MODIFICATIONS RAISE QUESTIONS

Three of the seven companies we reviewed consistently applied the AFRA/Worldscale method as published, to compute allowable transportation charges. One company used actual transportation costs; the remaining companies modified published industry procedures for applying AFRA.

Transportation charges of the last three companies were about $24 million more than those of AFRA. We question the appropriateness of these charges because the companies did not submit evidence or demonstrate to our satisfaction that the charges were more representative of actual costs than if the published AFRA/Worldscale method had been applied.

In the following two tables, total charges questioned are broken down by the type of practice in question, and by the total questioned charges for each company, regardless of practice.

Questioned charges which are AFRA related by practice

Practice	Amount
Trade-rate AFRA	$ 7,214 300
AFRA revised categories	6,562,200
Bunker surcharge	9,812,400
Demurrage	426,000
Deadfreight	195,000
Total	$24,209,000

NOTE: The questioned charges by practice identified in the table above do not necessarily correlate with the questioned charges by company identified in the table below.

Questioned charges which are AFRA related by company

Company	Amount
Gulf	$ -
EXXON	7,626,000
Getty	9,812,000
SOCIAL	-
Mobil	6,771,000
Shell	-
Texaco	-
Total	$24,209,000

The facts and circumstances surrounding the questioned charges for each company are discussed in the following sections of the chapter.

Trade-rate AFRA

Since 1972 EXXON has used what it calls trade-rate AFRA for pricing crude oil transportation between affiliates.

The U.S. importing affiliate paid the foreign transportation affiliate on the basis of an AFRA vessel category rate assigned to each load/discharged port combination or trade, used in importing crude oil into the United States. The AFRA category assigned by EXXON to each trade was established by (1) determining the maximum size vessel that can regularly and routinely serve the company's facilities at the load and discharge ports and (2) then determining the largest AFRA category for which the industry's average size vessel in that category can be regularly and routinely used. In effect, the application of trade-rate AFRA means that if the maximum size vessel which the company's trade regularly accommodates is below industry's average size vessel in an AFRA category, the trade is assigned the lower and more expensive AFRA category as the trade rate.

We compared transportation charges resulting from application of trade-rate AFRA to the transportation charges which would have resulted had EXXON applied published AFRA/Worldscale for 98 crude oil shipments. The shipments involved about 36 million barrels of crude oil with freight charges over $49 million and total transportation charges of about $52 million. Trade-rate AFRA transportation charges were higher by about $7 million. These charges are questioned because they are neither supported by actual cost data nor are they computed by using AFRA/Worldscale as published.

EXXON officials have stated that their system of applying AFRA has advantages for the refiner, the shipper, and the consumer. According to EXXON, the refiner can plan more effectively as his cost is less subject to fluctuations in transportation charges; and because the trade rate is predetermined, the shipper may optimize his worldwide operations without involving the domestic refiner. Our review was intended to focus on transportation charges, and we did not examine into the commercial benefits and costs accruing to involved corporate entities.

Another benefit of the system, according to EXXON, is that the trade-rate system protects the consumer from having to absorb higher costs when the shipping affiliate provides a vessel larger than the vessel implied by the assigned trade-rate AFRA category. In this case, we were told, the shipping affiliate must absorb any lightering or deadfreight charges rather than pass them along to the refiner and ultimately the consumer.

However, even after allowing for lightering and deadfreight costs of $141,000, which would only be passed through under published AFRA, the net difference between that and trade-rate is over $7 million. For the period of our review, the sampled shipments did not result in a net benefit for the consumer.

Moreover, our review showed that 24 vessels in our sample shipments were larger than implied by the trade-rate AFRA, and lightering and/or deadfreight charges were not absorbed by the shipping affiliate. As a result of these findings, EXXON reviewed all lightering and deadfreight transactions occurring from August 1973 through December 1975 1975 and stated that $1.9 million had incorrectly been paid by the U.S. refiner. The company made the cost passthrough adjustments required and stated that revised control procedures were instituted to avoid a recurrence of such billing errors.

EXXON provided documentation that its shipping affiliate did absorb lightering and deadfreight costs which decrease the difference between trade-rate AFRA and published AFRA by about $570,000 for 51 sample voyages. It also stated that had a vessel AFRA system been employed, EXXON would have incurred an additional $830,000 in demurrage costs, incurred on transshipped crude, further reducing the difference between its trade-rate and published AFRA/Worldscale. However, because the affiliate absorbed these demurrage costs in a lump sum, EXXON stated that these costs cannot be specifically identified or supported by invoices. For this reason, we could not verify the exact amounts of lightering, deadfreight, and demurrage costs estimated by EXXON to have been absorbed by the shipper. Therefore, we did not consider any of these costs as a reduction of the net difference between trade-rate and published AFRA.

Revised AFRA categories

Mobil used two different methods for applying AFRA to compute transportation charges during the 27-month review period. In 1973 it applied AFRA in a method similar to that used by EXXON. Each load-port/discharge-port combination was assigned an AFRA rate category and that rate category was used to compute transportation charges regardless of the size of the vessels actually used in delivering crude between the two ports.

Beginning in 1974 Mobil changed its method for applying AFRA and revised the vessel size ranges within each AFRA category. The result of the revision was to shift the AFRA vessel categories downward as much as 33 percent. Thus a crude oil shipment which would be charged at the lower Medium-Range rate under AFRA, as published, instead might be charged at the more costly General-Purpose rate under Mobil's revised AFRA categories. Mobil stated that the change in method resulted in lower transportation charges.

Although our analysis of several crude shipments confirmed that the change did result in a reduction of charges, Mobil's application of AFRA, both before and after the change, resulted in higher transportation charges when compared to charges computed using published AFRA. We found the reported transportation charges of about $65 million exceeded published AFRA charges by over $6.6 million.

Mobil's rationale for revising AFRA categories was that published AFRA represents the average cost of all vessels in any particular category. Its port restrictions often preclude the use of vessels larger than the average size vessel in any particular AFRA category. Smaller than average size vessels within each AFRA category are more expensive to operate than larger vessels; therefore, Mobil is denied the economies of scale if it uses AFRA as published. However, Mobil did not have a voyage cost accounting system and did not present other data to demonstrate that the revised AFRA categories more precisely reflected actual cost.

While we leave the final decision to FEA, Mobil's change from the port-rating method to the revised-vessel-category method appears to violate the FEA regulation requiring the use of customary accounting procedures consistently and historically applied. Although the change did result in reduced transportation charges, the regulatory restriction on accounting procedure change does not except changes which result in reduced charges.

AFRA and the "bunker index"

Since October 1973 the cost of bunkers--the fuel used to operate tankers--has quadrupled. Worldscale could not publish rate schedules with sufficiently up-to-date bunker prices due to the rapid changes in them. As a result, in January 1974 Worldscale publishers began a system whereby changes in bunker prices could be reflected with minimum delay through a provision known as a monthly bunker index. The index was calculated for posted bunker prices in force over the previous 1-month period ending on the 15th day of the month. For example, the January 1, 1974, index reflected posted bunker prices in force from November 16 through December 15, 1973.

In announcing the index, Worldscale publishers stated that use of the index could impair the comparability of rates to some degree, and that its use must be a specific agreement between the contract parties. Further, the announcement made it clear that the index was in no way to be construed as an amendment to the basic Worldscale rate schedule.

Getty, however, used the index as just such an amendment. In 1974 it applied the monthly bunker index to the Worldscale rate before applying AFRA when computing charges for transportation provided by affiliate-owned vessels. As a result, transportation charges on some imports in 1974 were increased by as much as 52 percent.

Getty was the only company among the seven included in our review that used the bunker index. Its reason was that neither Worldscale nor AFRA published rates reflected the higher bunker prices. However, the bunker index was designed as a guideline in negotiating tanker contracts, and AFRA reflects the weighted average costs of these contracts. Further, monthly AFRA computations include provisions for reflecting current vessel operating costs, including the cost of bunker fuel. Thus, in applying the bunker index in conjunction with AFRA, compensation for bunker costs may have been higher than warranted by the increase in such costs. We question $9.8 million in transportation charges derived from applying the bunker index.

AFRA and deadfreight and demurrage charges

If AFRA and Worldscale values are used to calculate transportation charges, then the same should also be used to calculate deadfreight charges. The AFRA rate should also be applied to the daily demurrage rate to derive the demurrage charge. The following table summarizes the subsequent explanations of deadfreight and demurrage charges which are questioned because of modifications made to AFRA.

Charge questioned	Company	Shipments involved	Charges involved	Amount questioned
Deadfreight:	EXXON	21	$ 482,000	$133,000
	Mobil	11	234,392	62,510
Total		32	716,392	195,510
Demurrage:	EXXON	34	1,200,000	279,000
	Mobil	38	3,400,000	147,121
Total		72	4,600,000	426,121
Total		(a)	$5,316,392	$621,631

a/Due to overlap in shipments, total shipments are not meaningful.

We questioned EXXON's reported charges for both deadfreight and demurrage which were calculated using trade-rate AFRA. Deadfreight charges of $482,000 were reported for 21 shipments in our sample. Of this amount, $133,000 are questioned as a result of the application of trade-rate AFRA. In addition, $279,000 of the $1.2 million in demurrage charges reported on 34 sample shipments are questioned as a result of the application of trade-rate AFRA.

By revising the published AFRA vessel size categories, Mobil also reported higher charges for deadfreight and demurrage. Deadfreight charges totaled $234,392 on 11 sample shipments, $62,510 of which are questioned because revised AFRA rates were used. For 38 demurrage charges totaling about $3.4 million, questioned charges totaling $147,121 resulted from the use of revised AFRA rates.

Conclusions

As a result of the variety of methods used for calculating transportaton charges, importing refiners reported widely varying charges for similar shipments. Some of these we questioned because they were supported neither by actual cost data nor by AFRA. These questioned transportation charges totaling over $24 million were found at three companies.

The change in accounting practices by one company does appear to be a violation of regulations even though it did not result in additional charges.

CHAPTER 4

REASONABLENESS OF TRANSPORTATION PRACTICES

Our review of the reasonableness of the practices and their costs, ancillary to the transportation of imported crude oil, showed that generally they were reasonable and were supported by company documentation. We did question the appropriateness of about $940,000 in transportation charges claimed by one company because the charges for one transportation practice exceeded the average costs of such practices and its cost representativeness was not demonstrated by any facts we reviewed.

TRANSPORTATION PRACTICES

In addition to the basic shipping charge, numerous charges and fees are associated with the transportation of imported crude oil. Some of these charges and fees contribute more significantly to transportation costs than do others. We concentrated our review efforts on those practices which were apt to have the greater impact. Such practices, including transshipment, demurrage, lighterage, deadfreight, backhauling, and slow steaming are discussed in later sections of this chapter.

We also reviewed documentation supporting other charges and fees of lesser importance, such as port charges, terminalling fees, diversion, inspection fees, and war risk insurance. Generally, all of the charges and fees for the shipments reviewed appeared reasonable and were supported by company documentation.

The following table indicates the frequency of occurrence for transportation practices associated with the shipments reviewed and which occurrence could be readily identified from the companies' records.

Company	Occurrences: Shipments reviewed	Lighterage	Deadfreight	Demurrage	Transshipment
Gulf	100	30	6	38	0
EXXON	98	33	21	34	43
Getty	100	47	0	0	0
SOCAL (note a)	-	-	-	-	-
Mobil	100	(b)	11	38	20
Shell	98	19	0	21	26
Texaco	100	2	5	57	65
Total	596	131	43	188	154
Average	99	26	7	31	26

a/ The review at SOCAL concentrated on the company's voyage cost accounting system. Charges for such transportation elements as lightering, deadfreight, demurrage, and transshipping fees were not reviewed.

b/ Lighterage could not be readily identified, because Mobil included lightering costs as part of miscellaneous adjustments to the total landed cost.

A brief description of each of these practices shown in the above table follows.

Transshipping

Transshipping involves the transfer of crude oil from one tanker to another for further transportation. Transshipping allows the use of much larger and lower cost tankers on the long transportation leg from very large crude carrier (VLCC)-rated Persian Gulf loading ports to transshipping points such as Curacao in the Caribbean. From there, the crude is transshipped on smaller vessels which can enter U.S. ports too shallow to accomodate VLCCs.

Transshipping can be accomplished in several different ways:

--Direct vessel-to-vessel-transfer without using the docking facilities at the transshipping terminal.

--Direct vessel-to-vessel transfers using a transshipment terminal's docking facilities.

--Actual unloading and storage of crude oil in terminal facilities where it is later reloaded onto smaller vessels.

In each case a handling fee for each barrel of crude transshipped is usually added to the transportation charge.

Demurrage

Demurrage is a charge for vessel delay beyond the loading and unloading time allowed by the charter party agreement. The time allowed, referred to as laytime, is normally 72 hours. Delays may occur because of

--vessel scheduling at the loading port and

--lightering operations at the discharge port due to the extended crude discharge time.

Because the vessel owner or operator wishes to maximize use of his vessel, any extra port time limits the potential revenue producing voyages. Thus, the owner or operator protects himself from potential revenue losses by requiring reimbursement for undue delays. Demurrage rates per day by size of vessel are published by Worldscale. In 1975 these rates varied from $875 per day for 8,500 DWT vessels to $75,000 per day for 399,000 DWT vessels. For companies using AFRA, the rates per day are applied to the appropriate AFRA assessments to determine the daily demurrage charges.

Lighterage

Lightering is the practice of unloading part of the crude from a tanker onto a smaller vessel, usually a barge, to allow the partially loaded tanker to enter a port. Lightering is generally practiced as an alternative to light-loading (deadfreight). Lightering costs, called lighterage, are the fees paid for the use of the small vessel. The fees vary from location to location and can be based on a per barrel basis, an hourly basis, or a time-charter. Lighterage is usually offset through the economies of scale by using a large tanker to transport a large quantity of crude oil (as opposed to transporting a less amount of crude on a small tanker which can enter the discharge port without lightering).

Deadfreight

Deadfreight refers to unused vessel cargo carrying capacity. Deadfreight may occur either because the fully loaded vessel could not enter a shallow port or because the refiner's crude storage facilities are inadequate to accomodate the full cargo. Deadfreight is paid to the vessel owner or operator under most commercial voyage charter contracts. As in lightering, deadfreight normally occurs when the cost is offset by the freight savings which result from use of a larger, more efficient vessel. When using AFRA, deadfreight charges are calculated in the same manner as the basic freight charge.

APPROPRIATENESS OF COMPANY TRANSSHIPPING CHARGE QUESTIONED

Five of the seven companies we reviewed practice transshipping involving offloading the crude oil into storage facilities. The transshipping fees reported by four of the five companies ranged from 15 to 25 cents per barrel. EXXON, however, reported a 38 cents per barrel transshipping fee. Although the fee was paid to an affiliate that operated a transshipping terminal in the Caribbean, EXXON has stated that transshipping fees should include all costs that a company would incur if it purchased the crude delivered in the United States from a third party which used transshipping facilities. The company noted that commonly publicized transshipping fees often exclude many operational charges which were included in its transshipping fee. The company provided a list of the categories included in the transshipping fee:

--Tankage/handling.

--Cargo loss.

--Demurrage.

--Cargo insurance.

--Inventory carrying charges.

--Charges for nonperformance in transshipping facility.

--Diversion costs/vessel slowdown.

--Administrative costs/salaries.

--Commercial fee.

We did not find these items identified as transshipping costs at other companies. Such charges may be a valid cost of imported crude, but we question whether they should be included as transshipping costs, and we think that FEA ought to resolve this question.

Petroleum Economics Ltd. of London, England, a firm recognized as an expert in the field of international tanker operations, stated that, within its experience, a reasonable transshipping fee should not exceed 27 cents per barrel. In addition, a recent study made by a consultant for FEA reported that the transshipping cost involving Caribbean terminals was about 27 cents per barrel.

On the basis of the charges reported by the other companies and expert opinion provided us, we believe that the 38 cents per barrel transshipping charge by EXXON should be questioned by FEA. We estimated the transportation charges resulting from the 38 cents per barrel fee when compared to a 27 cents per barrel fee at over $940,000 for 20 transshipments.

BACKHAULING AND SLOW STEAMING DID NOT MATERIALLY AFFECT TRANSPORTATION CHARGES

As part of our review, we attempted to determine what impact the practices of backhauling and slow steaming might have on transportation charges because they are not reported as cost related items. We found that for the sample shipments the practices were infrequent and did not materially increase transportation charges.

Backhauling

After discharging crude oil at a U.S. port, a tanker may load a cargo for transport to another port thereby taking advantage of what is normally the ballast (empty) leg. This practice is known as backhauling. Backhauling cargoes can include products such as grain, coal, or ore. Some tankers referred to as OBOs (oil-bulk-ore) have been built or modified to haul oil, bulk, or ore cargoes.

Worldscale and AFRA values are based on a round-trip voyage--a loaded leg and a ballast leg. The question arises whether a credit should be applied against transportation charges for any revenues received by the shipper by virtue of backhauling another cargo on the return trip.

Backhauling can involve the direct return from the port of discharge to the port of loading, or travel to a third port where the cargo is loaded and delivered to yet another port. For example, one vessel included in our review discharged crude oil obtained from the Persian Gulf at a U.S. east coast port and proceeded in ballast to a South American port. At that port the vessel loaded crude and hauled it to another South American port. From there the vessel hauled crude up and down the coast for 3 months landing at 16 South American ports. The vessel finally left the coast of South America and traveled empty to the Persian Gulf.

Three of the seven companies we reviewed practiced backhauling. Only two of the companies had frequent backhauls and one of these companies stopped the practice in early 1976 because, according to the company, it was not profitable.

Some tankers involved in backhauls were more costly to build and operate. Also, additional costs, such as port charges, demurrage charges, and in some cases, vessel cleaning charges, are incurred as a result of the backhaul. These additional costs might be used to offset at least a portion of the backhaul revenue.

Because only some of a return leg may involve backhauled cargo and because some costs are spread over an entire schedule of voyages, we found that determining which costs and revenues and how much of each, if any, should be included in the credit calculation was extremely complex and could not readily be determined. Because of this factor and the fact that backhauling was infrequent for the sampled shipments, we did not pursue the matter further as part of our review.

Slow steaming

Slow steaming involves reducing vessel speed to extend voyage time. Slow steaming is customary when the tanker industry is in a position of excess capacity. The practice keeps a vessel, for any given voyage, in service longer and thereby causes more tankers to be kept in operation if the same tonnage is to be moved in the same time period as if there were no slow steaming. In this way, slow steaming helps to absorb the excess capacity. Slow steaming, however, does have its drawbacks. An oil company would need to strike a balance between (1) the costs saved by consuming less fuel and by carrying more cargo in place of fuel and (2) the lost opportunity cost on the vessel plus the inventory cost incurred by increasing the voyage time. Our concern with slow steaming in this review was whether increased transportation charges may result from the practice.

Although several of the companies in the review had practiced slow steaming, we found no adverse effects on transportation charges. Six of the seven companies used AFRA and Worldscale values for computing transportation costs. Because both Worldscale and AFRA are based on a standard voyage, including the number of steaming days, slow steaming would not result in additional transportation charges. In the case of the one company that did not use AFRA, its actual cost system did not reflect inflated transportation costs as a result of slow steaming.

CONCLUSIONS

Lightering, transshiping, deadfreight, and demurrage are integral parts of the cost of transporting imported crude oil and should be allowed as part of total transportation costs. Also, backhauling and slow steaming practices were infrequent and did not appear to materially increase transportation charges to justify adjustments in the basic shipping charge. Except for a transshipping charge claimed by one company, all of the charges and fees reviewed for our sample shipments appeared reasonable and were supported by company documentation.

CHAPTER 5

CONCLUSIONS AND RECOMMENDATIONS

Company computations of transportation charges reported to FEA were generally accurate. However, we did find specific overcharges of about $975,000, net, at five of the seven companies. The overcharges resulted mostly from accounting and reporting errors, but we found no evidence of intent to misstate transportation costs. Due to regulatory complexities and market forces we could not determine whether the overcharges resulted in price increases. Nonetheless, the overcharges should be adjusted against the five companies' costs passthrough.

Generally, the companies were inconsistent in the manner in which they reported transportation cost data to FEA. A major cause for some of this problem is the incompatibility of FEA reporting requirements with the corporate accounting and industry shipping practices on which the companies must rely to meet those requirements. This incompatibility resulted in extensive estimation of charges which, in turn, resulted in numerous adjustments once actual or up-to-date data became available. In the end the various impacts of specific transportation charges are indeterminant and transportation cost data is uncertain in its timeliness, accuracy, and utility. In our opinion the information reported to FEA was not effective for assuring price control. Consistent reporting practices by the companies would help to mitigate some of the problem, but the basic reporting incompatibilities must be identified and some reporting requirements modified if the problems are to be resolved. Residual incompatibilities must be managed closely.

For the period October 1973 through December 1975, we found the FEA regulations to be ineffective in establishing enforceable criteria for assessing the cost representativeness of transportation charges for imported crude oil. As a result, the application of the dollar-for-dollar cost passthrough provision of the 1973 EPAA was not assured. FEA has issued new regulations effective January 1, 1977, which, if properly implemented, will eliminate future problems of the nature described in this report.

We found that FEA has not adequately fulfilled its responsibilities of assuring compliance with transportation cost regulations. FEA assigned a low priority status to the audit of transportation charges. Regardless of priority FEA's pursuit of problems and quality of audit work were not sufficient to assure reliable data. Regardless of resources audits of transportation charges for imported crude oil must be made with expertise and in a depth sufficient to assure data reliability and regulatory compliance.

IRS and the United Kingdom Inland Revenue performed an indepth audit of the AFRA system and concluded that the methodology and procedures are what they purport to be and that AFRA provides an accurate statistical index of chartered tanker costs. At the same time, FEA concluded that published AFRA/Worldscale should lead to close agreement between allowed and actual transportation costs. In conjunction with these conclusions and based on our review of company data, we believe that AFRA use meets the need of determining reasonable charges between affiliates for transportation of crude oil and fulfills EPAA requirements.

To have continued assurance of AFRA's regulatory appropriateness, periodic assessments need to be made to determine the systems integrity and to make sure that its terms of reference remain intact.

Three of the seven companies used modified components or applications of AFRA which, when compared to the published AFRA/Worldscale method, resulted in about $24 million more in transportation charges. We question the appropriateness of these charges because the companies neither submitted evidence nor demonstrated to our satisfaction that the charges were more representative of actual costs than if the published AFRA/Worldscale method had been applied.

Under the new regulations companies are required to clearly demonstrate that, if they wish to retain accounting methods not prescribed in the regulations, such methods will not result in costs greater than the approved method. We believe that this requirement is necessary if the new regulations are to prove effective. Also we believe that these same criteria can be applied to the charges questioned in this report to determine if any adjustments need to be made.

We found that ancillary shipping practices and their costs were generally reasonable and supported by company data. We did question the appropriateness of nearly $1 million in transshipping fees claimed by one company because the costs exceeded industry averages and were not demonstrated as reasonable by the company data supplied to us. Backhauling and slow steaming do not appear to have a material effect on transportation charges at the time and need not require an adjustment in the basic shipping charge.

GAO RECOMMENDATIONS

The Secretary, DOE, should take the following actions with regard to regulatory compliance, administration, and systems support.

Compliance

--Verify that the companies have reported cost adjustments for the overcharges discussed in this report.

--Determine whether the charges we questioned represent recoveries greater than cost and, if so, require companies to make appropriate adjustments.

--Assure proper implementation of new transportation regulations.

--Assure that all companies applying for exceptions to standard transportation accounting methods, demonstrate that the company method results in costs no greater than those resulting from the use of published AFRA/ Worldscale. It is important that data offered by companies in support of exceptions receive indepth audit.

Administration

--Insure that reviews of imported crude oil transportation charges, when made, are of sufficent scope to assure continued compliance with applicable regulations.

--Evaluate AFRA periodically to assure the continued integrity of the AFRA system. This will be especially important if either the status of the tanker market changes significantly or if AFRA's terms of reference should change.

Systems support

--Eliminate to the greatest extent practical problems arising from DOE reporting time frames that are incompatible with the time span in which the reported events take place.

--Require respondent companies to use uniform reporting procedures that identify clear and discrete transportation data.

CHAPTER 6

AGENCY AND COMPANY COMMENTS AND OUR EVALUATION

We furnished a draft of this report to FEA and IRS and draft report extracts to the seven companies named in the report for review and comment.

AGENCY COMMENTS

FEA's comments are included as appendix I. FEA considered the report's conclusions and recommendations to be reasonable and stated that in each case action had been initiated or would be taken to implement them. IRS comments were not received in time for inclusion in this report.

COMPANY COMMENTS

Four of the companies--Gulf, Shell, SOCAL, and Texaco--that submitted comments on the draft report did not have any substantive comments regarding the report material. EXXON, Getty, and Mobil took issue with report statements concerning their companies and made substantial comments to that effect. The full text of the company comments are available from us upon request.

We considered all comments and where warranted made appropriate changes to report data and statements. There is, however, a residual difference of opinion concerning the interpretation of certain facts and practices. These matters are discussed in the following pages.

EXXON

EXXON argues that our questioning of its trade-rate is invalid because trade-rate is based on is AFRA and therefore represents essentially the same values derived under published AFRA/Worldscale. We disagree.

Published AFRA/Worldscale is a component in EXXON trade-rate calculations. In our opinion the resultant trade-rate, applied on a port/trade basis, is not the equivalent of unmodified AFRA/Worldscale applied on a vessel-by-vessel basis. Furthermore, EXXON argues extensively in the balance of its comments that there are significant quantitative and qualitative differences between trade-rate and AFRA and that the two will have disparate results. This appears to refute EXXON's contention that the two rates represent equivalent values.

EXXON argues that trade-rate offers an advantage to the consumer because there are costs which, under trade-rate, are incurred by the shipping affiliate and not reported to

FEA as transportation charges to be passed through. On the other hand, were EXXON to use a published AFRA/Worldscale system, these costs would be borne by the U.S. importer, reported to FEA, and ultimately passed on to the consumer. EXXON has identified charges which it did not incur under trade-rate, but would have incurred had it used AFRA. In its comments EXXON argues that these charges would reduce the transportation charge differential between trade-rate and AFRA and that we ought to apply them to the questioned charges noted in the report. Since, as the importer, EXXON could not incur these charges, it did not provide us with invoiced cost data to support them. In this category are included charges of $570,000 for deadfreight and $830,000 for demurrage which have been enumerated in the report because we were able to relate them, as lump sums, to a group of voyages. In each of these cases, however, invoice documentation was not available which would allow us to apply them as reduction to the difference between trade-rate and AFRA.

EXXON also maintains that costs passed through during the period of our review were unrepresentatively high and that the data indicates that the difference between trade-rate and AFRA is much less in subsequent periods. The data covered in our review does in fact show a significantly smaller difference between trade-rate and AFRA for the period subsequent to June 1975 than it shows for earlier periods. EXXON maintains that this lesser disparity is indicative of the true relation of trade-rate to AFRA and that our sample is not representative.

This contention could be valid but it was neither demonstrated by the data nor the argument presented to us by EXXON at the time of the review, in subsequent discussions, nor in the current comments. The fact remains, not disputed by EXXON, that for the 98 shipments during the 27-month period we examined, trade-rate results in higher charges than does AFRA. Secondly, AFRA, as an average, will over time range higher and lower in its relation to trade-rate. We found no evidence to suggest that the diminished difference between trade-rate and AFRA, found in the later period, was more representative of the long-term relationship than the larger difference found in earlier periods. We feel that EXXON should demonstrate the validity of its claim to DOE.

Lastly, EXXON states that vessel use will be tailored to the specifics of AFRA. That is, vessels used under trade-rate would become uneconomic under AFRA and therefore, due to the use of AFRA, smaller, more costly tankers will be routed to U.S. ports. To illustrate the undesirable impacts of changing from trade-rate to AFRA, EXXON suggests that if

"* * * all vessels above the trade rate size were replaced with vessels equal to the trade rate classification" transportation costs would be increased significantly.

We accept that there is some incentive to make vessel substitutions, on the basis of category, when opportunities permit. We think, however, that there are practical limits on the availability of ships of such specific size so as to preclude such complete selectivity and sweeping replacement. Although it may warrant attention, EXXON's assumption does not appear useful for projecting significant changes in transportation charges due to the use of AFRA.

Getty Oil Company

Of the five firms included in our review which used AFRA, only Getty applied any identifiable mechanism or index by which a surcharge was applied against AFRA for increased bunker fuel costs. We do not know what other firms, which were not included in the scope of our review, did regarding the use of the bunker index; therefore, we cannot comment on whether Getty's practice was common. Getty also contends that if, as questioned by us, the $9.8 million was an unwarranted recovery of increased costs, then company owned and controlled tankers would have shown a $1 million loss in 1974.

First of all it appears that AFRA would in time reflect such costs and Getty would recover them in the normal course of events. Getty has not demonstrated that such is not the case. Secondly, due to the nature of the tanker market during this period, many tank ship companies incurred losses. As our report shows, two companies show losses when AFRA revenue is compared to actual cost for sample voyages. In addition, the three shipping affiliates of another company included in our review suffered huge losses during this period. It is the nature of AFRA, as an average, to periodically offer advantage or disadvantage when compared to actual costs.

We continue to believe that DOE should resolve our question of the impact of Getty's use of the bunker index.

Mobil Oil Corporation

Mobil contends that its change from accounting for imported crude oil freight charges by using a port-trade related method, similar to EXXON's trade-rate, to a method of revised AFRA categories was not a change in accounting procedures. We disagree.

The trade-port or trade-rate method is a system based on the average trade experienced over a given route. The revised-category method is a system based on the actual vessel used on a shipment-by-shipment basis. Both use some form of published AFRA/Worldscale as computational input--but they are distinctly different systems. We continue to believe that the change of systems appears to be contrary to the regulation which requires the use of customary accounting procedures consistently and historically applied. Mobil further claims that, even assuming the change was a potential violation, such potential is neutralized by the fact that transportation charges passed through were reduced. While it is true that reported transportation charges were reduced, we note that the regulatory restriction against accounting procedure change does not make exception for changes which result in reduced changes.

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Congress of the United States
House of Representatives
Committee on Interstate and Foreign Commerce
Room 2125, Rayburn House Office Building
Washington, D.C. 20515

February 11, 1976

The Honorable Elmer B. Staats
Comptroller General of the United States
General Accounting Office
441 G Street, N. W.
Washington, D. C. 20548

Dear Mr. Staats:

The costs of imported crude oil and product are important ingredients of the prices American consumers pay for petroleum products. The recent increase in those costs adds to those prices directly, and domestic crude oil and product prices have risen to reflect the costs of imports. A significant part of import costs is attributable to charges for transportation from overseas locations to the United States by tanker.

Government policy has allowed importers to recoup only their actual costs of imported crude, plus a fixed increment of profit. I am concerned that the portion of those costs attributable to transportation by tankers which is in fact passed through in consumer prices may well exceed the actual costs experienced by importers who control or are affiliated with transportation subsidiaries within integrated, international petroleum companies. This would be true if, as appears to be the case, company claims for transportation costs are required to be supported not by actual cost data, but only by reference to a standard which does not realistically reflect actual costs. It would also be true, even using actual cost data, if costs were purposely inflated.

Current Federal Energy Administration regulations allow importers to pass on to consumers the cost of transporting crude oil and products from overseas locations to the United States as part of "landed cost".

The Honorable Elmer B. Staats
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February 11, 1976

When the transportation is carried out by an entity affiliated with the importing refiner or marketer, the transportation cost allowed is that "computed by the use of the customary accounting procedures generally accepted and consistently and historically applied by the firm concerned."

On the basis of an initial analysis by this Committee's Subcommittee on Energy and Power there appears to be a possibility that some of the integrated, international oil companies are charging transportation fees in excess of those which are allowable and proper. If this should prove to be the case, this would have large implications for consumers and certain sectors of the oil industry. Specifically, consumer prices would appear to be higher than justified. Moreover, in addition to the unjust enrichment which results from passing such inflated costs down to the consumer, offending entities may have acquired unfair market advantages under the crude oil entitlements program in effect under current regulation.

This is obviously a matter of considerable significance. I believe it evidences a need for a most careful assessment of the administration and enforcement of Federal Energy Administration regulations which pertain to transfer pricing of crude oil and petroleum prices -- with particular emphasis with respect to the accounting for transportation costs. Accordingly, on behalf of the Committee I wish to request that your office use the full measure of your authorities (including those most recently granted to you in the Energy Policy and Conservation Act) to inquire into this matter. In this endeavor you are specifically requested to conduct such verification examinations, as may be necessary, of the books, records, papers or other documents of any vertically integrated petroleum company with respect to the financial information of these companies as may relate to the matters described above and to conduct such other verification examinations as may be necessary, to verify filings as may relate to compliance with applicable law and regulation.

I appreciate the complexity of the issue I am requesting you to investigate and recognize that the scope of this effort will have to be scaled with this in mind and within your staffing limits. In this regard, primary effort -- if it will accelerate the reporting of results -- should be placed on crude oil imports as opposed to product. While the end result of this first effort may not fully exhaust the subject, I believe it could prove invaluable in shedding enough light on this subject to effect immediate corrective action and/or signal the need for further work in this or related areas.

The Honorable Elmer B. Staats
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February 11, 1976

I would ask that, as this study progresses, you contact Mr. Charles B. Curtis, at 225-3147, and Mr. Frank M. Potter, Jr., at 225-1030, members of the Full Committee and Subcommittee staffs, and that you keep them posted on your progress.

Based on the results of your examinations, you are requested to submit any recommendations for action that you deem appropriate to correct past abuses and prevent their continuance in the future.

Sincerely,

Harley O. Staggers

HARLEY O. STAGGERS, M.C.
CHAIRMAN

HOS:bf

FEDERAL ENERGY ADMINISTRATION
WASHINGTON, D.C. 20461

June 30, 1977

OFFICE OF THE ADMINISTRATOR

Mr. Monte Canfield, Jr.
Director
Energy and Minerals Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Canfield:

FEA has reviewed the draft report entitled "Transportation Charges for Imported Crude Oil" which was prepared for Congress by the General Accounting Office (GAO).

A decision was made in the early part of calendar year 1976 to defer the Compliance review of transportation until reviews of certain other regulatory areas were completed and sufficient Compliance resources became available. Two of these other regulatory areas were the establishment of "classes of purchaser" and the verification of the May 15, 1973 selling prices, which are the foundation of FEA's pricing regulations. In the interim, however, certain administrative actions have been taken for developing more explicit transportation regulations. Two proposed rulemakings were issued (March 29, 1976, and August 27, 1976) prior to the promulgation of the transportation regulation (10 CFR 212.85) which became effective January 1, 197. With the publication of this regulation and the availability of Compliance manpower, steps were taken in January and February of 1977 to establish transportation as part of the priority Compliance workload.

The FEA considers the GAO's conclusions and recommendations to be reasonable. Action has been, or will be taken, to implement them. Your recommendations (presented on page vi of your report) and FEA's comments are as follows:

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COMPLIANCE

GAO Recommendation: "verify that the companies have reported cost adjustments for the overcharges discussed in the [GAO] report."

FEA Response: This will be done. It is requested that the FEA be given copies of, or access to, the GAO workpapers pertaining to this area so that audit work will not be duplicated and the firms involved will not be inconvenienced unnecessarily.

GAO Recommendation: "determine if the charges GAO questioned represent recoveries greater than cost and, if so, require companies to make appropriate adjustment."

FEA Response: This will also be done. Again, to facilitate implementation of this recommendation, FEA requests copies of, or access to, the workpapers of the GAO.

GAO Recommendation: "assure proper implementation of new transportation regulations."

FEA Response: Action on this matter is underway. Key Compliance personnel have received intensive training in marine transportation and we are developing guidelines for auditing transportation. In addition, a course for training Compliance personnel in the use of the guidelines is being prepared. These preliminary steps, and FEA's commitment to a vigorous Compliance program relating to imported crude oil transportation charges, will assure proper implementation of the new transportation regulations.

GAO Recommendation: "assure that all companies applying for exceptions to standard transportation accounting methods demonstrate that the company method result in costs no greater than those resulting from the use of the published AFRA/ Worldscale. It is important that data offered by companies in support of exceptions receive indepth audit."

FEA Response: This is being done. To date, seven firms have applied for exceptions to standard transportation accounting methods. These requests are being given careful consideration and review. In-depth audits will be done before any exceptions are granted.

ADMINISTRATION

GAO Recommendation: "insure that reviews of imported crude oil transportation charges, when made, are of sufficient scope to assure continued compliance with applicable regulations."

FEA Response: This will be done through the training of the Compliance staff, the provision of detailed guidance, the supervisory and management review of audit results, the strict enforcement of the regulations, and the follow-up reviews and audits.

GAO Recommendation: "evaluate AFRA, periodically, to assure the continued integrity of the AFRA system."

FEA Response: This is being done. The FEA is closely monitoring and reviewing, on a continuing basis, the official publications and other output regarding imported crude oil transportation charges made by the London Tanker Brokers Panel, the Internal Revenue Service, and Worldscale. It is anticipated that through these sources the FEA will be able to adequately assess and evaluate AFRA.

SYSTEMS SUPPORT

GAO Recommendation: "eliminate to the greatest extent practical problems which arise from FEA report period time frames which are incompatible with the time span in which the reported events take place."

FEA Response: Action is being taken. At the present time, a uniform technique for adjusting the differences between the various FEA forms (e.g. P-110 and F701-M-0) is being studied with a view toward eventual regulatory implementation.

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GAO Recommendations: "require respondent companies to use uniform reporting procedures which identify clear and discrete transportation data."

FEA Response: This will be done to the maximum extent possible.

I trust these comments provide an added perspective to the audit conclusions and recommendations. If we can be of any further assistance in this matter, please do not hesitate to contact us.

Sincerely,

John F. O'Leary
Administrator

(00135)