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POWER MARKETING ADMINISTRATIONS

Repayment of Power Costs Needs Closer Monitoring





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Accounting and Information
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The Honorable John R. Kasich
Chairman
Committee on the Budget
House of Representatives

The Honorable John T. Doolittle
Chairman, Subcommittee on Water
and Power Resources
Committee on Resources
House of Representatives

This report responds to your request that we examine the monitoring of the repayment of the power-related costs and debt¹ of four of the Department of Energy's (DOE) power marketing administrations (PMA). The PMAS' costs and the power-related costs of the agencies that produce the power marketed by the PMAS are required by law to be repaid.² Repayment is to be made through revenues from federal power sales. You expressed concern about issues we previously reported related to the under-recovery of certain power-related costs³ and the large amount of debt outstanding—more than \$14 billion as of September 30, 1997. Specifically, you asked us to determine (1) whether DOE or the Department of the Treasury (Treasury) actively monitors the amount of debt to be repaid and the appropriateness of the annual payments and (2) whether there is a potential for financial loss to the federal government as a result of any lack of such monitoring of the repayment.

We evaluated the effectiveness of the existing monitoring activities to determine whether they ensure that repayment amounts are complete, accurate, and timely. As agreed with your offices, we did not attempt to

¹PMA debt consists of reimbursable appropriations used to construct power facilities and certain capital costs associated with irrigation facilities (i.e., "irrigation assistance"). The irrigation assistance costs arise when the Secretary of the Interior determines that some of the capital costs allocated to completed irrigation facilities are beyond the ability of irrigators to repay. In this report we refer to the amounts to be repaid related to both power and irrigation facilities as debt. However, Department of the Treasury officials do not consider these amounts to be receivables and record them as appropriations paid.

²Some power-related costs, such as those for environmental mitigation activities at certain projects, are legislatively exempted from the repayment requirement; these legislatively exempt costs are not the subject of this report.

³Federal Electricity Activities: The Federal Government's Net Cost and Potential for Future Losses, volumes 1 and 2 ([GAO/AIMD-97-110](#) and 110A, September 19, 1997) and Power Marketing Administrations: Cost Recovery, Financing, and Comparison to Nonfederal Utilities ([GAO/AIMD-96-145](#), September 19, 1996).

quantify the potential financial loss to the federal government resulting from any ineffectiveness in monitoring repayment. This report covers the four PMAs⁴ and the power-related activities of the Department of the Interior's (DOI) Bureau of Reclamation (Bureau) and the Department of Defense's (DOD) Army Corps of Engineers (Corps). It also includes the portion of capital expenditures for irrigation facilities that becomes repayable through the PMAs' power rates. We conducted our review from December 1997 through June 1998 in accordance with generally accepted government auditing standards. Additional information on our objectives, scope, and methodology in conducting this review is contained in appendix I.

Results in Brief

Current monitoring activities do not ensure that the federal government recovers the full cost of its power-related activities from the beneficiaries of federal power. The full cost of the power-related activities—which are to be recovered under current legislation and DOE policy—include all direct and indirect costs incurred by the federal government in producing, transmitting, and marketing federal power. Key participants responsible for monitoring repayment include the Secretary of Energy, who is responsible for ensuring that the PMAs' power-related costs are recovered, and the Federal Energy Regulatory Commission (FERC), which reviews the PMAs' rate proposals. However, neither of these entities is effectively monitoring the rate-making process and the amounts due and repayments made to ensure their accuracy, completeness, and timeliness. While the Department of the Treasury receives and records the repayments, it is not responsible for monitoring repayment.

Audits by external auditors and our own work have identified various unrecovered power-related costs that have resulted in financial loss to the federal government. In several instances in which problems with the repayment of power-related costs have been reported to PMA management, progress toward resolving the issues has been slow or nonexistent. Unrecovered power-related costs relate to (1) Civil Service Retirement System (CSRS) pensions and postretirement health benefits, (2) life insurance benefits, (3) workers' compensation benefits for Corps employees at projects marketed by Southeastern, and (4) interest on some of the federal appropriations used to construct certain projects. We

⁴The four PMAs covered in this report are: Bonneville Power Administration (Bonneville), Southeastern Power Administration (Southeastern), Southwestern Power Administration (Southwestern), and Western Area Power Administration (Western). We sometimes discuss Bonneville separately because it is different in size and characteristics than the others, which we refer to as the three PMAs. We excluded the fifth PMA—Alaska Power Administration—from our analysis because legislation has been enacted to sell it to nonfederal entities.

estimated that the federal government's unrecovered costs for CSRS pensions and postretirement health benefits for PMA employees and operating agency employees involved in power-related activities were about \$37 million for fiscal year 1996 and about \$192 million (in constant 1996 dollars) for fiscal years 1992 through 1996. The full magnitude of the under-recovery of power-related costs is unknown. Until an effective monitoring system is implemented, the federal government will continue to be exposed to financial loss due to the under-recovery of power-related costs.

The current activities for monitoring the repayment of power-related costs and debt are less extensive than those undertaken in prior years. Previously, DOE's Office of Power Marketing Coordination (OPMC) monitored repayment and reviewed rate proposals before they were sent to FERC for review; however, DOE disbanded OPMC in 1984 and its monitoring duties generally were not assigned to another entity. OPMC assessed whether appropriate costs were included in rates, but did not review the PMAS' power repayment studies in detail. In addition, FERC previously had more latitude in reviewing the PMAS' rates. The scope of FERC's review of the three PMAS' rates was limited by the Secretary of Energy's 1983 revision to the delegation order under which FERC carries out that function. The scope of FERC's review of Bonneville's rates was limited by the passage of the Pacific Northwest Electric Power Planning and Conservation Act (Northwest Power Act). The review procedures previously performed by DOE's OPMC and FERC provided greater assurance that repayment amounts were accurate, complete, and timely. Better monitoring is essential to protect the federal government's right to recover the costs of its investments that are to be repaid through power revenues.

Background

The PMAS were established from 1937 through 1977 to sell and transmit electricity generated mainly from federal hydropower facilities. Most of these facilities were constructed and continue to be owned and operated by the Bureau and Corps (operating agencies). The operating agencies constructed these facilities as part of a larger effort to develop multipurpose water projects that have functions in addition to power generation, such as flood control, irrigation, navigation, and recreation. As required by law, the PMAS give preference in the sale of power to public power customers. These preference customers include public utility and irrigation districts, customer-owned cooperatives, municipally-owned utilities, and, in some cases, state governments and the federal government.

With the exception of Bonneville, the Congress appropriates money each year to the PMAS for power-related purposes and to the operating agencies for both power and nonpower purposes. The PMAS, other than Bonneville, generally receive appropriations annually to cover operations and maintenance expenses (O&M) and, if applicable, capital investments in their transmission assets. Since 1974, Bonneville has operated without annual appropriations from the Congress and has financed its activities through a revolving fund.⁵ Bonneville is, however, responsible for repaying its pre-1974 appropriations.⁶ The operating agencies receive appropriations for all aspects of their multipurpose water projects, including O&M expenses and capital expenditures.⁷ The portion of these appropriations expended for power-related purposes is allocated to the PMAS for repayment by power customers.

Section 9(c) of the Reclamation Project Act of 1939 and section 5 of the Flood Control Act of 1944 generally require that the PMAS recover through power rates the costs of producing, transmitting, and marketing federal hydropower. Bonneville is covered additionally under the Northwest Power Act. In addition, the PMAS that market power from multipurpose projects also having irrigation as a purpose—Bonneville and Western—are responsible for repaying certain irrigation assistance costs. Costs are recovered by the PMAS through rates charged the customers who benefit from the federal power. The PMAS generally repay appropriations expended for O&M expenses in the same year that the expenses are incurred, but generally repay appropriations expended for capital investments and other debt, with interest, within the repayment period prescribed by law and/or DOE order.

As shown in table 1, the PMAS differ substantially in annual revenues and the amount of outstanding debt to be repaid to the federal government. Table 1 and the notes thereto include information on (1) the outstanding appropriated debt and irrigation costs that are to be repaid by the PMAS, (2) Bonneville Power Administration Treasury bonds, and (3) certain nonfederal debt.

⁵Western also has three projects with revolving funds.

⁶In addition to the outstanding pre-1974 appropriated debt and irrigation debt, Bonneville's debt includes Treasury bonds and obligations related to certain nonfederal power projects. Bonneville is to repay all these debts, except those pertaining to irrigation facilities, with interest.

⁷Following agreements reached with the operating agencies, Bonneville currently directly funds the power-related O&M costs of Bureau projects in the Federal Columbia River Power System (FCRPS). Beginning in 1999, Bonneville will directly fund Corps power-related O&M costs. In addition, Bonneville also directly funds selected capital investments in FCRPS for both the Bureau and Corps.

Table 1: Annual Revenues and Outstanding Appropriated and Irrigation Debt of the PMAs for the Fiscal Year Ending and as of September 30, 1997

Dollars in millions			
PMA	Revenues for Fiscal Year 1997	Outstanding Appropriated Debt ^b as of September 30, 1997	Outstanding Irrigation Debt as of September 30, 1997 ^f
Southeastern ^a	\$168	\$1,519	n/a
Southwestern	112	695 ^c	n/a
Western	793	3,142 ^d	\$3,528
Bonneville	2,272	4,452 ^{d,e}	857
Totals	\$3,345	\$9,808	\$4,385

^aSoutheastern's data on revenues and outstanding appropriated debt is based on draft financial statements for fiscal year 1997.

^bOur calculation of outstanding appropriated debt may differ from the amount of unpaid investment reported by the PMAs in their annual reports primarily because the PMAs do not include construction-work-in-progress in their totals.

^cSouthwestern's appropriated debt data are as of September 30, 1996; fiscal year 1997 data were not available at the time of our review.

^dIn addition to the appropriated and irrigation debt, Western and Bonneville also have \$163 million and \$7,037 million of nonfederal debt, respectively. Bonneville also has \$2,499 million of medium- and long-term debt held by Treasury in the form of Bonneville Power Administration bonds.

^eAs a result of legislation passed in 1996 (Omnibus Consolidated Rescissions and Appropriations Act of 1996 - Public Law 103-134, April 26, 1996, 110 Stat. 1321-350), Bonneville's appropriated debt was restructured to reduce the principal owed by about \$2,560 million and increase the associated interest rate by about 3.6 percentage points. This figure reflects that restructuring.

^fSince projects marketed by Southeastern and Southwestern do not have irrigation as a purpose, irrigation debt is not applicable (n/a).

Source: Audited financial statements and other information provided by the PMAs.

DOE's policy for implementing the cost recovery requirement is set forth in DOE Order RA 6120.2,⁸ which states that all costs of operating and maintaining the power system, as well as transmission and irrigation assistance costs, are generally to be included in the rates set by the PMAs. This order does not specifically identify and define all costs that must be recovered. To define the full costs associated with producing, transmitting, and marketing the federal hydropower, we referred to Office of Management and Budget (OMB) Circular A-25 and federal financial accounting standards recommended by the Federal Accounting Standards Advisory Board (FASAB) and adopted by GAO, OMB, and Treasury. OMB Circular A-25 defines the full costs of providing goods or services—in this case federal power marketed by the PMAs—as all direct and indirect costs

⁸Power Marketing Administration Financial Reporting, October 1, 1983.

of delivering those goods or services. The federal financial accounting standard⁹ defines the full costs of an entity's outputs as "the sum of (1) the costs of resources consumed by the segment that directly or indirectly contribute to the output, and (2) the costs of identifiable supporting services provided by other responsibility segments within the reporting entity, and by other reporting entities." As we reported in 1996,¹⁰ applying these definitions of full cost, the full cost of the power marketed by the PMAS includes all direct and indirect costs incurred by the operating agencies to produce the power, the PMAS to market and transmit the power, and any other agencies to support the operating agencies and PMAS.

DOE Order RA 6120.2 requires the PMAS to annually conduct power repayment studies to evaluate whether power rates are sufficient to recover all costs that must be repaid within the rate-making period. These power repayment studies form the basis for setting the PMAS' rates. Specifically, the power repayment studies must identify, among other things, estimated revenues, expenses, repayments of debt, and the total amount of debt to be repaid generally over the next 50 years.

Under the Department of Energy Organization Act of 1977 (DOE Act), the Secretary of Energy is responsible for monitoring the PMAS to ensure that all applicable costs are recovered. The Secretary has delegated to the Deputy Secretary the primary responsibility for PMA-related issues. The Deputy Secretary's office is to review the rate proposals of the three PMAS before they are sent to FERC for review. For Bonneville, in accordance with provisions of the Northwest Power Act, the administrator develops the rate proposals and submits them directly to FERC without review by the Deputy Secretary.

FERC, an independent agency within DOE, reviews the three PMAS' rates under authority delegated to it by the Secretary of Energy under DOE Delegation Order 0204-108.¹¹ For Bonneville, FERC reviews rates under the requirements of the Northwest Power Act. The Secretary's delegation order and legislation limit FERC's review authority.

The public also plays a role in the rate review process. Whenever a PMA proposes a new rate, a public hearing process takes place to obtain input

⁹FASAB Statement of Federal Financial Accounting Standards (SFFAS) No. 4, Managerial Cost Accounting Concepts and Standards for the Federal Government, June 1995.

¹⁰Power Marketing Administrations: Cost Recovery, Financing, and Comparison to Nonfederal Utilities (GAO/AIMD-96-145, September 19, 1996).

¹¹Delegation Order for Approval of Power Marketing Administration Power and Transmission Rates, December 14, 1983, and subsequent amendments.

on the proposed rate. This process ensures that members of the public, such as PMA customers, have an opportunity to provide input for the PMAs' consideration before the rate becomes effective. According to DOE and FERC officials, most comments received during this public process are received from customers, who have an incentive to keep rates as low as possible.

See appendix II for more information on the legal responsibilities and delegated authorities regarding PMA rate-making.

Current Monitoring of Repayment Is Ineffective

Current monitoring activities do not ensure that all power-related costs are recovered and that cost recovery issues identified in audit reports are resolved in a timely manner. There is little monitoring performed at DOE's departmental level and FERC's monitoring efforts are limited in scope. Neither DOE nor FERC performs independent, detailed reviews of the power repayment studies that form the basis for the PMAs' rates. Thus, there is little assurance that the power repayment studies provide for complete, accurate, and timely repayment of the PMAs' power-related costs and debt. Treasury's involvement in the repayment process includes receiving and recording the repayment transactions, but does not include monitoring the repayment for appropriateness.

Department of Energy

The Secretary of Energy has delegated to the Deputy Secretary the responsibility for monitoring the PMAs' activities to ensure that power-related costs and debt are repaid. The Deputy Secretary does so through interaction with the PMA administrators in the field and with the two Washington, D.C., PMA liaison offices at DOE headquarters.

The Deputy Secretary receives the rate proposal packages from the three PMAs, approves the rates established by the three PMAs on an interim basis, and sends the rate proposal packages to FERC for review. The sole staff person in the Office of the Secretary involved in doing this told us that he spends most of his time on national energy policy issues, such as the administration's recent proposal for restructuring the electricity industry. He estimated that only about 30 percent of his time is spent on PMA activities, little of which is devoted to detailed review of rate-making and cost recovery issues. As a result, the Deputy Secretary's office does not perform the monitoring activities necessary to ensure that all of the appropriate costs are included in the PMAs' power repayment studies, on which rates are based. In addition, not all information that would be

relevant to FERC's consideration of rate proposals, such as audit reports, is routinely gathered and submitted to FERC.

Bonneville's rates are established by the administrator and sent directly to FERC for review without review by the Deputy Secretary's office. Therefore, as with the current situation for the three PMAS, there is no assurance that FERC will routinely receive all information, such as audit reports, that would be relevant to FERC's consideration of Bonneville's rate proposals.

Federal Energy Regulatory Commission

The Secretary of Energy has delegated to FERC the responsibility for reviewing and approving the final rates of the three PMAS. According to FERC officials, their review of the PMAS' rate proposals focuses on reviewing financial and other information provided to FERC by the PMAS. Although FERC has the authority to do so, FERC officials told us that when reviewing a rate proposal they generally do not obtain and review documentation related to the three PMAS' costs, such as audit reports that have raised cost recovery issues, beyond that provided by the three PMAS. Under Department of Energy Delegation Order 0204-108, FERC's review of the three PMAS' rates includes assessing (1) whether the rates are the lowest possible to customers consistent with sound business principles, (2) whether the revenue levels generated by the rates are sufficient to recover the costs of producing and transmitting electric energy, and (3) the assumptions and projections used in developing the rate components. However, according to FERC officials, the delegation order allows FERC to reject a rate proposal only if it finds the proposal to be "arbitrary, capricious or in violation of law." According to FERC officials, since this standard for rejection imposes a significant practical limitation on FERC's review of the three PMAS' rates, FERC rarely disapproves a rate request. FERC officials told us that they have rejected a rate proposal on only one occasion. This proposal was by Western for the Parker-Davis Project and FERC rejected it because it did not provide for the recovery of significant expected costs of future power facility additions and replacements.

FERC's review and final approval of Bonneville's rates is authorized under the Northwest Power Act. This act requires FERC to assess whether Bonneville's rates (1) are sufficient to ensure repayment of the federal investment in the Federal Columbia River Power System (FCRPS),¹² (2) are

¹²Bonneville is part of FCRPS, which also includes the power-related operations of the Corps and the Bureau. Bonneville is responsible for marketing power from the FCRPS.

based on total system costs, and (3) reflect equitable allocation of transmission system costs between federal and nonfederal users. However, FERC's review of Bonneville's rate proposals is limited by its interpretation of two court opinions issued by the Ninth Circuit Court of Appeals, which is statutorily charged with reviewing actions arising under the Northwest Power Act. FERC has interpreted the opinions to mean that it may not obtain and review documentation other than that provided by Bonneville and therefore FERC generally does not request additional documentation from Bonneville in its consideration of Bonneville's rate proposals. In one case,¹³ the court held that under the Northwest Power Act, FERC's review of rates is limited to the three previously mentioned standards specified in the act and that FERC's limited review properly reflects congressional desire to limit its role to financial oversight rather than rate-making. In a second case,¹⁴ the court held that FERC should not seek new evidence in reviewing Bonneville's rate proposals. Instead, the court held that FERC should evaluate the evidence developed by Bonneville, which is required to develop a "full and complete record" under section 7.(i) of the Northwest Power Act. As a result of its interpretation of these court opinions, FERC generally does not request additional documentation and limits its review to the documentation submitted with Bonneville's rate proposals.

For all four PMAs, FERC analyzes the PMA-provided information to determine whether the proposed rates appear to be sufficient to recover the costs the PMAs have included in the power repayment studies. FERC relies on the amounts and due dates for repayment reported by the PMAs in the power repayment studies as being complete, accurate, and timely. According to FERC officials, they rely on the financial and other data provided by the PMAs, and not on other evidence, such as audit reports. Based on its restricted analysis, FERC either approves or disapproves the PMAs' rate proposals; it cannot modify a proposed rate. However, FERC officials told us if FERC disapproves a PMA's rate proposal, the existing (and typically lower) rate remains in effect until the PMA submits a new one that is reviewed and approved by FERC.

Department of the Treasury

The Department of the Treasury's role in the repayment process is minimal. Currently, Treasury is responsible for receiving and recording the repayments, but is not responsible for monitoring or assessing the

¹³Central Lincoln Peoples' Utility District v. Johnson, 735 F. 2d 1101, 1115 (9th Cir. 1984).

¹⁴Aluminum Company of America et al. v. Bonneville Power Administration, 903 F. 2d 585 594 (1990). Although this case deals with nonregional rather than regional rates, FERC has applied the holding of this case to regional rate proposals.

appropriateness of the repayment amounts and timeliness. In fact, Treasury does not have available to it the information on amounts due, due dates, and interest rates that would be necessary for it to do so. In addition, since it has no role in rate-making, Treasury does not have staff with the knowledge and expertise necessary to assess the PMAS' power repayment studies and rate proposals.

Ineffective Monitoring System Has Resulted in Financial Loss to the Federal Government

Audits by external auditors and GAO have identified various unrecovered power-related costs that have resulted in financial loss to the federal government. Until an effective monitoring system is implemented, the federal government will continue to be exposed to financial loss due to the under-recovery of costs. Better monitoring is essential to protect the federal government's right to recover the costs of its investments that are to be repaid through power revenues.

The PMAS' financial statements are audited by external auditors. The results of the financial statement audits are contained in auditor's reports, reports on compliance with laws and regulations, reports on internal controls, and management letters. All of these documents can contain valuable information pertaining to cost recovery by the PMAS. For the three PMAS, the external auditors have repeatedly identified certain power-related costs that are not being recovered,¹⁵ even though they do not specifically evaluate the PMAS' power repayment studies as part of the financial statement audits. Unrecovered costs that have been identified relate to federal employee CSRS pension, postretirement health benefits, life insurance benefits, workers' compensation benefits, and certain interest expenses related to federal appropriations. Some of the same cost recovery issues also exist at Bonneville, but they have generally not been raised by Bonneville's external auditors in their audit reports. These types of costs are recoverable under the definitions of full cost contained in OMB Circular A-25 and Statement of Federal Financial Accounting Standard No. 4.

¹⁵The objective of a financial statement audit is to express an opinion on whether the statements are fairly stated. A financial statement audit would not be expected to detect all issues related to repayment or resolve all cost recovery issues identified.

Examples of unrecovered costs identified by external and GAO auditors that are symptomatic of the lack of effective monitoring of repayment¹⁶ include the following.

Unrecovered Pension and Postretirement Health Benefits Costs

PMAS historically have not recovered the full costs of providing pensions and postretirement health benefits for PMA employees and operating agency employees involved in power production and marketing. As part of their fiscal year 1994¹⁷ financial statement audits, the three PMAS' external auditors raised the lack of recovery of these costs as a compliance issue in reports to the PMA administrators. We determined that Bonneville also is not recovering the full costs of pensions and postretirement health benefits.¹⁸ In 1996, and again in 1997, we reported that the PMAS still were not recovering the full costs to the federal government of providing these benefits. We reported that the full costs of providing CSRS pensions were not being recovered because the combined contributions of federal employees and the PMAS do not cover the federal government's full cost of providing these benefits, including payments by other federal agencies. The PMAS' rates include only the costs actually paid by the PMAS, not the additional payments by the Office of Personnel Management (OPM) related to PMA and operating agency personnel involved in power-related activities. We also reported that the full costs of providing the federal government's portion of postretirement health benefits were not being recovered and would eventually have to be paid by the general fund of the Treasury.

For fiscal year 1996, we estimated that the net cost to the federal government of providing these benefits was about \$37 million (\$21 million for Bonneville and \$16 million for the other three PMAS). Cumulatively, for fiscal years 1992 through 1996, we estimated that the net cost, in constant 1996 dollars, was about \$192 million (\$110 for Bonneville and \$82 million for the other three PMAS). These estimates covered only current PMA and operating agency employees involved in power-related activities.

¹⁶Our objective was not to quantify the amounts of unrecovered costs and financial loss to the federal government, but to show that financial loss occurred, which demonstrates that monitoring is ineffective. However, in some cases we had estimated amounts while conducting previous work or obtained estimates from the PMAS' external auditors.

¹⁷Western's external auditor first raised this issue in its review of Western's fiscal year 1993 financial statements.

¹⁸Bonneville's external auditor told us that it considers this an area open to differing legal interpretation and has not reported these as unrecovered costs. However, the auditor said that it had discussed the ramifications of possible future liability for these costs with Bonneville's management.

All four PMAs have said that they plan to begin recovering the full costs of providing these benefits. Bonneville began recovering some of these costs in 1998 and plans to phase in full cost recovery over time, with full cost recovery beginning in 2002.¹⁹ Bonneville estimated the amounts related to operating agency personnel, since the operating agencies did not determine the appropriate amounts and allocate the costs to Bonneville. The three PMAs began recovering the full costs of CSRS pension and postretirement health benefits for their own employees in 1998; however, they have not begun to recover the costs for operating agency personnel. According to PMA officials, the three PMAs will begin recovering the costs for operating agency personnel if the operating agencies determine the amounts to be recovered and allocate the costs to the PMAs. However, PMA and operating agency officials told us that the operating agencies are still deciding how this will be done. None of the four PMAs plans to recover these costs retroactively by placing them in current power rates, according to PMA officials.

Unrecovered Life Insurance Costs

Similarly, the PMAs have not recovered the full costs of providing life insurance benefits for PMA employees and operating agency employees involved in power production and marketing. As part of their fiscal year 1994 financial statement audits,²⁰ the three PMAs' external auditors reported to the respective administrators that the PMAs were not recovering these costs. Recovery of the costs is still under consideration by the three PMAs. We determined that Bonneville also had not been fully recovering the costs of life insurance. However, Bonneville and operating agency officials told us that Bonneville began recovering some of these costs in fiscal year 1998 by including an estimate of the amounts related to life insurance benefits in the estimates discussed above. As with CSRS pensions and postretirement health benefits, Bonneville plans to phase in full cost recovery in rates over time, with full cost recovery beginning in 2002.²¹

¹⁹Although Bonneville will not begin recovering the full amount of these costs through its rates until 2002, it plans to ensure that Treasury will be compensated for the period of time in which rates do not fully reflect these costs. Accordingly, Bonneville plans to pay interest on such costs that are not included in rates. Once these costs are included in rates, they will be repaid, with interest, over a period of years, including the unpaid costs of any such benefits for the period 1998 to 2001. In this manner, Bonneville plans to repay Treasury the full cost of these benefits, including interest.

²⁰Western's external auditor first raised this issue in its review of Western's fiscal year 1993 financial statements.

²¹Bonneville plans to recover these costs in a manner similar to its recovery of the CSRS pension costs mentioned above. By 2002, Bonneville plans to include in its rates the full cost of employee life insurance and plans to repay, with interest, any unpaid life insurance costs for the period 1998-2001.

Unrecovered Workers' Compensation Costs

Southeastern's external auditor reported as part of its fiscal year 1995 financial statement audit that Southeastern was not recovering the full costs to the federal government of providing workers' compensation benefits. Specifically, the auditor reported that the Corps was not allocating any of its workers' compensation costs to Southeastern and that Southeastern was therefore not recovering these costs through rates.

Unrecovered Interest Costs

Auditors have also identified instances of incorrect interest calculations and/or payments by the three PMAs. The errors related to interest on moveable equipment at Western, interest on deferred assets²² at the Harry S. Truman Dam and Reservoir (Truman Project) marketed by Southwestern, and calculations using incorrect interest rates at certain projects marketed by Southeastern and Southwestern.

As part of its fiscal year 1993 financial statement audit, Western's external auditor reported that Western was not recovering about \$3 million annually in interest on moveable equipment. In fiscal years 1994 and 1995, Western developed a common approach for all projects designed to ensure that it recovered this interest in the future. However, Western's external auditor reported that the problem had not yet been resolved as of the end of fiscal year 1995. Specifically, the auditor reported that certain area offices had not calculated interest on an allocated amount of movable equipment located at headquarters. Western did not address this issue until 1996, when it began charging interest on the balance of all moveable equipment. However, according to Western's external auditor, Western did not retroactively charge interest on moveable equipment for years prior to 1993.

We also found an error related to the calculation of interest on deferred assets at the Truman Project, marketed by Southwestern. Because of fish kills, the project has never operated at its 160,000 kilowatt capacity; instead, only 53,300 kilowatts have been declared to be in commercial operation. As a result, Southwestern has deferred from recovery the estimated costs—\$31 million—of the nonoperational portion of the Truman Project. However, Southwestern's stated policy is to recover the interest expense of the Truman deferred investment annually.

Until 1994, the Corps calculated the interest expense for Truman and other projects marketed by Southwestern. Interest costs were to be based on the

²²At the Truman Project, deferred assets represent the costs for the nonoperational portion of the project that are not yet being recovered through rates.

entire power-related construction costs of these projects, including the \$31 million Truman deferral. In 1995, Southwestern began calculating the interest expense on the projects it markets. However, Southwestern's fiscal year 1995 calculation of interest expense for the Truman project mistakenly excluded interest associated with the \$31 million Truman deferral. As a result, about \$930,000 in interest on the Truman deferral was not recovered. Southwestern officials acknowledged the mistake and said that the underpayment of interest would be corrected in fiscal year 1996. Southwestern did subsequently recover the \$930,000 associated with the Truman deferral, along with approximately \$71,000 in additional accrued interest.

As a result of its fiscal year 1994 financial statement audit, Southeastern's external auditor informed Southeastern's management that, in several instances, the Corps had improperly calculated interest expense on the federal government's outstanding power-related appropriations. According to the auditor, these errors resulted from the misinterpretation of the interest calculation guidance. For example, the external auditor reported that since 1983, three Corps district offices had not applied the current interest rate on plant additions, even though the policy has been to use current interest rates since 1983. Instead, the Corps had been using the original project interest rates, which for 1984 through 1994 ranged from a low of 2.5 percent to a high of 6.1 percent. These interest rates were considerably lower than the 7.1 to 12.4 percent interest rates that should have been applied to hydropower investments during this period.

Under a methodology proposed by its auditor, Southeastern estimated that as of September 30, 1994, using the incorrect interest rates had understated interest expense by about \$1.7 million at two of its four rate-making systems.²³ Southeastern officials did not agree with the methodology proposed by its auditor and told us that the \$1.7 million represents the maximum amount of the interest understatement. Southeastern subsequently took over the calculation of interest on federal investment that had previously been done by the Corps; however, it did not determine the total magnitude of the error. Southeastern officials told us that they do not plan to recover these costs because they considered them immaterial to Southeastern's financial statements. We do not agree that materiality in relation to financial statements is the appropriate criteria for deciding whether to recover a known power-related cost.

²³The two systems were the Georgia-Alabama-South Carolina system and the Cumberland Basin system, which collectively encompass 19 of Southeastern's 23 projects.

Similarly, as a result of its fiscal year 1994 financial statement audit, Southwestern's external auditor informed Southwestern's management that, for the years 1984 through 1988, the Corps had used interest rates lower than those that should have been used to calculate interest on additions to the federal power facilities marketed by Southwestern. The auditor also noted that, as of fiscal year 1994, three Corps districts had continued to use the lower interest rates to calculate interest. Southwestern adjusted its books to properly record interest expense for fiscal years 1989 through 1995 when it took over responsibility for calculating interest on investment from the Corps in fiscal year 1995. However, as of fiscal year 1996, Southwestern had not applied the appropriate interest rates to additions to the federal investment for fiscal years 1984 through 1988, and Southwestern officials told us that they do not plan to do so.

A long delay in recovering the costs of a transmission line on which construction began in 1965, and which was later abandoned, is another example of the ineffectiveness of the current monitoring system. According to the Bureau,²⁴ a transmission line, which was planned to be part of the Pacific Northwest-Pacific Southwest Intertie Project, was abandoned in fiscal year 1969 due to sporadic funding. Western and its external auditor agreed in 1996 that the total unrecovered amount for the abandoned transmission line was about \$20 million. However, even though these costs were power-related, Western was able to delay making any principal or interest payments to the federal government until 1997, about 28 years after the project had been abandoned.

The current monitoring efforts do not ensure that costs such as those described above are fully recovered, and therefore that the federal government does not incur unnecessary losses on power-related activities. It is important to note that although the aforementioned unrecovered costs have been documented, there is no assurance that all unrecovered costs have been identified. Other instances of under-recovery could exist which we did not identify as a result of the limited scope of our work. Thus, the full magnitude of the unrecovered costs is unknown. If the PMAs were to begin recovering all of these costs, in many cases they would first need to develop estimates of the amounts to be recovered in cooperation with the appropriate operating agency. These estimated costs would then need to be included in the PMAs' power repayment studies and rates for recovery, as is commonly done now for other costs. If the PMAs were to begin

²⁴Western was established on December 21, 1977, pursuant to Section 302 of the DOE Act. Power marketing responsibilities and the transmission system assets—including those of the abandoned project—previously managed by the Bureau of Reclamation were transferred to Western.

including these unrecovered costs in power rates, the result could be upward pressure on rates.

Current Monitoring Activities Are Less Extensive Than Those Performed in Prior Years

The current activities for monitoring the repayment of power-related costs and debt are less extensive than those performed in prior years. For several years prior to 1984, DOE's Office of Power Marketing Coordination (OPMC) monitored the PMAS' activities and reviewed their rate proposals. This provided some additional assurance that information provided to FERC on costs to be recovered by the PMAS was complete and accurate. In addition, before the Secretary of Energy's order delegating to FERC the authority to review the PMAS' rates was revised in 1983, FERC had more latitude in reviewing the PMAS' rates. According to FERC officials, this latitude enabled FERC to more actively review rate proposals and challenge rates that they thought did not recover all relevant costs. FERC's review of Bonneville's rate proposals was similarly broader before the passage of the Northwest Power Act. The act limited FERC's scope of review to the standards specified in the act.

Office of Power Marketing Coordination Practices

Prior monitoring practices used by OPMC, which was disbanded in 1984, were more extensive than those performed by DOE today. According to former OPMC officials, including the former director of that office, OPMC's monitoring practices included reviewing the PMAS' rate proposals and power repayment studies before they were sent to FERC. They told us that one of OPMC's key responsibilities was to assess whether appropriate costs were included in rates, and the office employed a staff with expertise in PMA rate-making to help it carry out this responsibility. However, OPMC did not perform detailed reviews of the power repayment studies which form the basis for the PMAS' rate proposals.

According to DOE officials, when OPMC was disbanded, its monitoring activities were not assigned to another entity and have not been subsequently assumed by another entity. Although the two Washington PMA liaison offices began to perform some of the functions of the disbanded OPMC, they generally have not reviewed the PMAS' rate proposals and power repayment studies. As a result, the assurance that the PMAS' rate proposals provide for accurate, complete, and timely repayment was decreased when OPMC was disbanded.

FERC Delegation Order Revision

Because the Secretary of Energy's 1978 delegation order did not specify the standard of review, FERC interpreted the order as allowing the same

type of review that it had previously carried out as the Federal Power Commission (FPC) when it applied its independent expertise in evaluating the PMAS' rate proposals.²⁵ Subsequently, the December 14, 1983, revision to the delegation order,²⁶ which is currently in effect, limited FERC's review to the previously discussed three standards set forth in the order. In FERC's view, under this order, rate proposals can only be rejected if found to be arbitrary, capricious, or in violation of law. In addition, the revision indicated that the operating agencies' policy judgments and interpretations of laws and regulations were not reviewable by FERC. These limitations significantly reduced FERC's ability to ensure that all power-related costs are included in the three PMAS' rates.

Prior to the passage of the Northwest Power Act in 1980, the DOE delegation order to FERC applied to all PMAS, including Bonneville. The current delegation order does not cover Bonneville due to provisions of the act. As previously discussed, the act limits the scope of FERC's review of Bonneville's rates.

Conclusions

While Treasury is responsible for receiving and recording the repayment of the PMAS' power-related costs and debt, it is not responsible for monitoring repayment and is not in a position to effectively do so. DOE is responsible under the law for monitoring the repayment of the PMAS' power-related costs and debt and is in the best position to perform this function. However, until an effective monitoring system is established by DOE, including at FERC, the federal government will continue to be exposed to financial loss.

Recommendations

We recommend that the Secretary of Energy move quickly to enhance the department's oversight of the repayment of the PMAS' power-related costs and debt and thereby increase the likelihood that the federal government will receive all money due it in a timely manner. To provide this additional assurance, the Secretary of Energy should do the following.

- Require independent, outside reviews by qualified parties of the power repayment studies prepared by the PMAS to increase assurance that all power-related costs are included in rates. These reviews should assess (1) the appropriateness of the assumptions and methodologies used in the

²⁵See, e.g., U.S. Secretary of Energy, Bonneville Power Administration, 20 FERC par. 61,291 (Sept. 1, 1982), U.S. Department of Interior, Bonneville Power Administration, 34 F.P.C. 1462; 1965 (Dec. 14, 1965). The DOE Act transferred most of FPC's functions to the Secretary of Energy and FERC.

²⁶DOE Delegation Order No. 0204-108.

power repayment studies, (2) whether all power-related costs are included, and (3) whether appropriate interest rates are used by the PMAS and operating agencies to calculate interest to be charged on completed projects or capitalized for projects being constructed. The results of the reviews should be summarized in written reports. These independent reviews should initially be done for each power repayment study the next time it is updated. Thereafter, the frequency of the reviews should be based on the results of prior review(s) and assessments of the risk of financial loss to the federal government. The independent review costs, as valid power-related costs, should be included in power rates.

- Include the full costs of CSRS pension and postretirement health benefits, life insurance, and workers' compensation benefits in the PMAS' rates. The costs should include not only those for PMA employees, but also those for operating agency employees involved in power-related activities either full-time or part-time, directly or indirectly. Amounts pertaining to operating agency personnel should be obtained from the operating agencies or, if necessary, estimated by the Department of Energy in cooperation with the appropriate operating agency.
- Incorporate and maintain updated cost recovery guidance in DOE Order RA 6120.2 that ensures full recovery of power-related costs, including the full costs of CSRS pension and postretirement health benefits, life insurance, and workers' compensation benefits for all PMA employees as well as operating agency employees involved in power-related activities either full-time or part-time, directly or indirectly.
- Establish a process within DOE for tracking and resolving issues that affect the repayment of power-related costs and debt. Specifically, DOE should:
 - Review the three PMAS' (Southeastern, Southwestern, and Western) rate proposals before they are sent to FERC. For all four PMAS (Bonneville, Southeastern, Southwestern, and Western), review the reports summarizing the results of the independent, outside evaluations of the power repayment studies, for purposes of identifying any issues that require follow-up and resolution with the PMAS.
 - Review audit reports (Auditor's Reports, Reports on Compliance with Laws and Regulations, Reports on Internal Controls, and Management Letters) for all four PMAS and ensure the timely resolution of all identified management, cost recovery, and repayment issues.
 - Ensure that all four PMAS pass onto FERC the reports referred to above for its use in reviewing PMA rate proposals.
- Revise Delegation Order 0204-108 to give FERC more authority to review and challenge the rate proposals of the three PMAS. Specifically, the Secretary of Energy should (1) clarify that the "arbitrary and capricious" standard does not preclude FERC from rejecting a rate proposal that it finds

to be inconsistent with cost recovery guidance contained in DOE Order RA 6120.2, (2) allow FERC to go beyond the three specific standards of review specified in the order, as necessary, and (3) allow FERC to modify a rate proposal rather than merely accept or reject it.

In addition, we recommend that the Federal Energy Regulatory Commission utilize this additional authority in its reviews of PMA rate proposals, including analysis and consideration of audit reports and the results of independent evaluations of the PMAS' power repayment studies.

Agency Comments and Our Evaluation

We provided a draft of this report to FERC, DOI, Treasury, DOD, DOE, and the PMAS for comment. FERC, DOI, Treasury, and DOD generally agreed with the report. FERC and DOD provided informal technical comments which we incorporated into the report, as appropriate.

DOE's Office of the Secretary did not provide written comments, but told us that they concurred with the PMAS comments. The PMAS agreed with many of the facts contained in our report, but disagreed with our conclusions and recommendations for improving the monitoring. The PMAS' comments are reprinted in appendix III. Their major comments are evaluated below; other comments are evaluated in appendix III. The PMAS also provided us with informal technical comments which we evaluated and incorporated, as appropriate.

The PMAs Are Already Subject to Extensive Oversight

The PMAS stated that current monitoring activities are extensive and additional monitoring is not necessary. They cited 10 types of oversight, monitoring, and appeals that are currently available over PMA repayment practices, and stated that our recommendation for an independent, outside review of the PMAS' power repayment studies would seem to be an unnecessary, expensive, and time-consuming duplication of existing reviews. We do not agree. Based on our review, the current monitoring activities are not designed to ensure that repayment is complete, accurate, and timely. For example, none of the activities delineated by the PMAS include detailed reviews of the PMAS' power repayment studies, upon which rates are based. Therefore, there is little assurance that these repayment studies provide for complete, accurate, and timely repayment of the costs that the federal government is entitled to recover under current law.

Our report includes several examples of (1) significant power-related costs that historically have not been recovered and (2) the lack of timeliness in resolving cost recovery issues once they were raised. It is important to note that our review was not designed to detect and quantify all losses, but rather to evaluate the effectiveness of the system for monitoring repayment and determine if there was the potential for financial loss to the federal government. Based on our assessment of the monitoring system, we concluded that there is the potential for loss to the federal government, beyond the identified examples in the report, and therefore that the system is ineffective and needs enhancing through closer monitoring of the PMAS' repayment. However, in response to the PMAS' comments, we have revised our report to clarify that we are not proposing multiple detailed reviews of the power repayment studies. Instead, the detailed, independent power repayment study reviews should be performed and summaries of the results of those reviews used by DOE to identify issues that require follow-up and resolution with the PMAS and by FERC in assessing the PMAS' rate proposals.

The PMAS also stated that the three PMAS' respective financial statement auditors perform compliance testing which already accomplishes our recommendation that the power repayment studies be independently reviewed to determine whether they provide for complete, accurate, and timely repayment. We do not agree. As we state in the report, the objective of a financial statement audit is to express an opinion as to whether the statements are fairly stated and the audit would not be expected to detect all issues related to repayment or cost recovery. The financial statement audits—and other audits—have not included detailed reviews of the power repayment studies that assessed their completeness, assumptions, methodologies, and the reasonableness of estimates used. Since the existing reviews of the power repayment studies have not included such assessments to ensure that repayment is complete, accurate, and timely, it is not possible to determine whether all cost recovery issues have been identified. Moreover, the PMAS' assertion relates to the compliance testing at the three PMAS rather than at Bonneville, which receives a different type of audit and less compliance testing, according to a Bonneville official. As we state in our report, some of the same cost recovery issues exist at Bonneville but generally have not been raised by its financial statement auditor in audit reports.

Additionally, even when cost recovery issues have been identified as part of the audits, they have often not been addressed in a timely manner by the PMAS. For example, the unrecovered CSRS pensions and postretirement

health benefits cost issue was first reported by Western's financial statement auditor as part of its fiscal year 1993 audit and by Southeastern's and Southwestern's auditors in 1994, but still has not been fully resolved by PMA management.

Most Cost Recovery Disagreements Involve Policy Matters

The PMAS stated that the failure to recover costs that we identified in this and previous reports largely involved differing interpretations of law or policy, rather than a failure to follow clear guidance. While differing interpretations of law or policy can lead to a failure to recover power-related costs, this is one reason closer monitoring is needed so that issues can be resolved in a more timely manner. For example, as discussed above, Western's financial statement auditor first recommended that Western begin recovering CSRS pension and postretirement health benefits costs in 1993. This issue has only recently begun to be resolved. Some of the delay in resolving the issue could be attributable to differing interpretations of law or policy. However, a monitoring system at the DOE level would likely have identified this as an issue that might also exist elsewhere and would have facilitated quick resolution at all four PMAS to ensure that the federal government did not continue to suffer financial loss. As we state in our report, the amount of the four PMAS' unrecovered CSRS pension and postretirement health benefits costs over a 5-year period (fiscal years 1992-1996) was an estimated \$192 million (in constant 1996 dollars). This financial loss could have been mitigated by timely identification of the scope of the problem at the DOE level and resolution at each of the PMAS.

The PMAS also maintain that OMB Circular A-25 and federal accounting standards do not apply when "the amount to be priced is provided for by statute or regulation." This statement does not appear to be relevant to the unrecovered costs identified in our report, which the PMAS have now agreed should be recovered. Recovering these power-related costs is in accordance with laws and regulations. Moreover, statutes, regulations, and DOE Order RA 6120.2 require that the PMAS' power-related costs be included in rates, but do not specifically identify and define all costs that must be recovered. Therefore, using guidance set forth by OMB Circular A-25 and federal accounting standards to help define the full costs of federal power is appropriate.

Description of Unrecovered Costs Is Misleading

The PMAS state that the description of unrecovered power-related costs included in our report is misleading in that it claims that four types of power-related costs are not being recovered. The PMAS further state that

they generally agree that these costs should be recovered and have been taking steps to ensure that this occurs, beginning in fiscal year 1998. They also object to our characterization of progress towards resolving problems as slow or nonexistent. However, as our report demonstrates, progress toward resolving some of the cost recovery issues has been slow. For example, Western delayed making principal or interest payments on a transmission line for about 28 years after the project was abandoned. The total amount of the unrecovered costs during that time period was approximately \$20 million.

No progress has been made toward resolving certain other cost recovery issues. For example, our report discusses unrecovered workers compensation costs at Southeastern that were reported as a result of Southeastern's fiscal year 1995 financial statement audit. The PMAS' comments acknowledge that these costs should be included in rates; however, no progress has been made to do so. In addition, Western's financial statement auditor reported as part of its fiscal year 1993 financial statement audit that Western was not recovering about \$3 million annually in interest on moveable equipment. Western subsequently recovered interest for 1993 and later years; however, it has not taken any steps to recover interest for prior years, even though DOE policy has always been to recover interest on the federal government's outstanding investment in power-related activities. Similarly, our report describes unrecovered interest costs at Southeastern and Southwestern related to the application of incorrect interest rates to the federal investment that remain unrecovered.

The PMAS state that many of the findings reported by the external auditors and GAO were initially raised by PMA personnel. They also state that because the errors related to unrecovered interest on federal investments at certain projects were raised by the three PMAS' external auditors, that "it is apparent that the present oversight and monitoring practices are working." We do not agree. Many of the issues we discuss had been problems for a number of years before they were identified. Further, while financial audits are an important element of monitoring, they do not relieve management of its responsibility to establish an effective monitoring system within its own organization.

FERC's Authority Is Broad Enough to Ensure Repayment

The PMAS believe that FERC's current authority is sufficient to allow FERC to provide effective monitoring and oversight of the three PMAS' repayment. This is at odds with FERC's position. FERC officials told us that, in their

opinion, the “arbitrary and capricious” standard specified in the current delegation order is very difficult to meet and thus imposes a significant practical limitation on FERC’s review authority. As a result, FERC rarely disapproves a rate request. Our recommendation involves returning to a more general delegation of authority to FERC that does not impose unnecessary limits on its review authority, including the “arbitrary and capricious” standard that was not a part of the Secretary of Energy’s previous delegation order.

We agree with the PMAS’ position that revising the delegation order to allow FERC to modify the three PMAS’ rate proposals, rather than merely accepting or rejecting them, is worthy of consideration. This change, along with the removal of the restrictions on FERC’s review, would better enable FERC to help ensure that costs are recovered. As a result, we have revised our recommendation pertaining to revising the delegation order.

As agreed with your offices, unless you publicly announce its contents earlier, we will not distribute this report until 30 days from its date. At that time, we will send copies to appropriate House and Senate Committees; the Ranking Minority Members of the House Committee on the Budget and the House Committee on Resources’ Subcommittee on Water and Power Resources; interested Members of the Congress; the Secretary of Energy; the Secretary of the Interior; the Secretary of Defense; the Secretary of the Treasury; the Chairman of the Federal Energy Regulatory Commission; the Director of the Office of Management and Budget; and other interested parties. We will make copies available to others upon request.

Please call me at (202) 512-8341 if you or your staff have any questions. Major contributors to this report are listed in appendix IV.



Linda M. Calbom
Director, Resources, Community, and Economic Development
Accounting and Financial Management Issues

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Abbreviations

CSRS	Civil Service Retirement System
DOD	Department of Defense
DOE	Department of Energy
DOI	Department of the Interior
FASAB	Federal Accounting Standards Advisory Board
FCRPS	Federal Columbia River Power System
FERC	Federal Energy Regulatory Commission
FPC	Federal Power Commission
O&M	operations and maintenance
OMB	Office of Management and Budget
OPM	Office of Personnel Management
OPMC	Office of Power Marketing Coordination
PMA	power marketing administration

Objectives, Scope, and Methodology

We were asked by the Chairmen of the House Budget Committee and the Subcommittee on Water and Power Resources, House Resources Committee, to examine the monitoring of the repayment of the power-related costs and debt of the Department of Energy's (DOE) Power Marketing Administrations (PMA). Specifically, the Chairmen asked us to determine (1) if DOE or the Department of the Treasury actively monitors the amounts of debt to be repaid and the appropriateness of the annual payments and (2) if there is a potential for financial loss to the federal government due to lack of such monitoring. We determined whether the current activities for monitoring repayment effectively ensure that repayment amounts are complete, accurate, and timely, but did not attempt to quantify the financial loss to the federal government resulting from any monitoring ineffectiveness.

This report provides information on the Bonneville, Southeastern, Southwestern, and Western Area Power Administrations. It also includes the power-related activities of the Department of the Interior's Bureau of Reclamation (Bureau) and U.S. Army Corps of Engineers (Corps), which own and operate virtually all of the multipurpose federal water projects that provide power to the PMAs' customers.

Assessing Monitoring Effectiveness and the Potential for Financial Loss to the Federal Government

To determine if current monitoring activities ensure that all repayments were accurate, complete, and timely, we first determined who has the legal responsibility for ensuring that the PMAs recover all power-related costs and repay debt and then obtained an understanding of the current system for monitoring the repayment. We did this by researching relevant laws, regulations, and court cases and interviewing senior officials from DOE headquarters; the two PMA liaison offices in Washington, D.C.; the four PMAs; the Department of the Treasury; the Federal Energy Regulatory Commission (FERC); and the operating agencies (the Department of the Interior's Bureau of Reclamation and U.S. Army Corps of Engineers).

We then assessed the potential for financial loss to the federal government. In doing so, we relied extensively on audited financial information for each of the four PMAs. Specifically, we obtained and analyzed the external auditors' reports of the results of their financial statement audits, reports on the PMAs' compliance with laws and regulations, reports on the effectiveness of the PMAs' systems of internal controls, and letters to management highlighting cost recovery and other issues. Many of these reports contained information on cost recovery issues. For each PMA, we reviewed the most recently available reports as

well as those for several previous years. In addition, we reviewed and synthesized recent GAO reports that assessed cost recovery by the PMAS. In performing the reviews that resulted in these previous reports, we had developed a good understanding of the PMAS' requirement for recovering power-related costs and for several of the costs that were not being fully recovered. We also reviewed reports by the DOE, DOI, and DOD Inspector General offices.

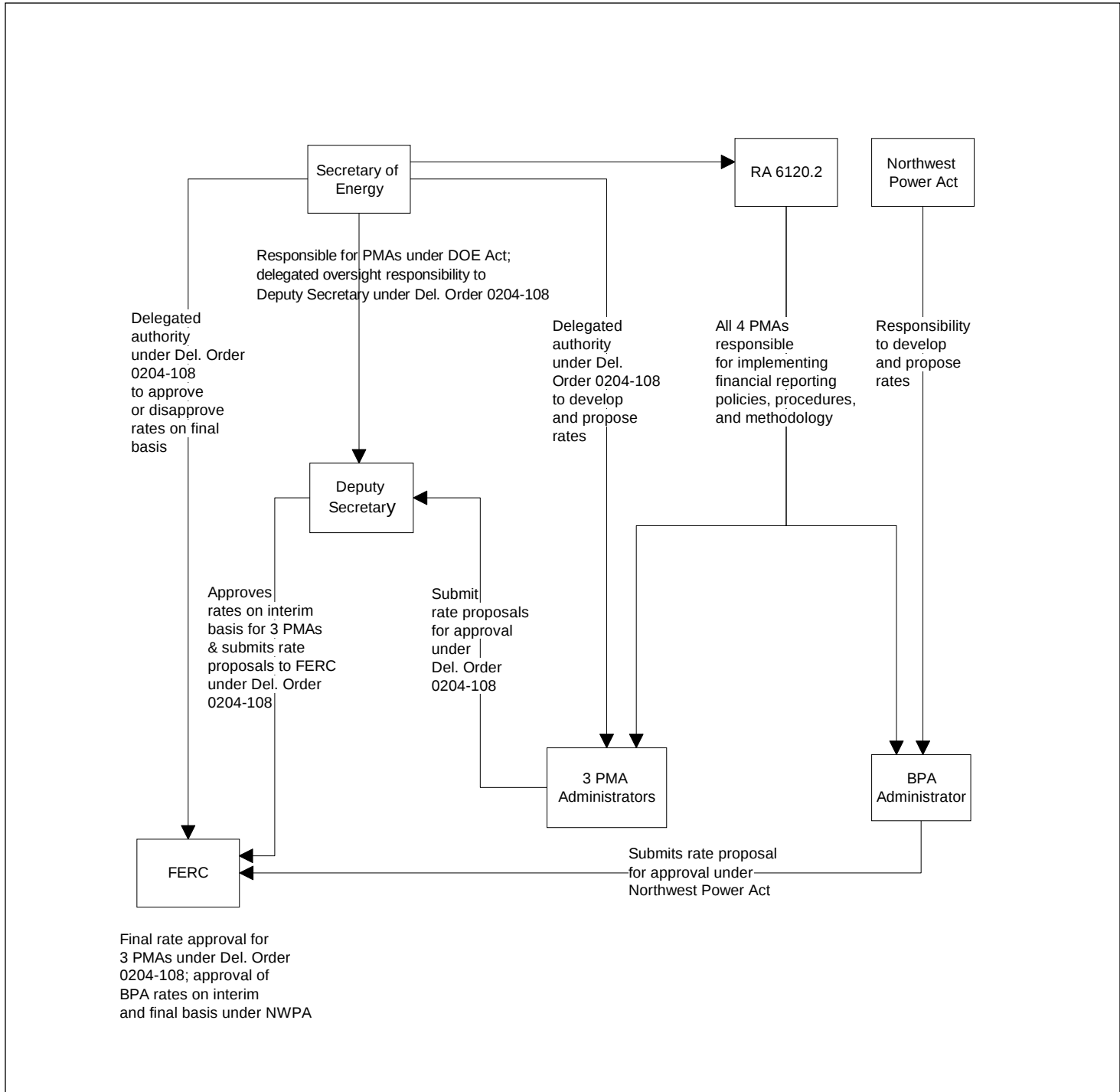
After developing an understanding of cost recovery and repayment issues at each of the four PMAS, we corroborated our understanding of those issues by interviewing appropriate officials. Specifically, we corroborated the results of our analyses by interviewing DOE officials and the PMAS' external auditors.

**Determining Whether
Current Monitoring
Activities Are as Extensive
as the Prior Ones**

We identified how current activities for monitoring the repayment of the PMAS' power-related costs and debt differ from prior ones by obtaining and reviewing documentation on organizational changes within DOE pertaining to the monitoring of the PMAS. Specifically, we obtained and reviewed organization charts and delegation orders spanning more than a decade. In addition, we interviewed officials from DOE, the PMA liaison offices, the PMAS, the Department of the Treasury, and FERC. To follow up on these discussions, we also interviewed former officials of DOE's disbanded Office of Power Marketing Coordination (OPMC), which previously monitored the PMAS' activities in the late 1970s and early 1980s. Among the officials we interviewed was the former director of OPMC. We then assessed whether these changes could affect the potential for financial losses to the federal government.

We conducted our review from December 1997 through June 1998 in accordance with generally accepted government auditing standards.

Legal Responsibilities and Delegated Authorities for Bonneville, Southeastern, Southwestern, and Western Area Power Administrations



Note: The three PMAs are Southeastern, Southwestern, and Western Area Power Administrations.

Comments From the Four Power Marketing Administrations

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



Department of Energy
Power Marketing Liaison Office
Washington, DC 20585

June 5, 1998

Mr. Gene L. Dodaro
Assistant Comptroller General
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Dodaro:

This letter responds to your request for written comments from elements of the United States Department of Energy on the draft United States General Accounting Office report *POWER MARKETING ADMINISTRATIONS: Repayment of Power Costs Needs Closer Monitoring*.

Thank you for your interest in improving the repayment practices of the power marketing administrations (PMAs). While, in general, we believe the current monitoring practices are adequate to ensure repayment, we also believe that certain of your recommendations warrant further consideration and implementation. Our reasoning is explained below.

PMAs Are Already Subject to Extensive Oversight. The PMAs' ratemaking and repayment practices are subject to oversight by a number of different Federal and nonfederal entities. The following 10 types of oversight, monitoring and appeals are currently available over PMA repayment practices:

- FERC Rate Review. The Secretary of Energy has delegated the authority to confirm and approve rates for the Southeastern, Southwestern, and Western Area Power Administrations (hereafter referred to as the "three PMAs") on a final basis to the Federal Energy Regulatory Commission (FERC), consistent with the authority previously exercised by the Federal Power Commission. FERC confirms and approves Bonneville Power Administration's (Bonneville's) rates after a formal, on-the-record proceeding in which Bonneville must submit its repayment model and its revenue requirement, including its Federal repayment obligation. Bonneville's rate setting process and the standards by which FERC reviews Bonneville's rate proposals are governed by detailed provisions of Section 7 of the Northwest Power Act (Pub. L. 96-501) and other law.
- Department of Energy Rate Review. The Secretary of Energy delegated the authority to confirm and approve the three PMAs' rates on an interim basis to the Deputy Secretary of Energy. The Deputy Secretary's review is not limited to any particular aspect of the rates.
- Public Rate Review. PMA rates and repayment are subject to public review through a public participation process each time new rates are proposed. In Bonneville's case, detailed legislation guides Bonneville's public process for ratemaking, in which a formal

See comment 1.

Appendix III
Comments From the Four Power Marketing
Administrations

administrative record is prepared by an independent administrative law judge. The legislation and Bonneville's own practices provide for broad participation by Bonneville's customers and others. Other Federal agencies are free to participate in these proceedings. Parties have the right to provide written testimony and witnesses, cross-examine Bonneville's witnesses and submit motions to the hearings officer. Parties may also submit briefs to Bonneville arguing for substantive ratemaking provisions and outcomes.

- Annual Independent Financial Audit. The PMAs have national accounting firms (currently, KPMG Peat Marwick for the three PMAs and Price Waterhouse for Bonneville) perform annual financial audits of the Federal power systems. Auditors are legally required to be independent in their review. For the three PMAs, part of the auditors' responsibility is to conduct compliance tests on cost recovery. Specifically, the three PMAs' auditors verify that the power repayment studies utilize the audited financial data for the historical year -- providing a direct link between audited financial numbers and the PMAs' power rates. The three PMAs' audit results are reviewed by the Department of Energy's Inspector General (IG) prior to the final report being issued. Bonneville has received an "clean" audit opinion for thirteen consecutive years, and the three PMAs have received "clean" opinions since FY 1991. This means the auditors have judged any and all audit findings to be immaterial as to their impact on the overall financial statements. Actions are taken by the PMAs to resolve issues brought to their attention by their auditors after assuring that such corrections are verifiable and consistent with law. Bonneville is directed by law to keep a complete and accurate account of operations and to obtain annually independent, commercial-type audits of its accounts. Legislation enacted in 1974 established that Bonneville falls under the Government Corporation Control Act which directs Bonneville to maintain financial records and prepare annual financial reports. OMB procedures have subsequently identified that government corporations should operate consistent with Generally Accepted Accounting Principles, rather than Federal government accounting principles.
- Annual Financial Reporting. The three PMAs prepare annual reports for the Secretary of Energy that incorporate the financial audit, financial and program performance measures, repayable Federal investment for generation and transmission facilities and cumulative repayment status, along with other operating statistics. Copies are provided annually to Congress, the FERC, customers and the general public, upon request. Bonneville submits its audited financial statements directly to the President and Congress, pursuant to the 1974 Act. A copy is provided to DOE and to the public, upon request. Bonneville regularly provides its audited annual reports to the investing public, in compliance with security regulation, and certifies that they are not materially misleading. Under relatively new financial regulations, Bonneville is also obligated to provide its reports annually to certain repositories for access by the investing public.
- Annual Budget Review. The PMAs' annual budget submission provides the Department of Energy, the Office of Management and Budget, and Congress with information on the annual and cumulative repayment of Federal investment. A "Revenue and Receipt Report" is also provided that reflects actual gross revenues and estimated revenues for the out years. In addition to the budget submission, the PMAs provide Congress, specifically, the House Appropriations Subcommittee on Energy and Water

See comment 2.

- Development, with data for the record on composite rates, power investment, power revenues, operating and maintenance costs, purchase power costs, principal and interest payments, and unpaid investment.
- Congressional Oversight. The PMAs' authorization committees, the House Resources Committee and the Senate Energy and Natural Resources Committee, have authority to review the PMAs' repayment status. Congress can and does utilize its investigating arms, such as GAO, to look into repayment.
 - CFO Biennial Review. As required by the Chief Financial Officers Act of 1990, the Office of Chief Financial Officer (CFO) exercises its authority to "review on a biennial basis, the fees, royalties, rents, and other charges imposed by the agency for services and things of value it provides..." for the three PMAs.
 - Ongoing Records Availability. The PMAs' records are subject to review by customers, GAO, IG, and FERC. In addition, Freedom of Information Act requests make such records available to the general public.
 - Litigation. Aggrieved parties can appeal FERC rulings/decisions, and can litigate in Federal court if an issue arises that is outside of FERC's PMA rate review jurisdiction.

It was these types of review and appeal processes, particularly the financial audits, that surfaced the issues raised in this and previous GAO reports. The draft report's recommendation that an independent, outside review of the PMAs' power repayment studies is needed would seem to be an unnecessary, expensive, and time-consuming duplication of existing reviews. Specifically, the three PMAs' auditors' existing compliance testing of cost recovery already accomplishes the draft report's recommendation that an outside review is needed to assess whether power repayment studies include all costs. In addition, the final GAO report should acknowledge that the existing review process uncovered the issues cited in the report that, although immaterial, the three PMAs are working to resolve. Yet a former Department of Energy reviewing organization (the Office of Power Marketing Coordination) never addressed these issues. This confirms that the present oversight is functioning as intended.

See comment 1.

Most Cost Recovery Disagreements Involve Policy Matters. The majority of issues raised by GAO in this and its previous reports on PMA repayment practices have involved interpretation of law or policy -- not failure to follow clear guidance. Interpretations are, by their nature, subjective. The fact that GAO and the PMAs have reached different conclusions about the proper recovery of certain administrative expenses is not, by itself, evidence that monitoring is inadequate. Rather, it merely shows that opinions can differ.

For example, GAO believes that OMB Circular A-25 and Statement of Federal Financial Accounting Standard No. 4 (SFFAS No. 4) provide the best definition of "full costs." The PMAs, in contrast, believe that rates are to be set to recover all power-related costs as provided by law, and note that OMB Circular A-25 and SFFAS No. 4 do not apply when the amount to be priced is provided for by statute or regulation.

An outside reviewer can always offer the Secretary a second opinion, but this duplicates the mission of existing PMA staff who have been entrusted by the Secretary to ensure PMA

repayment is appropriate. If the Secretary has concerns about PMA repayment, it would seem more prudent to direct the PMAs' management to take corrective action than to establish a new bureaucracy. The same goes for additional monitoring within DOE.

See comment 1.

Description of Unrecovered Power-related Costs is Misleading. The draft report claims that four types of power-related costs are not being recovered. The PMAs wish to comment on each. In general, however, the PMAs agree that these costs should be recovered and have taken steps to ensure this occurs, beginning in FY 1998. The PMAs object to the report's characterization of PMA management's progress towards resolving several problems as being "slow or nonexistent" and note that no evidence for this assertion is provided. In fact, many of the "findings" reported by the external auditors and GAO were initially raised by PMA personnel.

- Civil Service Retirement System (CSRS) Pensions and Post-retirement Health Benefits. The draft report's "Results in Brief" states that these expenses are not being fully recovered even though the body of the report indicates that the PMAs stated that they will begin to include these additional costs in their FY 1998 rate studies. While there is some concern over how best to capture generating agencies power-related retirement benefits, there is no disagreement over this policy. The PMAs are a rarity among Federal agencies engaged in business-like, revenue-producing activities by recovering CSRS and other post-retirement costs presently funded by the Office of Personnel Management (OPM). In addition, related costs of the generating agencies that supply power to the PMAs are planned for recovery beginning in FY 1998. The PMAs have scheduled a meeting with the Corps and the Bureau to determine these costs. The PMAs will accomplish this cost recovery despite the pervasive problems GAO has identified with accounting for some of these costs; "...the federal government cannot provide adequate assurance about the reliability of historical claim information at the insurance carrier-level used to estimate the \$159 billion reported for civilian postretirement health benefit liabilities." [GAO/T-AIMD-98-128]. PMA ratepayers will pay the "full costs of providing the federal government's portion of postretirement health benefits" determined using unreliable and unaudit data. The final GAO report should emphasize that the CSRS benefits issue was identified and resolved in the taxpayers' favor under the existing administrative process and as a result of existing financial reporting and audit procedures.
- Life Insurance Benefits. Postretirement life insurance benefits paid by the Federal government and similarly funded by OPM in excess of those life insurance costs already being recovered will begin to be repaid by the PMAs for FY 1998.
- Workers' Compensation Benefits. Southeastern was cited in the report for failing to recover the generating agency's workman's compensation costs. Southeastern agrees that these costs should be included in their rates and will work with the generating agency to ensure that these costs are properly reported.
- Interest on Some Federal Investment for Certain Projects. Errors in assigning interest rates to certain investments of certain projects have all been corrected prospectively, to the extent such decisions are under the three PMAs' control. Since these errors were all discovered by the three PMAs' external auditors, or PMA personnel, it is apparent that the present oversight and monitoring practices are working. The draft report does not identify any interest rate assignment deficiencies for Bonneville. Moreover, in 1996,

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Congress enacted legislation reconstituting Bonneville's then-outstanding appropriated repayment obligation. Pursuant to that law, Bonneville prepared for Treasury certification a complete investment-by-investment compilation of the appropriated investments, the net present values of their repayment streams referenced to a Treasury yield curve, and new interest rates applicable after the redetermination of the outstanding principal amounts. In view of this careful process, which was enacted by Congress with the endorsement of the Administration and the consent of Treasury staff, additional interest rate verification for Bonneville investment obligations would not be useful.

See comment 3.

PMAs Have Achieved an Enviably Record of Repayment. The findings and recommendations of the draft report should be read in the context of the PMAs' record of repayment. As of the end of FY 1997, Bonneville has made roughly \$11 billion in principal and interest payments to the Treasury. Southeastern, Southwestern, and Western have repaid the U.S. Treasury \$1.5 billion, \$1.0 billion, and \$5.1 billion for interest and principal as of the end of FY 1997, respectively. Bonneville has remained current on scheduled Treasury payments for the past 14 consecutive years and anticipates this will continue for the foreseeable future. The PMAs have achieved this financial performance notwithstanding drought conditions in the early 1990s, competing missions for Federal water projects, and increasing competition in the electric utility industry.

See comment 1.

FERC's Authority Is Broad Enough to Ensure Repayment. The draft report emphasizes that FERC's review authority over the three PMAs' ratemaking is limited because any rejection of a rate proposal must find the proposal to be "arbitrary, capricious, or in violation of the law." However, this is the same standard of review mandated by Congress in the Administrative Procedure Act (5 U.S.C.A. §706) and is a relatively common standard throughout the Federal government. In addition, FERC's authority does include rejecting decisions that are not in accord with DOE Order RA6120.2, which requires full cost recovery.

Moreover, FERC review clearly extends to "whether the revenue levels generated by the rates are sufficient to recover the costs of producing and transmitting electric energy, including repayment, within the period of cost recovery permitted by law, of the capital investment allocated to power and costs assigned by Acts of Congress to power for repayment;..." (Amendment No. 3 to Delegation Order No. 0204-108) This authority, in our opinion, gives FERC sufficient authority to provide effective monitoring and oversight of the three PMA's repayment.

The Department of Energy believes one modification of Delegation Order No. 0204-108 is worthy of further analysis. At present, FERC's authority is limited to approving or remanding rates for Southeastern, Southwestern, and Western Area Power Administrations. A more flexible alternative would allow FERC to modify the three PMAs' rate proposals if the Commission found them to be in violation of any of the existing standards of review. DOE will examine whether such a change in the Delegation Order would enhance oversight of repayment and is feasible.

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See comment 4.

Updating DOE Order RA6120.2 is Unnecessary. A recent DOE General Counsel's office opinion has clarified that collection of CSRS and other post-retirement expenses currently funded by OPM can be considered a cost to be recovered by the PMAs. This illustrates the language of DOE Order RA6120.2 is presently sufficient to accommodate this revenue requirement. Making RA6120.2 more definitive and prescriptive risks failing to account for the diversity that exists among the PMAs. Any DOE Order must strike a careful balance between being specific enough to accomplish its objectives without being so specific that it cannot accommodate the variety of situations that exist. We believe the current version of RA6120.2 strikes the proper balance.

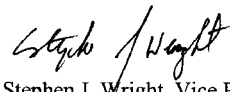
See comment 5.

PMAs Are Willing to Provide Audit Reports to FERC. The draft report recommends that audit reports be passed on to FERC for their use in reviewing PMA rates. The PMAs agree with this recommendation and will begin to include audit reports with the rate case material they submit to the FERC, even though other utilities regulated by FERC are not required to do this.

In conclusion, the PMAs believe that, with the modifications the Department is adopting or considering, the level of monitoring and oversight provided is sufficient to protect the interests of the Nation's taxpayers, as well as the PMAs' ratepayers. Thank you for this opportunity to comment on your draft report. We are enclosing several pages of technical comments for your further review.

Yours truly,


Timothy Meeks, Assistant Administrator
Power Marketing Liaison Office


Stephen J. Wright, Vice President
Bonneville Power Administration

Enclosure

The following are GAO's comments on the Department of Energy's letter dated June 5, 1998.

GAO Comments

1. Discussed in the "Agency Comments and Our Evaluation" section of the report.
2. Our involvement in raising cost recovery issues to the Congress should not be considered a part of the monitoring process designed by the Secretary of Energy to ensure that he or she fulfills his or her responsibility to recover these costs. Our audit work is generally performed at the specific request of the Congress and cannot be considered to be routine, ongoing monitoring of PMA activity.
3. We believe that the return of the federal government's investment in the PMAS' power-related activities to the Treasury through scheduled payments is an expectation of the federal government and the taxpayers, and should not necessarily be thought of as a record of achievement. While we agree that the PMAS have made substantial repayments to Treasury on a timely basis, this report and our previous reports¹ clearly point out that the PMAS have not recovered all of the costs that the federal government has incurred to produce, market, and transmit federal power.
4. We disagree. There should not be diversity among the PMAS in recovering the costs discussed, or in recovering other costs that are power-related. Clarifying the requirement that these costs be recovered in DOE Order RA 6120.2 would help ensure the necessary consistency among the PMAS and, as discussed previously, would avoid any confusion which might arise from differing interpretations regarding these costs in the future. Moreover, significant unrecovered cost categories identified in future monitoring efforts, such as detailed reviews of the PMAS' power repayment studies, should be specified as recovery requirements in the DOE Order. In addition, since Bonneville is not subject to the delegation order under which DOE reviews the other three PMAS' rate proposals before they are sent to FERC, monitoring of cost recovery issues at Bonneville at the DOE level is curtailed; clarifying cost recovery guidance in DOE Order RA 6120.2 is especially important to ensure power-related costs are treated alike among all the PMAS.

¹Power Marketing Administrations: Cost Recovery, Financing, and Comparison to Nonfederal Utilities (GAO/AIMD-96-145, September 19, 1996) and Federal Electricity Activities: The Federal Government's Net Cost and Potential for Future Losses, volumes 1 and 2 (GAO/AIMD-97-110 and 110A, September 19, 1997).

5. The PMAS' willingness to provide audit reports, including management letters, to FERC will enhance FERC's ability to effectively evaluate the PMAS' rate proposals. However, as noted in our response to comment 4, it is important to include this requirement in RA 6120.2 because Bonneville is not subject to the delegation order under which DOE transmits case materials to FERC.

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