



UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

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GENERAL GOVERNMENT
DIVISION

B-180229

April 6, 1979

Views on the Benefits of The Federal Trade Commission's

LB Program

The Honorable Michael Pertschuk
Chairman, Federal Trade Commission

AGC 00059

Dear Mr. Pertschuk:

On January 10, 1979, we accepted your agency's request for review and clearance of an extension without change of the Line-of-Business (LB) Form, pursuant to section 409 of Public Law 93-153. The LB form is to be used by the Federal Trade Commission in its collection of line-of-business data for respondents' 1977 fiscal years. During our review, your staff agreed to extend our decision date to March 12, 1979.

We find that the information sought in the proposed 1977 LB form is not presently available from other Federal sources and that the respondent burden has been minimized, consistent with the stated needs of the Federal Trade Commission. Therefore, we are approving the 1977 LB form for use. *AGC 00059*

When the LB form is printed and sent out by your agency, it should carry the following information on the first page:

Approved by GAO
B-180229 (R0048)
Expires 79-12-31

This clearance information was provided verbally to your staff on March 12, 1979. We ask that a copy of the form containing our clearance information be sent to the Regulatory Reports Review Staff.

This is the fourth time that we have reviewed and approved the LB form. Completion of the data collection for respondents' 1977 fiscal years will provide the Federal Trade Commission with four complete rounds of data. Consequently, we believe the Commission needs to begin assessing the benefits of the LB Program against its costs. Our views on this issue are set forth below.



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SUMMARY

A major purpose of the Line-of-Business Program is to collect and publish aggregated financial data from a sample of the Nation's largest businesses. We have closely monitored the Federal Trade Commission's efforts in developing and implementing the LB form for the past 5 years. During that time, the LB Program has been involved in litigation. Primarily because of that litigation, no LB reports have been published and none of the program's objectives have been achieved.

The recent completion of the litigation resolved the legal issues in favor of the Federal Trade Commission. However, the ultimate usefulness and reliability of the LB reports in relationship to the program's costs have not been determined. Although the Federal Trade Commission believes the value of the data will justify the program's costs, there is no systematic plan for resolving this management issue.

We believe the Federal Trade Commission should begin developing a plan for determining if the benefits of the LB Program justify its total costs, including the compliance costs to respondents.

Our observations, conclusions, and recommendations are based on four reviews of the LB form under the provisions of Public Law 93-153, which amended the Federal Reports Act. These reviews included evaluating formal comments of many respondent corporations. We also reviewed the Federal Trade Commission's implementation of the LB Program at its Washington, D.C., offices.

LB PROGRAM OBJECTIVES ARE
COMPREHENSIVE AND COMPLEX

The Federal Trade Commission has cited two specific developments as factors underlying the need for LB data.

- The serious loss of information on industrial performance caused by the sharp upward trend of corporate diversification during the 1960s and the great increase in corporate mergers.
- The Commission's efforts to improve the effectiveness of its law enforcement resource allocations for antitrust and consumer protection through industry-wide investigations.

These broad requirements were largely a result of the Congress' concern over the need for data on economic concentration in an era of massive corporate mergers. Building on these requirements, the LB Program was designed to collect financial data from a sample of the Nation's largest corporations, aggregate the data, analyze the results, and publish reports showing revenues, costs, profits, and related information on a "line-of-business" or product-line basis.

The LB Program objectives are comprehensive and complex. The annual reports to be produced by the program are to serve a variety of needs and users. Some of those needs and users are internal to the Commission, but many including those of the Congress, are external to it.

According to the Commission, the LB reports are to achieve the following specific objectives:

- Enhance the Commission's insight into how well competition is functioning in major industries and permit the Commission to effectively allocate its enforcement resources.
- Contribute to the ongoing program of industry studies in the Commission's Bureau of Economics.
- Provide a data base of unprecedented richness for economists.
- Provide industrial decisionmakers with better data to identify industries in which competitive entry has been insufficient.
- Aid company executives in judging their own performance against industry-wide averages.
- Provide investment analysts and investors with valuable information in selecting investment opportunities.

LB PROGRAM OBJECTIVES
HAVE NOT BEEN ACHIEVED

No LB reports have been published and, despite several years of effort and the expenditure of substantial sums of Federal and respondent corporation funds, none of the LB Program's objectives have been achieved.

The principal reason for the lack of success has been litigation by respondent firms which challenged the Commission's authority to collect LB data, questioned the confidentiality protections provided, asserted that compliance costs were excessively burdensome, and said that LB reports would be unreliable and have little, if any, usefulness.

The courts ruled in favor of the Commission on all of these issues, resolving any question of its authority to collect LB data. The courts concluded that the Commission's confidentiality rules and procedures were adequate. With respect to the issues of "relevance" and "burdensomeness," the courts determined that LB data "****is reasonably relevant to the Commission's general purpose****" and that "****the costs of compliance were de minimus relative to the overall corporate operating budgets."

The courts' decisions resolved the legal issues surrounding the LB Program and cleared the way for the Commission to proceed with the program. We believe these decisions have created the proper climate for determining whether the benefits of the LB Program justify its total costs.

UNRESOLVED ISSUES:
LB PROGRAM COSTS AND BENEFITS

The burden (cost) imposed on respondents by the LB form and the question of the reliability and usefulness of the LB reports have been central issues in the long-running controversy surrounding the LB Program. Before completion of the litigation, it was not feasible to begin the steps necessary to resolve these issues. Now that litigation is complete, we believe that the obstacles have been removed and that the Commission can start developing a plan for resolving the issues.

LB Program costs

The LB Program is somewhat unusual in that major program costs are borne by the private sector respondents in providing the required data. Public sector costs--those borne by the Commission in developing and implementing the program--are substantial but have not been a major source of controversy.

To illustrate, the Commission estimates that its total LB Program costs for the five-year period ended September 30, 1978, were about \$1.2 million. In contrast, using the Commission's estimates, respondents' costs for filing the four annual LB forms due during this period could total over \$37 million.

The \$37-million figure is based on the Commission's estimate of average annual cost per respondent. Therefore, the respondents' actual costs could be higher or lower, depending on the nature and organization of the companies, the structure of the accounting systems in place, and the willingness to use estimates in providing the required data. Nevertheless, the major cost component of the LB Program is that portion borne by the respondents.

Differing views on
LB Program costs

The Commission and many respondents have held widely differing views on the costs of providing LB data. Respondents have asserted that the Commission has understated what it will cost them to provide the required data. The Commission, on the other hand, believes that its cost estimate is accurate, if respondents are willing to use estimates in preparing LB data where appropriate.

The Commission's most current estimate of average respondent burden, submitted to us in support of the 1977 LB data collection, is 960 hours. The Commission estimates that the average cost is \$24,000 per respondent.

The Commission stated that this estimate assumed that:

***many firms should be able to complete the form for well under \$10,000. For a few very large and diversified corporations, the cost of compliance could be as high as \$75,000 to \$100,000 assuming that the opportunity to use well-informed estimates is exploited where appropriate." (Commission's emphasis.)

To support the validity of its estimate, the Commission cites a 1977 survey of 30 firms which filed the 1974 LB form. Of the 17 firms responding, the Commission stated that the costs ranged from \$1,500 to \$100,000--all within the range established by the Commission.

Five of the respondents involved in the litigation, however, provided estimates which were higher than that of the Commission. These five estimates ranged from \$150,000 to as high as \$3 million. The District Court noted that these companies' estimates were probably not representative of all the companies required to file LB reports. The Court also found that the \$3 million estimate was not substantiated and did not regard it as a valid figure. The Court further believed the other estimates,

ranging from \$150,000 to \$700,000, were also overstated, primarily because they appeared to be based on providing higher-quality data than required by the Commission's LB form instructions.

We believe that the crucial factor in resolving this issue is that about 40 percent of the LB respondents had not actually provided LB data. Now that the litigation is complete, these firms will acquire actual experience in compiling the required data and, as a result, should be able to document the compliance costs. Clearly, respondents' actual compliance costs will depend on their willingness to provide estimates and unaudited data as allowed by the LB form instructions.

LB Program benefits

Many respondents have argued from the earliest stages of the LB Program that LB reports would not, and could not, provide useful and reliable data. The Commission, on the other hand, maintains that the LB reports can provide useful and meaningful data and can meet the program's objectives.

The reasons for these divergent views are complex, technical, and subject to differing explanations by experts in the field of financial reporting and economic analysis. An in-depth treatment of the views of the Commission and respondent corporations is beyond the scope of this report. We will attempt to briefly summarize the opposing views in the following paragraphs.

Differing views on LB Program benefits

The LB Program is based on the concept that financial data can be collected from individual companies on a "line-of-business" basis and then aggregated in such a way that the resulting figures are meaningful in terms of an economic market for a given product or group of products. In general, a company which produces multiple products must separate its revenues, expenses, and profits for each line-of-business and recompute them as if each line-of-business was a separate company. The data for each company's lines-of-business are then combined by the Commission with similar lines-of-business supplied by other companies producing products in the same industry category.

The controversy between respondents and the Commission about the reliability and usefulness of LB data has centered around two points:

--The classification system used to define lines-of-business.

--The accounting procedures used in compiling line-of-business data.

Respondents have argued that the classification system used by the Commission does not define economically meaningful lines-of-business or markets. They also have argued that the widely varying accounting procedures used by different companies in compiling line-of-business data cannot result in data which are comparable between companies--a basic objective of the LB Program.

The Commission, on the other hand, believes that the classification system used for defining lines-of-business is the best available starting point for defining LB categories because it is well known and widely used, in both the Government and the private sector. The Commission feels that, although the classification system could be improved, it can provide meaningful results.

The Commission also believes that the problems caused by varying accounting procedures can be overcome by sophisticated mathematical techniques employed by the Commission staff. In addition, the Commission asserts that differences caused by varying accounting procedures will tend to offset each other.

Our views on LB Program data reliability and usefulness can be readily summarized in the following quote from our July 26, 1976, letter granting approval for 1975/1976 LB data collection.

"The question of data reliability remains unresolved. First, the FTC has yet to publish any reports based on LB data. This is primarily due to the fact that numerous firms have not complied with either 1973 or 1974 LB. Litigation on both sides--by FTC to enforce compliance and by the firms involved to avoid compliance--is still pending.

"Second, because of the strict confidentiality rules applied to the LB data collected to date, neither GAO nor anyone else outside of the FTC is currently able to make an independent assessment of data reliability.

"We believe the best test of data reliability will occur when LB reports are published. This will enable industry, accountants, economists, scholars, and other interested parties to carefully analyze the results and, certainly, to critique FTC's efforts. We believe that, over time, this type of scrutiny will tend to greatly improve both the reliability and utility of the LB data."

These points remain valid today, except that the litigation has been completed and the LB data is now being collected. The first LB report has yet to be published. However, completion of the litigation, together with our approval for collection of 1977 LB data clears the way for completing data collection for the years 1974 through 1977, and for publication of LB reports for those years. Thus, the appropriate circumstances now exist to begin development of a systematic plan for weighing the benefits of the LB Program against its costs.

CONCLUSIONS

The Commission's LB Program has been controversial since its inception and involved in litigation for several years. Consequently, it has not yet achieved its objectives. The litigation has been completed, resolving the legal issues in favor of the Commission, but the fundamental management issue of whether the program's usefulness justifies its costs remains unresolved.

Completion of the litigation makes it feasible for the Commission to lay the groundwork for addressing this issue. However, no systematic plan for weighing the LB Program's total costs against its usefulness currently exists. We believe the Commission should begin to develop such a plan.

We recognize that evaluating the LB Program will be a difficult task. The major component of program cost is borne by the respondents in providing the required data. In our view, respondents' actual costs will be heavily influenced by the degree to which respondents are willing to provide estimated and unaudited data, as allowed by LB Program instructions. The willingness to provide such data will be influenced, in turn, by how carefully the Commission's LB Program staff maintains its confidentiality pledges.

We also recognize that determining the LB Program's usefulness in meeting its stated objectives will be difficult.

The LB reports' usefulness in allocating Commission antitrust resources, in providing input to the Congress for policymaking, and for enhancing private investment decisions will accrue over time. Also, if the LB reports should prove to be unreliable, they could produce little, if any, benefits. In any event, the benefits will be difficult to measure. Consequently, we expect that the initial evaluation plan will require modification as the Commission gains more experience with the program.

RECOMMENDATIONS

We recommend that you

- develop a plan for weighing the benefits of the LB Program against its total costs;
- complete an initial plan by December 31, 1979; and
- modify the initial plan appropriately as additional experience is gained with the program.

AGENCY COMMENTS

Our conclusions and recommendations were discussed with members of the Commission staff. They agreed, in principle, with our recommendations; however, they expressed serious reservations about the feasibility of preparing a traditional cost-benefit analysis of the LB Program. They expressed particular concern about the difficulties in quantifying LB Program benefits, noting that the benefits would accrue over a long period of time. However, the Commission staff has asserted on numerous occasions that the LB Program has potentially enormous long-term benefits to consumers and the public. Accordingly, we believe the scope, the costs, the importance of the Program, and the controversy it has generated, demand that the effort be made and that it begin now.

As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations within 60 days of the date of the report and to the House and Senate Committees on

Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

Copies of this report are being sent to the Chairmen, Senate Committee on Governmental Affairs, House Committee on Government Operations, House and Senate Committees on Appropriations, and the Director, Office of Management and Budget.

We will be happy to meet with you or your staff to discuss this matter further if you so desire. We plan to continue monitoring the Commission's efforts in implementing the LB Program.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "A. R. Voss".

Allen R. Voss
Director