

GAO

Report to the Chairman, Subcommittee
on Interior and Related Agencies,
Committee on Appropriations,
House of Representatives

June 2000

HYDROPOWER RELICENSING

Federal Costs Are Not Being Recovered



G A O

Accountability * Integrity * Reliability

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Abbreviations

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| FERC | Federal Energy Regulatory Commission |
| FPA | Federal Power Act |
| NEPA | National Energy Policy Act |
| OMB | Office of Management and Budget |



United States General Accounting Office
Washington, D.C. 20548

**Resources, Community, and
Economic Development Division**

B-285047

June 30, 2000

The Honorable Ralph Regula
Chairman, Subcommittee on Interior
and Related Agencies
Committee on Appropriations
House of Representatives

Dear Mr. Chairman:

About 10 percent of all electricity produced in the United States is generated by federal and nonfederal hydroelectric power (hydropower) projects. Approximately half of the electricity generated by hydropower is produced by federally owned and operated projects. Nearly all of the remaining half is produced by about 1,000 nonfederal hydropower projects that are licensed by the federal government, of which about 400 are located on federal lands.¹ Hydropower projects include dams, reservoirs, stream diversion structures, powerhouses containing turbines driven by falling water, and transmission lines.

The Federal Power Act, as amended (FPA), authorizes the Federal Energy Regulatory Commission (FERC)—an independent five-member commission appointed by the President and confirmed by the Senate—to issue licenses to construct and operate nonfederally owned hydropower projects, including those located on federal lands. Licenses can be issued for a period of up to 50 years, after which the projects must be relicensed in order to continue operating. Licenses that expire while undergoing relicensing may receive temporary 1-year extensions, called annual licenses, until relicensing is completed.

Although FERC continues to issue licenses to operate new, previously unlicensed hydropower projects, most of the about 1,000 nonfederally owned and operated projects were originally licensed several decades ago. About 270 of these projects, including over 120 located on federal lands,

¹About 600 additional hydropower projects nationally are granted exemptions from the federal licensing requirement, generally because of their small generating capacity. Unless otherwise noted, the term “projects” in this report refers to larger, licensed projects.

either are currently undergoing relicensing or have licenses that will expire in the next 10 years.

In addition to FERC, federal and state resource agencies have responsibilities for ensuring that hydropower projects meet the requirements of environmental and planning laws that have been enacted in recent decades. These requirements also apply to the relicensing of many projects whose original licenses are expiring.

FPA requires licensees to pay reasonable annual charges in amounts fixed by FERC to reimburse the United States for, among other things, the costs of FERC's and other federal agencies' administration of the act's hydropower provisions. To identify these costs—virtually all of which are now related to the relicensing process—FERC annually requests federal agencies to report their hydropower-program-related costs for the prior fiscal year. FERC then bills individual licensees for their shares of its and the other federal agencies' administrative costs, basing these shares largely on the generating capacity and amount of electricity generated by the licensees' projects. FERC deposits the licensees' reimbursements of its and the other federal agencies' administrative costs—together with other annual charges and filing fees that it collects—into the U.S. Treasury as a direct offset to its annual appropriation. Receipts that exceed FERC's annual appropriation are deposited in the General Fund of the U.S. Treasury.

Because of your concern about increasing costs and controversies related to federal agencies' hydropower relicensing activities, you asked us to identify and assess significant issues related to nonfederally owned and operated hydropower projects. In this report, we assess one issue—the status of efforts to recover the costs incurred by federal agencies to administer the hydropower program. Our report does not address the appropriateness of the agencies' expenditures for the program but considers only the adequacy of efforts by FERC and the other agencies to recover costs they have incurred. Future work will assess other issues, such as the adequacy of payments made by licensees for the use of federal lands, the environmental and fiscal effects of delays in the relicensing process, and the potential costs to federal and state governments to remove nonfederal hydropower projects that are not relicensed.

Results in Brief

For fiscal years 1995 through 1998, federal agencies reported a total of about \$32 million in hydropower-program-related administrative costs.

However, on the basis of our review, we estimate that for the 4 fiscal years, about \$12 million in federal costs to administer the hydropower program either were not reported or may not be recovered because of appeals by licensees. According to agency officials with whom we spoke and documents that we obtained, costs were not reported, in part, because some federal agencies that incurred costs to administer the hydropower program (1) did not report any costs for any year to the Federal Energy Regulatory Commission; (2) reported costs in some years but not in other years; (3) did not report certain indirect costs (overhead), including unfunded future federal pension and postretirement health benefits and/or program-related legal costs; and/or (4) could not determine their costs. In addition, our analysis of the agencies' cost data showed that some of the \$32 million in costs that were reported have been withdrawn or may be not recovered because they cannot be adequately supported. We traced these problems to (1) the Commission's failure to provide clear guidance to the other federal agencies about what costs are recoverable and (2) the agencies' failure to improve their financial management and reporting systems to accurately account for the costs that they report. Agency officials expect the federal costs of administering the hydropower program to increase substantially as more and larger projects approach their dates for relicensing and as federal agencies take on additional responsibilities resulting from recent changes in the relicensing process. As a result, we estimate that tens of millions more dollars may not be recovered over the next decade unless corrective action is taken. Therefore, this report contains recommendations that, if implemented, would make clear what administrative costs should be reported and ensure that the costs that are reported are accurate. It also contains a matter for congressional consideration that would provide an incentive to the agencies to report their costs.

We obtained written comments on a draft of our report from the Federal Energy Regulatory Commission and the Department of the Interior. These agencies generally agreed with the thrust of our report's findings, conclusions, and recommendations, with certain exceptions. While agreeing to provide the other federal agencies with general information on reporting costs, the Commission did not indicate in its comments whether it would clarify which of the other agencies' administrative costs are eligible for recovery under the Federal Power Act as we have recommended. As a result, we have doubts about whether the problems we have identified will be resolved.

Background

Hydropower has several advantages over other methods of generating electricity. It is comparatively inexpensive to produce, can be increased quickly in periods of peak demand, is renewable, and produces no air pollution or radioactive wastes. Reservoirs created by hydropower projects also often provide opportunities for other uses, such as boating, fishing, flood control, irrigation, and municipal water supply.

Although hydropower has several advantages over other methods of generating electricity, it has disadvantages as well. For example, projects may prevent fish from moving upstream or downstream or may kill them as they pass through turbines used to generate power. Projects can also adversely affect water quantity and quality, as well as fish and wildlife habitat, by disturbing natural streamflows.

Requirements Related to Relicensing

FPA is the basic statutory authority governing the licensing and relicensing of hydropower projects. However, during the decades that have passed since FERC issued original licenses for most hydropower projects, the Congress has enacted numerous laws that can affect the projects' operations and the relicensing process.

Section 4(e) of FPA authorizes FERC to issue licenses to construct and operate nonfederally owned hydroelectric projects. In deciding whether to issue an original or renewed license, FERC must give equal consideration to developmental and nondevelopmental values, such as power and fish and wildlife. Under section 4(e), licenses for projects on federal lands that the Congress has reserved for other purposes, such as national forests—or that utilize federal facilities such as dams, outlets, or canals—are subject to terms and conditions established by the head of the land management agency responsible for protecting the lands or facilities.

In addition, section 10(a) of FPA requires FERC to solicit recommendations from federal and state resource agencies and Indian tribes on the terms and conditions proposed for inclusion in a license. Under section 10(j), the license must include conditions for the protection, mitigation, and enhancement of fish and wildlife, which must generally be based on recommendations by federal and state fish and wildlife agencies. Section 18 of FPA requires FERC to include conditions in the license providing for fish passage as prescribed by federal fish and wildlife agencies.

In developing their recommendations on the terms and conditions proposed for inclusion in a license, federal land management and resource agencies must address the requirements of the Clean Water Act, the Endangered Species Act, and several other environmental laws. In addition, decisions to relicense hydropower projects must be made in accordance with the National Environmental Policy Act (NEPA), which requires federal agencies to assess the impacts of proposed actions that may significantly affect the environment. Plans developed under federal land management planning laws may also affect relicensing, principally by serving as a basis for specifying conditions under section 4(e) of FPA.

The licensing terms and conditions prescribed or recommended by FERC and federal and state land and resource agencies may call for minimum water flows, the construction of fish passage facilities, or the installation of screens and other devices to prevent fish from being injured or killed. They may also limit reservoir drawdowns and require the purchase and restoration of lands affected by projects.

Traditional and Alternative Relicensing Processes

FERC's traditional relicensing process includes seven steps that we have grouped into two phases. (See app. I.) The first—the notification phase—begins about 5 to 5-1/2 years before a project's license expires, when the licensee notifies FERC of its intent to seek relicensing. During this phase, the licensee must consult with federal and state land and resource agencies, which must identify studies that they believe should be undertaken to determine the project's impacts on fish and wildlife, recreation, water, and other resources. If the licensee disagrees with the need to conduct a study, either party may ask FERC to resolve the dispute. After completing agreed-upon studies, the licensee prepares a draft application and obtains comments from, and attempts to resolve any disagreements on, needed actions with the relevant federal and state agencies.

The second phase in the traditional process—the application phase—begins when the licensee files a formal application to seek relicensing. This filing must occur at least 2 years before the license expires. The application is a comprehensive, detailed document that specifies the project's proposed operations, its anticipated impacts on resources and other land uses, and proposed actions to mitigate adverse effects. FERC reviews the application to ensure that it meets all requirements and then asks relevant federal and state land and resource agencies to formally comment on it. Depending on the comments, FERC may ask the licensee to provide

additional data and studies. When FERC is satisfied that these are sufficient, it conducts an environmental analysis under NEPA. After completing its environmental analysis, FERC negotiates with federal and state fish and wildlife agencies on recommendations to mitigate the project's impacts on these resources. In addition to using FERC's NEPA analysis, federal land and resource agencies frequently conduct separate environmental analyses under NEPA or assessments under other laws to determine the license terms and conditions they will prescribe or recommend to protect and enhance resources.

In recent years, the traditional relicensing process has often proved to be lengthy and acrimonious. As a result, in 1997, FERC issued regulations creating an alternative relicensing process. Termed the collaborative process, it is intended to (1) speed relicensing by combining many of the earlier consultations and studies with the later environmental reviews and (2) reduce acrimony by improving communication and collaboration among the participants in the process. The licensee may choose the alternative process if it can demonstrate that the participants agree on its use.

Requirements Related to the Recovery of Administrative Costs

Section 10(e) of FPA requires licensees to pay reasonable annual charges in amounts fixed by FERC to reimburse the United States for, among other things, the costs of FERC's and other federal agencies' administration of the act's hydropower provisions. These costs include those related to licensing and relicensing projects and to monitoring them after relicensing, as established in agreements reached through the collaborative process. In fixing these and other section 10(e) charges, FERC must seek to avoid increasing the price of power to consumers. FERC has recognized that any increase in charges may have an impact on consumers and interprets this provision to prohibit the assessment of unreasonable charges that would be passed along to consumers.²

²52 Fed. Reg. 18265.

The Office of Management and Budget's (OMB) *Circular A-25-User Charges* (Circular A-25)—which provides guidance to federal agencies in setting fees—calls for full cost recovery to the extent permitted by law, including the recovery of all unfunded retirement costs. In addition, in 1995, the Federal Accounting Standards Advisory Board—a body jointly established by the Department of the Treasury, OMB, and GAO to consider and recommend accounting principles for the federal government—issued a new standard (number 4) on the concept of full cost recovery, including the recovery of all indirect (overhead) costs.³

Millions of Dollars a Year in Federal Costs to Administer the Hydropower Program Are Not Being Recovered

For fiscal years 1995 through 1998, federal agencies reported a total of about \$32 million in hydropower-program-related administrative costs. However, on the basis of our review, we estimate that for the 4 fiscal years, about \$12 million in federal costs to administer the hydropower program either were not reported or may not be recovered because of appeals by licensees. According to agency officials with whom we spoke and documents that we obtained, costs were not reported, in part, because some federal agencies that incurred costs to administer the hydropower program (1) did not report any costs for any year to FERC; (2) reported costs in some years but not in other years; (3) did not report certain indirect costs (overhead), including unfunded future federal pension and postretirement health and/or program-related legal costs; and/or (4) could not determine their costs. In addition, our analysis of the agencies' cost data showed that some of the \$32 million in costs that were reported have been withdrawn or may be not recovered because they cannot be adequately supported. We traced these problems to (1) FERC's failure to provide clear guidance to the other federal agencies about what costs are recoverable and (2) the agencies' failure to improve their financial management and reporting systems to accurately account for the costs that they report. Agency officials expect the federal costs of administering the hydropower program to increase substantially as more and larger projects approach their dates for relicensing and as federal agencies take on additional responsibilities resulting from recent changes in the relicensing process. As a result, we estimate that tens of millions more dollars may not be recovered over the next decade unless corrective action is taken.

³*Managerial Cost Accounting Concepts and Standards for the Federal Government: Statement of Federal Financial Accounting Standard Number 4*, Federal Accounting Standards Advisory Board (Washington D.C.: July 1995).

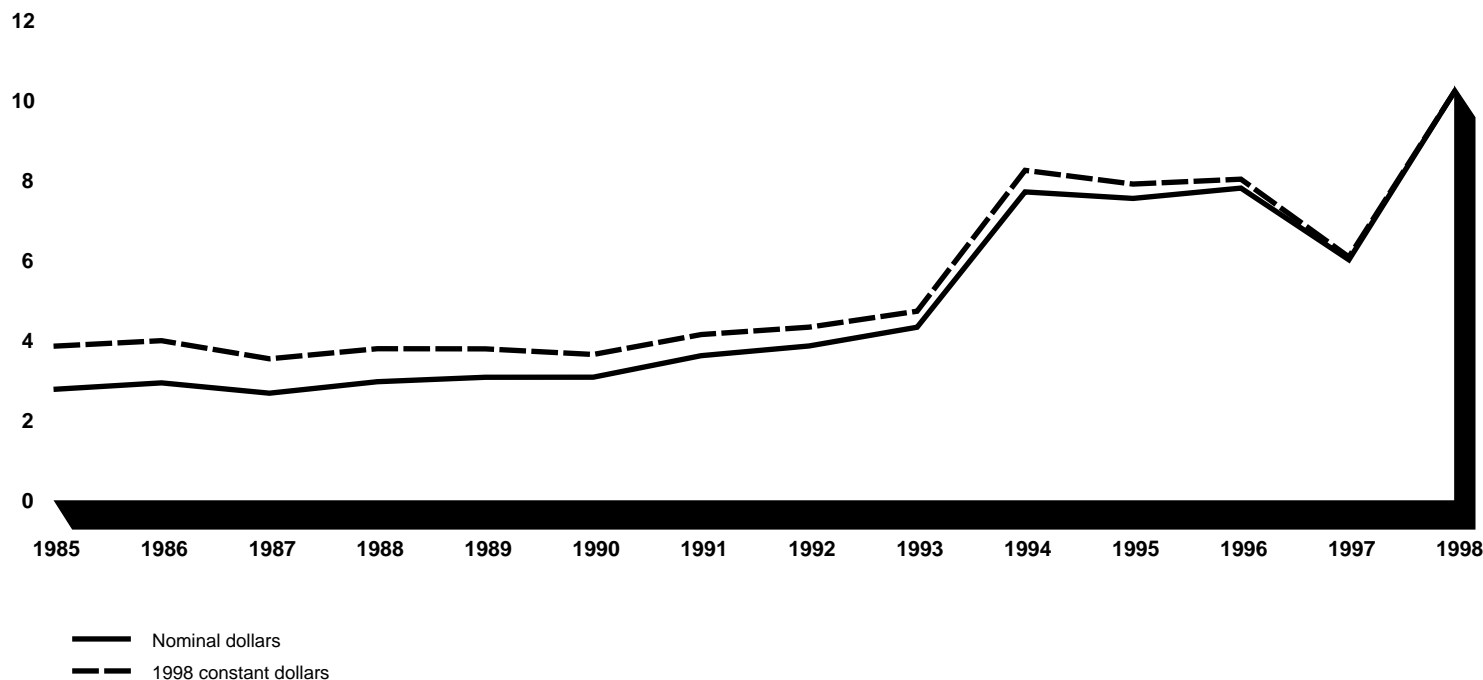
Many Administrative Costs Have Not Been Reported

In 1985, the Department of Energy's Inspector General observed that, although FERC had been annually billing licensees for its own administrative costs, it had not been billing them for the administrative costs incurred by other federal agencies.⁴ Accordingly, in fiscal year 1986, FERC began annually billing licensees for the prior fiscal year's administrative costs reported to it by other federal agencies. These agencies have, in different years, included the Forest Service in the Department of Agriculture; the National Marine Fisheries Service in the Department of Commerce; the Corps of Engineers in the Department of Defense; the Environmental Protection Agency; and the Bureau of Land Management, the Bureau of Reclamation, the Bureau of Indian Affairs, the Fish and Wildlife Service, and the National Park Service in the Department of the Interior. Interior's Office of the Solicitor has also provided data on its costs.

For fiscal years 1995 through 1998, federal agencies reported about \$32 million in hydropower-program-related administrative costs. (See fig. 1.) However, other administrative costs were not reported.

⁴*Assessment of Charges Under the Hydropower Licensing Program* (DOE/IG-0219, Sept. 18, 1985).

Figure 1: Federal Agencies' Hydropower-Program-Related Administrative Costs Reported to FERC, Fiscal Years 1985-98
Dollars in millions



Source: GAO's presentation of data from FERC.

Some federal agencies did not report any of their administrative costs to FERC. For example, Interior officials estimate that the National Park Service incurs costs of about \$200,000 a year to administer the hydropower program but never reports these costs to FERC. Similarly, an Environmental Protection Agency official estimates that the agency incurs annual costs of tens of thousands of dollars a year for the same purpose but never reports the costs to FERC. Officials from both agencies said they considered the amounts to be too small for them to account for and report to FERC. By contrast, both the Bureau of Land Management and the Bureau of Reclamation have annually reported comparable or smaller costs.

Other federal agencies reported their hydropower-program-related costs in some years but not in others. For instance, the Forest Service—which reported an average of about \$2.7 million a year for fiscal years 1996 and 1998—did not report any costs for fiscal year 1997. According to the

agency's national hydropower program coordinator, fiscal year 1997 "slipped through the cracks" because her position was vacant. Similarly, the Bureau of Indian Affairs did not report \$2.4 million in fiscal year 1995 costs until fiscal year 1997, or a year after it should have reported the costs to FERC. According to Bureau officials, the need to report its costs to FERC got lost as a result of personnel changes.

When agencies reported their costs, they often did so inconsistently. For example, the Bureau of Indian Affairs included indirect costs (overhead) for fiscal years 1995 and 1996, but not for fiscal year 1997. Similarly, the Fish and Wildlife Service reported indirect costs for some, but not all, of its regional offices in both fiscal years 1996 and 1997. Both agencies attributed the inconsistencies to the low priority given to accounting for and reporting these costs.

Moreover, while FERC included unfunded future federal pension and postretirement health benefit costs as recoverable indirect costs, the other agencies did not, even though those benefits will have to be paid by the federal government in future years. According to officials from these agencies, they had never been advised to include these costs. In 1996, we reported that the cost of future pension benefits was about 11 percent of the salaries of employees in the federal government's Civil Service Retirement System and that postretirement health benefits were estimated to be \$2,000 per year per employee.⁵

Agencies also reported their legal costs inconsistently. On the one hand, FERC included its legal costs, and the Department of the Interior reported the costs its Office of the Solicitor incurred in providing legal advice on hydropower-program-related activities to the five Interior agencies that are involved in administering the program. On the other hand, the Department of Agriculture did not report the costs incurred by its Office of General Counsel in providing legal advice to the Forest Service on such activities.

Other administrative costs that should have been reported were not because they could not be determined. For instance, according to its fiscal year 1998 budget justification, the Forest Service planned to spend about \$10 million on hydropower-program-related activities. However, the agency reported less than \$4.5 million to FERC. According to Forest Service

⁵*Power Marketing Administrations: Cost Recovery, Financing, and Comparison of Nonfederal Utilities* (GAO/AIMD-96-145, Sept. 19, 1996).

officials, a large but indeterminate portion of the remaining more than \$5.5 million was spent on hydropower-program-related activities but charged to other programs and activities. Similarly, the Bureau of Reclamation said it could not determine the hydropower-program-related costs incurred in its Pacific Northwest region for fiscal years 1996 and 1997 because these costs were intermingled with a variety of other expenditures in a single account. In addition, the Bureau of Land Management estimated that it did not report as much as \$250,000 in administrative costs to FERC for fiscal year 1999—a year that was outside the period covered by our review.

Some Administrative Costs That Have Been Reported May Not Be Recovered

Of the \$32 million in hydropower-program-related administrative costs reported by federal agencies for fiscal years 1995 through 1998, some may not be recovered. In 1997, hydropower licensees began to challenge certain federal agencies' costs for which they had been billed. In a series of appeals filed with FERC, the licensees asserted that FPA prohibits them from being billed for certain costs, including costs not reported in the appropriate fiscal year, agencies' legal costs, some overhead costs, and costs whose accuracy or sufficiency of documentation they believe FERC did not adequately review.

At the order of an administrative law judge, the Bureau of Indian Affairs submitted additional information on its fiscal year 1995 costs (because its costs were the only ones appealed for that fiscal year) and it and other federal agencies, except FERC, submitted additional information on their costs for fiscal years 1996 and 1997. Some of the agencies revised their earlier submissions to FERC to either add or reduce the amounts reported. For example, the Bureau of Indian Affairs withdrew about \$3.9 million of its initially reported \$6.2 million in costs for fiscal years 1995 through 1997 because it could not adequately support the costs.

In March 2000, counsels for FERC and the appellant licensees negotiated a settlement agreement on the basis of the data and documentation submitted by the federal agencies and jointly proposed that the administrative law judge forward it to FERC's five Commissioners for their consideration. The proposed negotiated settlement would refund to the appellants 77 percent of the final costs submitted by the Bureau of Indian Affairs for fiscal year 1995 and 77 percent of the final costs submitted by the Bureau and other federal agencies for fiscal years 1996 and 1997 without identifying which costs are being disallowed or why.

Lack of Adequate Guidance Contributes to Costs Not Being Reported or Recovered

One of the two reasons for the cost recovery problems that federal agencies have experienced is that FERC has not provided clear guidance to the other federal agencies on what costs should be reported.

In a 1986 report, we identified reporting deficiencies similar to those discussed above and encouraged FERC to ensure the recovery of as many hydropower-program-related administrative costs as possible.⁶ However, in 1987, despite the urging of hydropower industry groups and the Department of the Interior, FERC declined to issue regulations or enter into a memorandum of understanding with other federal agencies on cost recovery because it had not determined that there was a need for formal guidance. Instead, FERC issued one page of guidance to the agencies requesting them to (1) identify their direct and indirect costs and (2) indicate whether these costs were related to projects owned by nonmunicipal utilities or by municipal utilities, which are charged differently.

According to FERC officials, FERC uses OMB Circular A-25 as guidance for reporting its hydropower-program-related administrative costs, and the officials believe that other federal agencies should do so as well. However, FERC's one-page guidance does not mention the circular, and officials from the other federal agencies told us that FERC has never advised them to use it.

FERC officials told us that they have not advised the other federal agencies to use Circular A-25 because they believe that FPA does not provide FERC with the authority to require other federal agencies to use the circular or any other particular standard for identifying and reporting recoverable federal administrative costs under the act. Therefore, they believe it would be inappropriate for them to provide the other federal agencies with guidance on what costs they should report. Rather, FERC has accepted whatever costs are reported by the other federal agencies as the basis for annually billing licensees.

In response to the series of appeals by hydropower licensees, in 1998, FERC asked OMB to provide the other federal agencies with direction on reporting administrative costs and to require them to "certify" the accuracy of their costs. However, in a 1999 meeting with officials from FERC and the

⁶*Energy Regulation: More Effort Needed to Recover Costs and Increase Hydropower User Charges* (GAO/RCED-87-12, Nov. 25, 1986).

other agencies, OMB declined, noting that Circular A-25 and Federal Financial Accounting Standard Number 4 call for full cost recovery to the extent permitted by law.

According to Interior, Forest Service, and National Marine Fisheries Service officials, following the 1999 meeting with FERC and OMB, they had intended to propose guidance to FERC and OMB on recoverable administrative costs and on reporting these costs under FPA but had not done so. However, on the basis of our review, they drafted proposed guidance and, in March 2000, forwarded it to FERC for comment. Licensees have also recommended guidance for FERC to adopt. Whereas the guidance proposed by the agencies calls for reporting all their costs to administer the hydropower program, the guidance recommended by the licensees does not. FERC had not commented on either the agencies' or the licensees' suggestions as of June 1, 2000.

Lack of Adequate Accountability for Costs Also Contributes to Costs Not Being Reported or Recovered

The other reason that the federal agencies have not fully recovered their costs to administer the hydropower program is that they cannot accurately account for these costs.

The responsibility for producing accurate and reliable financial information on their costs to administer the hydropower program rests primarily with each of the federal agencies individually, rather than with FERC or OMB. For example, the Chief Financial Officers Act of 1990, as expanded by the Government Management Reform Act of 1994, calls for strengthening financial accountability and producing more reliable cost and performance information on federal operations.⁷ However, weaknesses in many of the federal agencies' financial management and reporting systems prevent them from accurately accounting for their hydropower program costs. These weaknesses include the inability to accurately report some costs and to adequately document some costs that are reported.

For instance, the National Marine Fisheries Service told FERC that its costs for fiscal year 1996 were "comparable" to its costs for fiscal year 1995 and that FERC should bill licensees for this amount. However, the Service had no system to identify the time its staff spent on hydropower-program-related activities. Instead, in fiscal year 1997, it asked its staff to review their personal daily appointment books for fiscal year 1996 to identify the

⁷See *High Risk Series: An Update* (GAO/HR-99-1, Jan. 1999).

activities and estimate the time spent on each hydropower project. Similarly, to identify the time its staff spent on hydropower-program-related activities, Interior's Office of the Solicitor (1) sampled a week's timesheets for each month in the fiscal year and extrapolated the time to arrive at a monthly estimate for all FERC-related activities and then (2) asked its staff to rely on their memories to separate the time that they spent on hydropower-program-related activities from the time that they spent on other FERC-related activities, such as those related to oil or natural gas pipelines.

**Unreported and
Unrecovered Federal Costs
to Administer the
Hydropower Program Are
Projected to Increase
Substantially**

The effects of the cost recovery problems experienced to date are likely to be exacerbated by projected increases in federal costs to administer the hydropower program. In total, tens of millions more dollars may not be recovered over the next decade unless the problems are corrected.

One reason for these projected increases in federal administrative costs is that the number of hydropower projects to be relicensed in the next decade—including some whose original licenses have already expired—will continue to grow. In addition, per-project federal administrative costs are expected to rise because the proportion of very large projects to be relicensed is growing. On average, the generating capacity of these very large projects is five times greater than that of the projects whose licenses expired in the last 8 fiscal years. Relicensing such large projects will require more complex studies of their likely effects and more extensive reviews by federal agencies of the licensees' applications.

Recent changes in the relicensing process that have increased federal agencies' responsibilities are also expected to drive up their costs to administer the hydropower program, according to agency officials. These changes include (1) the new collaborative relicensing process—which licensees are choosing with greater frequency—that combines many of the earlier consultations and studies with the later environmental reviews and thus requires earlier, more intensive, and more expensive involvement by federal agencies and (2) more intensive monitoring requirements for relicensed projects, as established in agreements reached through the collaborative process. In addition, agency officials stated that a recent court decision will require more substantial analyses to support the terms and conditions that federal land and resource agencies wish to impose on projects in order to protect or enhance resources.

Forest Service officials estimated that, with the projected increases in the number and size of projects approaching their dates for relicensing and the recent changes in the relicensing process, their annual costs to administer the hydropower program could double or triple over the next decade, from about \$10 million to as much as \$30 million a year. Interior and National Marine Fisheries Service officials estimated that their average annual hydropower-program-related costs over the next decade could increase by the same or an even greater multiple for many of the same reasons.

Federal Agencies Cite the Lack of an Incentive to Accurately Account For and Report Their Costs

Currently, FERC deposits licensees' reimbursements of other federal agencies' administrative costs into the U.S. Treasury as a direct offset to its annual appropriation. According to officials from several federal agencies, allowing the agencies to retain licensees' reimbursements of their hydropower program administrative costs would provide a strong incentive for the agencies to accurately account for and report their full costs. The officials noted that the agencies accurately account for similar reimbursements in other programs that they administer when they are authorized to retain reimbursements to cover the costs of providing services. For example, according to the National Marine Fisheries Service,

"...the procedures [the National Marine Fisheries Service] follows for FERC cost reporting are not the same as the procedures it follows for 'reimbursable' tasks. Reimbursable tasks are those for which we are reimbursed in full for our costs for either services or products. These reimbursable tasks are tracked through accounting which is kept separate by task number, with daily and often hourly entries...."

However, agency officials also expressed concern that, if the Congress authorized them to retain licensees' reimbursements of their administrative costs, it might also offset their appropriations by the amounts that they retained. They noted that the reimbursements might not keep pace with the rising costs of relicensing activities. They also expressed concern that this approach would reduce their current flexibility to shift funds between hydropower relicensing activities and other activities funded out of the same budget accounts. Moreover, as we have observed, such an approach to financing agencies' activities raises issues of (1) congressional control over accountability and priority-setting and (2) agencies' management of and competition for limited federal resources.⁸ For instance, allowing federal agencies to retain administrative costs reimbursements reduces the Congress's ability to use these funds for other priorities.⁹

Conclusions

The federal government may forgo tens of millions of dollars over the next 10 years unless FERC provides clear guidance on the costs that are recoverable and other federal agencies improve their financial management and reporting systems to identify and accurately report these costs.

FERC has declined to provide clear guidance on cost recovery because it believes that the need for such guidance has not been determined. Conversely, we believe that the failure to recover about \$12 million in federal costs in just 4 fiscal years clearly establishes such a need. In addition, FERC claims that FPA does not provide it with the authority to require other federal agencies to use OMB Circular A-25 or any other particular standard for identifying and reporting recoverable federal administrative costs under the act. However, FPA does not prohibit FERC from providing other federal agencies with guidance on what costs they should report. Furthermore, other federal agencies have urged FERC to provide such guidance and have even proposed guidance to FERC and OMB.

⁸*Federal User Fees: Budgetary Treatment, Status, and Emerging Management Issues* (GAO/AIMD-98-11, Dec. 19, 1997).

⁹*Forest Service: Barriers to and Opportunities for Generating Revenue* (GAO/RCED-99-81, Feb. 10, 1999).

In addition, all federal agencies that incur costs to administer the hydropower program must ensure that their financial management and reporting systems accurately account for the costs that they report. However, the Congress has options for addressing other federal agencies' administrative cost recovery that it can also consider.

Recommendations to the Federal Energy Regulatory Commission

Because the federal government will likely be at risk of continuing to lose millions of dollars a year until guidance is issued on which other federal agencies' costs are eligible for recovery under the Federal Power Act, we recommend that the Chairman and Members of the Federal Energy Regulatory Commission take the following actions:

- Issue guidance, developed in consultation with the Office of Management and Budget and all affected federal agencies, that specifies what federal administrative costs are eligible for recovery under the Federal Power Act and how these costs are to be reported. This guidance should take into account the Office of Management and Budget's *Circular A-25-User Charges* and Federal Financial Accounting Standard Number 4.
- Report the Commission's progress in developing this guidance in the Commission's fiscal year 2002 budget submission to the Congress in February 2001.
- Report annually to the Appropriations Committees of the Congress any failures by federal agencies to report costs in accordance with the Commission's guidance.

Recommendations to the Secretaries of the Interior, Commerce, and Defense and to the Chief of the Forest Service and the Administrator of the Environmental Protection Agency

Because the federal government will likely also continue to be at risk of losing millions of dollars a year until the agencies produce accurate, timely, and reliable information on their hydropower-program-related administrative costs, we recommend that the Secretaries of the Interior, Commerce, and Defense and the Chief of the Forest Service and the Administrator of the Environmental Protection Agency take the following actions:

- Ensure that their agencies' financial management and reporting systems are capable of producing accurate, timely, and reliable information on hydropower-program-related administrative costs eligible for recovery in accordance with the Federal Energy Regulatory Commission's prospective new guidance.

-
- Report their agencies' progress in improving their systems in their fiscal year 2002 budget submissions to the Congress in February 2001.
-

Matters for Congressional Consideration

Should the Commission not report adequate progress in developing the recommended guidance and/or federal agencies not report adequate progress in improving their financial management and reporting systems in their fiscal year 2002 budget submissions, the Congress may wish to consider directing the Commission and/or the other agencies to accomplish the action(s) by a certain date.

Additionally, the Congress may wish to consider whether to continue to fund the costs incurred by federal agencies (other than the Commission) to administer the hydropower program solely through the annual appropriations process or to allow them to retain licensees' reimbursements to offset some or all of these costs. In doing so, the Congress would need to weigh any benefits that such a provision would provide against the loss of flexibility over the use of the funds.

Agency Comments and Our Evaluation

We provided a draft of this report to Chairman of FERC; the Secretaries of the Interior, Commerce, and Defense; the Chief of the Forest Service; and the Administrator of the Environmental Protection Agency for their review and comment. FERC and the Department of the Interior generally agreed with our findings, conclusions, and recommendations. However, FERC did not indicate in its comments whether it would issue specific guidance identifying which other federal agencies' costs are eligible for recovery under FPA. Instead, it said it would (1) work with the other agencies to clarify the technical requirements of OMB's Circular A-25 and Federal Financial Accounting Standard Number 4 and explain how FERC uses them for determining its own costs and (2) recommend to OMB that OMB convene an interagency group or provide supplemental direction if this is necessary. Federal agencies already have Circular A-25 and Federal Financial Standard Number 4 available to them and, presumably, can currently call FERC staff with questions. Moreover, OMB has already declined to provide additional specific guidance beyond that contained in Circular A-25 and Federal Financial Standard Number 4. Accordingly, the steps FERC proposes do not appear to improve on the present situation, which has resulted in millions of dollars in unrecovered costs. Both OMB Circular A-25 and Federal Financial Standard Number 4 call for full cost recovery, but only to the extent permitted by law. As long as FERC

continues to decline to clarify what costs are recoverable under FPA and how they are to be reported, we do not believe the problems we have identified will be resolved. Because FPA assigns the responsibility of fixing annual charges to FERC, not OMB or any other entity, FERC is the agency in the best position to clarify the ambiguities that have plagued federal hydropower program cost recovery efforts. FERC's comments and our responses appear in appendix III.

Interior agreed with our report's conclusions and recommendations on FERC's providing additional guidance but raised concerns about some matters discussed in our draft report and made a number of technical suggestions, which we incorporated where appropriate. These concerns and suggestions, together with our responses to them, appear in appendix IV.

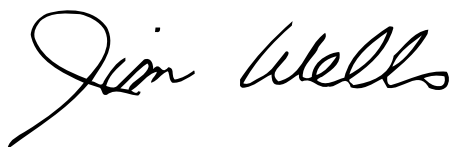
The Environmental Protection Agency and the Department of Defense's Corps of Engineers told us they had no comments. We did not receive comments from the Department of Agriculture's Forest Service or the Department of Commerce's National Marine Fisheries Service in time for inclusion in our report.

We conducted our work from August 1999 through June 2000 in accordance with generally accepted government auditing standards. Appendix II contains the details of our scope and methodology.

We are sending copies of this report to Representative Norm Dicks, Ranking Minority Member of the Subcommittee on Interior and Related Agencies, House Committee on Appropriations; the Honorable James Hoecker, Chairman, Federal Energy Regulatory Commission; the Honorable Bruce Babbitt, Secretary of the Interior; the Honorable Mike Dombeck, Chief of the Forest Service; the Honorable William M. Daley, Secretary of Commerce; the Honorable William S. Cohen, Secretary of Defense; and the Honorable Carol Browner, Administrator, EPA. We will also make copies available to others on request.

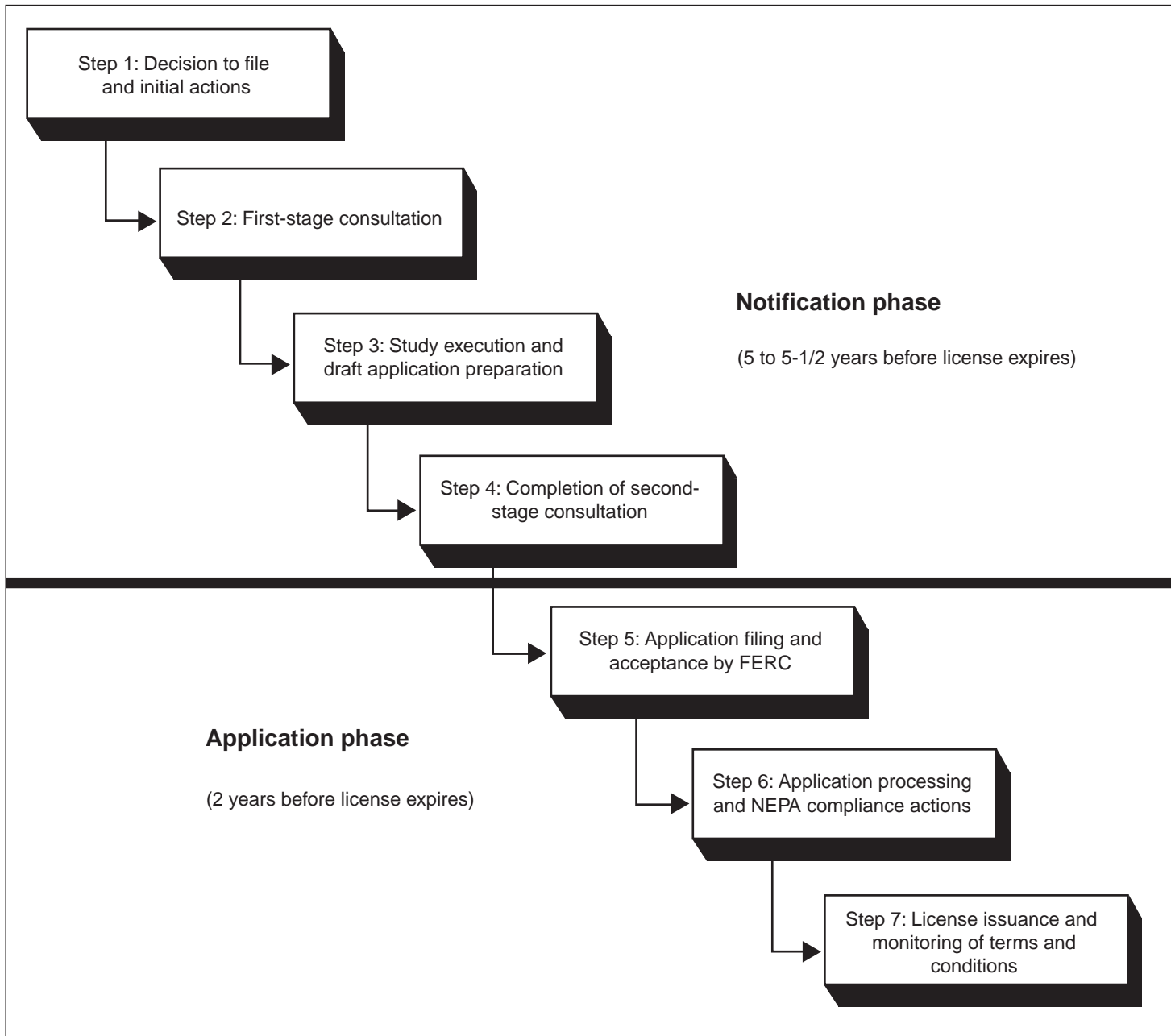
If you have any questions about this report, please call me or Charles S. Cotton at (202) 512-3841. Key contributors to this report are listed in appendix V.

Sincerely yours,

A handwritten signature in black ink that reads "Jim Wells". The signature is written in a cursive, flowing style.

Jim Wells
Director, Energy, Resources
and Science Issues

FERC's Traditional Relicensing Process



Source: GAO's adaptation of data from FERC.

Objectives, Scope, and Methodology

Concerned about increasing costs and controversies related to federal agencies' hydropower relicensing activities, the Chairman, Subcommittee on Interior and Related Agencies, House Committee on Appropriations, asked us to identify and assess significant issues related to nonfederally owned and operated hydropower projects. In this report, we assess the status of efforts to recover the costs incurred by federal agencies to administer the hydropower program.

In conducting our work, we reviewed relevant provisions of the Federal Power Act, as amended (FPA); the Federal Energy Regulatory Commission's (FERC) implementing regulations, the Office of Management and Budget's (OMB) Circular A-25, and Federal Financial Accounting Standard Number 4. We also met and discussed this issue with OMB and Federal Accounting Standards Advisory Board officials. In addition, we interviewed and obtained documents from FERC headquarters officials, as well as from headquarters and field officials in nine other federal agencies that incur hydropower program costs. We also reviewed the cost data that these agencies filed with the administrative law judge assigned to hear the licensees' challenges of the administrative costs reported to FERC by certain agencies in fiscal years 1995, 1996, and 1997 and total costs reported in fiscal year 1998. In addition, we discussed the appeals and the data filed with the judge with counsels for FERC and the licensees. We did not, however, independently verify the accuracy and completeness of these data or the weaknesses of the accounting systems that may have led to inadequacies in them. We also did not independently verify the reasonableness of the agencies' projections of likely future increases in such costs. Our report does not address the appropriateness of the federal agencies' expenditures but considers only the adequacy of efforts by FERC and the other agencies to recover costs they have incurred.

We attended a 3-day interagency training course on hydropower relicensing, which included presentations by representatives of industry and environmental groups, and a 4-day annual conference of the National Hydropower Association, which was devoted in large part to relicensing issues. In addition, we met with and obtained documents from participants in various federal government, industry, and environmental groups, including the Interagency Task Force on Hydropower, the Electrical Power Research Institute, and the Hydropower Reform Coalition. We also visited six hydropower projects in four western states (California, Idaho, Montana, and Oregon) and discussed their operations and relicensing with project staff. In addition, we spoke with representatives from FERC, other federal agencies, states, environmental groups, and hydropower licensees about

relicensing issues related to several other projects that we did not visit in these and other states.

We conducted our work between August 1999 and June 2000 in accordance with generally accepted government auditing standards.

Comments From the Federal Energy Regulatory Commission

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

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, DC 20426

OFFICE OF THE CHAIRMAN

JUN 14 2000

Mr. Jim Wells
Director, Energy, Resources, and Science Issues
Resources, Community, and Economic Development Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Wells:

Thank you for your letter of May 25, 2000, forwarding a copy of your draft report, *Hydropower Relicensing: Federal Costs Are Not Being Recovered* (GAO/RCED-00-107), and inviting comment on it.

As the draft report indicates, the Commission has been billing licensees for costs associated with other federal agencies' activities in implementing Part I of the FPA since 1986. The Commission each year solicits information from other federal agencies on their costs, with directions on how to report cost information. Moreover, Commission staff initiated discussions with OMB on accounting guidance on other agency costs in early 1999. The report recommends that the Commission provide additional guidance to the other federal agencies on how to account for their costs of administering Part I of the Federal Power Act. While this accounting guidance is applicable to federal agencies by its own terms, the Commission staff will provide the other agencies with copies of OMB Circular A-25 and Federal Financial Accounting Standard Number 4, which explain the requirements to fully recover all costs and to treat unfunded future pension and post-retirement health benefit costs as recoverable indirect costs. The Commission staff will also provide the other agencies with examples of how the Commission applies these requirements with respect to the accounting of its own costs.

As the report notes, the Commission staff has pursued ongoing discussions with the Department of the Interior, the U.S. Forest Service, the National Marine Fisheries Service, and the Office of Management and Budget (OMB) regarding procedures and standards to be applied by the other Federal agencies, particularly with respect to certification of costs and designation by the agencies of which of their costs (including indirect and overhead costs) are attributable to municipal and non-municipal licensees. The Commission staff stands ready to provide further technical assistance to the other

See comment 1.

See comment 1.

**Appendix III
Comments From the Federal Energy
Regulatory Commission**

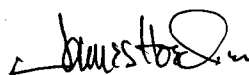
- 2 -

agencies, and will recommend to OMB that it convene an interagency group or provide supplemental direction if necessary to facilitate this process.

I cannot comment on the settlement negotiated two by licensee groups and Commission trial staff in the administrative hearing before a Commission administrative law judge (see the draft report at pages 11-12), because the settlement is currently pending before the Commission for decision. The trial staff is independent, and does not advise the Commission on this matter.

If I can be of further assistance on this or any other Commission matter, please let me know.

Sincerely,

A handwritten signature in black ink, appearing to read "James J. Hoecker", with a stylized flourish at the end.

James J. Hoecker
Chairman

The following is GAO's comment on the Federal Energy Regulatory Commission's letter dated June 14, 2000.

GAO Comment

1. Federal agencies already have the OMB and Federal Financial Standard Number 4 guidance documents available to them and, presumably, can currently call FERC staff with questions. Moreover, OMB has already declined to provide additional specific guidance beyond that contained in Circular A-25 and Federal Financial Standard Number 4. Accordingly, the steps FERC proposes do not appear to improve on the present situation, which has resulted in millions of dollars in unrecovered costs. Both OMB Circular A-25 and Federal Financial Standard Number 4 call for full cost recovery, but only to the extent permitted by law. As long as FERC continues to decline to clarify what costs are permitted to be recovered under FPA and how they are to be reported, we do not believe the problems we have identified will be resolved. Because FPA assigns the responsibility of fixing annual charges to FERC, not OMB or any other entity, FERC is the agency in the best position to clarify the ambiguities that have plagued federal hydropower program cost recovery efforts.

Comments From the Department of the Interior

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



United States Department of the Interior

OFFICE OF THE SECRETARY
Washington, D.C. 20240



JUN 15 2000

Mr. Jim Wells
Director, Energy, Resources,
and Science Issues
U.S. General Accounting Office
441 G Street, NW
Washington, DC 20548

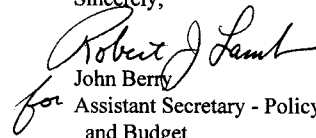
Dear Mr. Wells:

This is in response to the General Accounting Office Draft Report, "HYDROPOWER RELICENSING: Federal Costs Are Not Being Recovered" (GAO/RCED-00-107).

Overall we agree with the report's conclusions and recommendations that the Federal Energy Regulatory Commission (FERC) has not provided Federal agencies required to complete reviews of FERC licenses and re-licenses with adequate guidance regarding the various costs that should be reported. However, the Department is concerned with some of the findings in the draft report. Comments and technical corrections made by the individual bureaus are enclosed.

We appreciate the opportunity to review and comment on this draft GAO report.

Sincerely,


John Berry
for Assistant Secretary - Policy, Management
and Budget

Enclosure

ENCLOSURE

U.S. Department of the Interior
Comments on "HYDROPOWER RELICENSING: Federal Costs Are Not
Being Recovered" (GAO/RCED-00-107)

Bureau of Reclamation

The FERC guidelines provided to Reclamation use the term "costs" without further definition as to what should be included in the reported costs. This could result in the omission of some Reclamation costs associated with FERC license reviews and places an additional burden on the Federal power rate payers. Reclamation and Federal power marketing administrations are required by statute to recover all "reimbursable" costs associated with the generation and transmission of Federal power. Consequently, costs associated with FERC license reviews that have not been previously reported are included in the cost base used by the Federal power marketing administrations to develop Federal power rates.

Reclamation believes that FERC should consult with the Office of Management and Budget (OMB) and the other relevant Federal resource agencies to determine the specific costs data required by FERC so that it may charge appropriate licensing fees to dam owners and operators. Once such guidelines are established, OMB should issue a memorandum which instructs and directs all affected Federal agencies on how to consistently identify, record and report all appropriate costs incurred from activities associated with implementing Part I of the Federal Power Act. This would facilitate the retrieval and reporting of all related licensing costs in a complete, consistent, and timely manner.

Page 4, second paragraph under Requirements Related Relicensing. This section discusses FERC's authority under section 4(e) of the Federal Power Act to issue licenses on Federal lands, subject to terms and conditions established by the land management agency responsible for protecting such lands. It should be noted that under section 4(e), Federal agencies also establish terms and conditions related to non-Federal hydropower developments that utilize Federal facilities such as dams or canals. Such Federal facilities are not normally included within the licensed project boundaries. The last sentence of that second paragraph would be more accurate if restated as follows: "Under section 4(e), licenses for projects that are located on Federal lands or that utilize Federal facilities, such as dams, outlets, and canals are subject to terms and conditions established by the agency responsible for protecting such lands or facilities."

Now on p. 6.

See comment 1.

Page 2

Now on p. 20.

See comment 2.

Page 19, second paragraph under Matters for Congressional Consideration. A statement is made that "... Congress may wish to consider whether to continue to fund the costs incurred by federal agencies (other than the Commission) to administer the hydropower program through the annual appropriations process or to allow them to retain licensees' reimbursements to offset the costs." Reclamation believes that prior to making such a determination, further information may be needed on agency disbursements of other revenues received under section 17 of the Federal Power Act to determine if such revenues might be applied to agency administration efforts.

U.S. Fish and Wildlife Service

The Report characterizes that there are millions of dollars being wasted by agencies due to poor cost accounting procedures. We do not believe the characterization applies to the Service. Funds appropriated to the Service are spent appropriately on FPA activities as Congress intended. The agencies may not account for every cent spent for the purposes of cost recovery reporting, however, it is unfair to imply that taxpayer's money was wasted. We also agree with the statement in the report that lack of adequate guidance from FERC on what costs should be reported contributes to these non-reported costs, and is the main reason for cost reporting inconsistencies. We have recently been working with the Department to develop reporting guidelines for the submission of FERC cost information that will provide reporting consistency across the agency.

Now on p. 3.
See comment 4.

Page 1, revise the 3rd and 8th sentences regarding the number on nonfederally owned hydropower projects to: "about 1600 nonfederally owned and operated (FERC licensed) projects."

Now on p. 6.
See comment 5.

Page 3, revise the last sentence to read: "It is comparatively inexpensive to produce, can be increased quickly in periods of peak demand, and produces no air pollution or radioactive wastes." The Service does not agree that hydropower is a renewable energy source because it results in many irretrievable and irreversible commitments to river resources.

Now on p. 6.
See comment 6.

Page 4, revise the second full sentence to read: "For example, projects may prevent fish from moving upstream or downstream...."

Now on p. 7.
See comment 7.

Page 5, in Traditional and Alternative Relicensing Processes, remove: "If the licensee disagrees with the need to conduct a study, either party may ask FERC to resolve the dispute." This sentence is not relevant in this report and should be removed. The statement would require further explanation for better understanding of the issue.

Now on p. 8.
See comment 8.

Page 6, change the 6th sentence to read: "In addition, some Federal land and resource agencies may conduct separate environmental analyses under NEPA or assessments under other laws and/or utilize FERC's NEPA assessment of project impacts to determine ..."

Page 3

See comment 9.

Page 11, delete or further clarify the statement about the Service withdrawing costs for FY96 and FY97. The Service did not withdraw any costs and believes this statement to be inaccurate.

See comment 10.

Page 19, regarding the recommendation, we believe it would be difficult to support ongoing agency hydropower activities solely on licensees reimbursements because of the uncertainty associated with an inconsistent funding source.

Bureau of Land Management

See comment 11.

Page 1, 3rd paragraph verify that the figure "120" is correct; BLM was of the belief that 175 projects on Federal lands were up for relicense over the next 10 years.

Now on p. 6.
See comment 12.

Page 4, 2nd paragraph under "Requirements" subheading: Add the word "reserved" before the word "federal" in the 3rd sentence. Perhaps a statement also should be made that 4(e) conditions only apply if they affect an action which would impact the purpose for which the reservation was made.

The following are GAO's comments on the Department of the Interior's letter dated June 15, 2000.

GAO Comments

1. We added clarifying language in our report to this effect.
2. We agree that such information, among other factors, may be useful to consider for the purpose of making a determination on how best to fund the hydropower program.
3. We revised our report to state explicitly that it does not address the appropriateness of federal agencies' hydropower program expenditures but considers only the adequacy of efforts by FERC and the other agencies to recover the costs they have incurred.
4. About 600 of the 1,600 projects referred to by the Fish and Wildlife Service are exempt from licensing under FPA largely because of their small size, leaving about 1,000 licensed projects. We have clarified the language in our report to make clear that our report is generally focused on the licensed projects whose consideration results in the bulk of federal expenditures.
5. Our reference to hydropower as a renewable source of energy is intended as a narrow, descriptive one, based solely on its reliance on naturally occurring rainfall for energy production, and is used without consideration of any effects that projects might have on other resources or potential alternative uses of those resources.
6. We incorporated this change.
7. We believe the statement adequately serves the limited purpose for which it is included—providing background information on significant steps in the relicensing process as described in the *FERC Hydroelectric Project Relicensing Handbook*.
8. We added the information that agencies use FERC's environmental analyses to determine conditions they should impose for protecting federal lands and facilities.
9. We deleted this statement and made appropriate changes to other sections of the report.

10. We did not intend to suggest that retained payments covering prior years' administrative costs should be the only source of funding for the agencies' subsequent hydropower program activities. Our report notes likely increases in the agencies' hydropower program costs over the next decade, and nothing would prevent the Congress from supplementing those retained funds as it sees fit. Nonetheless, we modified our draft report to clarify that the Congress may wish to consider the payments covering prior years' administrative costs as the source of either some or all of the funding for the agencies' hydropower activities. The Congress could then consider the agencies' need and diligence in cost recovery as criteria for annual appropriations.
11. The source of our data is FERC. Differences between the numbers may relate to the inclusion or exclusion of exempted projects that may also be scheduled for consideration (see comment 1). However, we were unable to determine the cause for the difference because the Bureau of Land Management did not indicate the source of its data.
12. We added language to clarify the description of section 4(e).

GAO Contacts and Staff Acknowledgments

| | |
|-----------------|--|
| GAO Contacts | Jim Wells, (202) 512-3841 |
| | Charles S. Cotton, (202) 512-3841 |
| Acknowledgments | In addition to those named above, Alan Dominicci, Leanne Flama, Richard P. Johnson, Chester Joy, Jon Ludwigson, and George Senn made key contributions to this report. |

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