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FERC Issues Two Oil Pipeline Audits

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On June 17, 2015, the Federal Energy Regulatory Commission's (FERC) Division of Audits and Accounting, Office of Enforcement (DAA), issued two audit reports involving oil pipelines, the ***Colonial Pipeline Company Docket No. FA14-4*** and ***Enterprise Products Partners, L.P., Docket No. FA14-1***. The ***Enterprise audit*** focused on Mid-American Pipeline Company, LLC (MAPL), a subsidiary of Enterprise. These reports are significant because they demonstrate that FERC audit staff is taking a comprehensive look at oil pipeline accounting and rate issues along with enhanced scrutiny of affiliate issues. DAA found five minor areas of noncompliance in the Colonial audit and ten findings of noncompliance with respect to Enterprise. The Enterprise findings were more significant because they involved under recovery of revenues as a result of dealings with an affiliate and failure to follow proper accounting for depreciation and prepaid leases, among other findings. In addition to Colonial and Enterprise, FERC has also announced two other oil pipeline company audits involving Enbridge Energy Partners LP, Docket No. FA15-4, and Plantation Pipe Line Company, Docket FA15-12. Prior to these audits, FERC had not audited an oil pipeline in many years. FERC stated that Colonial owns and operates the largest volume refined liquid petroleum products pipeline in the United States. In 2014, DAA announced that it would be conducting an audit of Colonial for compliance with the Uniform Systems of Accounts and financial reporting requirements in FERC Form 6. This wide-ranging audit covered the period from January 1, 2011 through December 31, 2014. The Colonial audit report contained five findings and made a total of 14 recommendations. Specifically, DAA found that Colonial improperly reported its investments in various subsidiaries using the consolidated method of accounting instead of the required equity method of accounting; Colonial incorrectly accounted for interest during construction; improperly recorded amounts for donations, charitable contributions, fines, penalties and lobbying expenses; incorrectly accounted for regulatory fees paid to federal agencies; and did not remove intrastate amounts when reporting certain line items on page 700 of Form 6. Despite these findings, DAA did not observe significant financial or rate impact from any of the findings. Colonial accepted the findings in the audit report. In our view, the audit report can be viewed as a clean bill of health from FERC to Colonial as a result of the audit. In addition to the findings above, FERC made 14 recommendations to the pipeline to correct and avoid future accounting issues. The audit report required Colonial to submit to staff within 30 days plans for implementing the 14 recommendations contained in the audit report and to submit quarterly reports describing progress toward implementing the recommendations. Colonial though has already made changes to comply with DAA's findings. Colonial implemented procedures for using the equity method of accounting and has revised its accounting policies for reporting construction costs and charitable and other non-operating expenses as well as correcting the Form 6 errors. Finally, Colonial reported that it will update its accounting policies and procedures for reporting fees paid to federal agencies in the first quarter of fiscal year 2015. MAPL is a natural gas liquids pipeline system operating in 13 states with over 8,000 miles of pipeline. The audit period covered January 1, 1022 through January 30, 2015. As with Colonial, DAA staff conducted a thorough review of MAPL's accounting and recordkeeping. DAA met with company personnel, conducted site visit, submitted data requests, and interviewed company personnel. DAA also reviewed pipeline operations including nomination procedures, scheduling, delivery and billing as well as MAPL's FERC regulatory compliance program. The MAPL audit resulted in ten areas of noncompliance and 25 recommendations. The most significant findings were that MAPL did not apply correct rates to intermediate points for two series of product movements involving an affiliate on its system from 2011 to 2012. This resulted in an under recovery of revenues of $1.7 million and this understatement impacted Form 6. FERC audit staff stated that "MAPL's practices are problematic in that they were not in compliance with the tariff provisions"¦and are contradictory to Commission regulations." DAA also found that MAPL failed to properly account for depreciation resulting in a higher depreciation expense and larger accumulated reserve totaling $2.3 million; MAPL improperly accounted for $3.6 million in outside vendor charges; $141,000 in relocation expenses; and MAPL misclassified a prepaid lease asset in its books and records in the amount of $1,152,358. The audit report requires MAPL to submit a plan to comply with the recommendations within 30 days and to make quarterly progress reports. Enterprise stated that it accepts the findings in the report and will comply with all of the recommendations. We expect that FERC will conduct additional oil pipeline audits. As a result, oil pipeline companies will need to make sure that their accounting methods are in compliance with the FERC rules and regulations and that all of its reporting obligations have been met. Companies faced with an audit should expect a broad audit scope that could change during the course of the audit. Companies will have to respond to significant data requests along with multiple visits from staff to the company's headquarters. DAA staff will conduct extensive interviews of company personnel including with senior executives. DAA will also not limit their inquiries to the company under review. For example, in the Colonial audit, DAA staff contacted shippers on the Colonial system to discuss pipeline services and tariff administration.