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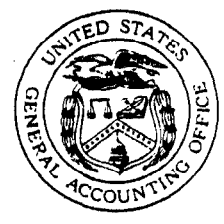
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Forest Service's Efforts to
Improve Its Financial Management Systems

Statement of
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Before the
Subcommittee on Interior and
Related Agencies
Committee on Appropriations
House of Representatives



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Mr. Chairman and Members of the Subcommittee:

I am pleased to update the Subcommittee on the Forest Service's efforts to improve its financial management systems. At your request, the Forest Service and GAO have continued efforts to outline an all-resource cost reporting system over the past year. As part of our ongoing work on the Forest Service's financial management, we also reviewed other areas of continuing interest to you:

- proposed changes in the Service's Timber Sale Program Information Reporting System (TSPIRS) and
- an initiative undertaken by the Service to assure that costs are properly reflected in their records ("charged-as-worked").

Also at your request, we examined the Service's appraisal process to determine if it (1) set advertised prices that were adequate to recover even the minimum costs of preparing the sale and (2) ensured that the government received fair market value for the timber sold.

Let me now take a few minutes to advise you on the status of these efforts.

THE ALL-RESOURCE COST REPORTING SYSTEM

Subsequent to our work associated with the design for TSPIRS, you asked that we cooperate in designing a similar system to report the costs of certain Forest Service natural resource programs. Our 1989 report to you described the Forest Service's progress in outlining this system.¹

Since that time, the Forest Service has refined, developed, and documented the system design. Our most recent report² describes the Forest Service's preliminary design at nine national forests and the areas where we believe the design could be improved.

System Design

The all-resource cost reporting system will account for all National Forest System appropriations and cooperative agreements involving the management of the national forests. Costs related to the Research or State and Private Forestry appropriations would not be included unless they are incurred to support national forest activities.

¹Forest Service: Status of the All-Resource Cost Reporting System (GAO/AFMD-89-65, April 14, 1989).

²Forest Service: The All-Resource System's Cost Features and Areas for Future Improvements (GAO/AFMD-90-62, May 1, 1990).

The system would report costs incurred in connection with operating the following natural resource programs: (1) timber, (2) range, (3) minerals, (4) recreation, (5) wildlife and fish, and (6) watershed. Costs which do not appear to provide direct benefits to the natural resource programs, but rather are undertaken to fulfill the Service's overall land ownership responsibilities, will be separately reported within the "protection" program.

For those programs which receive income, revenues will also be reported. Costs and revenues are expected to be matched on an accrual basis, allowing the user to view the revenue or costs of a particular program area.

The national forests are the organizational units held accountable for planning, implementing, and managing resource programs. As such, they are to be the cost accounting centers for reporting costs and revenue. Cost and revenue information will also be summarized for each Forest Service region as well as the Forest Service in total.

In order to disclose the cost of the national forest operations, the system will produce the following reports for each forest:

- A Program Activity Statement of Revenues and Expenses is expected to display expenses and revenue for each program's

activities on an accrual basis. For example, the statement for the recreation program would report expenses and revenues connected with wilderness, cultural resources, developed recreation, and other activities which comprise a forest's recreation program. The excess of either expenses or revenue would be shown for the program.

- A Program Summary Statement of Revenues and Expenses is expected to provide a summary of revenues and expenses on an accrual basis for each of the natural resource programs administered by the forest.

Weaknesses Identified in
Proposed System Design

In working with the Forest Service on this project, we identified several areas where we believe the Service can improve the basic design proposed for the system. These areas include the following.

In considering how to organize and report costs relating to its natural resource programs, the Forest Service concluded that costs such as insect and disease suppression, law enforcement, and fire protection are incurred to fulfill legal, regulatory, and congressional mandates separate from the goals of the Service's natural resource programs. The Service proposes to report these

costs in the all-resources protection category. However, we believe that some of these costs may be more appropriately related to one or more of the Service's resource programs.

For example, the Forest Service proposes to report law enforcement activities as a protection cost. Our study suggests that the Service incurred some of these costs directly to support timber or recreation program operations. In such cases, we believe law enforcement activities should be reported directly as a timber or recreation program cost.

In contrast, law enforcement activities that do not directly help to achieve resource program objectives, such as those undertaken to train forest law enforcement personnel, should be allocated as an indirect cost of other programs if possible.

We also believe that the system design could be improved by better distinguishing between revenue and nonrevenue producing activities in its reports. The system design currently being tested does not clearly disclose activities which receive revenues separately from those which do not. For example, forests incur costs in operating campgrounds and recover a portion of these costs from users who purchase camping permits. The net revenue or cost of the campground permit program would be better disclosed if the costs incurred in this activity were separated from recreation program activities which do not earn revenue, such as the

management of wilderness areas.

I would now like to update you on the Forest Service's efforts to implement the Timber Sale Program Information Reporting System (TSPIRS).

TIMBER SALES PROGRAM INFORMATION
REPORTING SYSTEM

We have continued to monitor the implementation of TSPIRS during the past year. Also, we are currently conducting an audit of the Forest Service's financial statements for fiscal year 1988 and will report as to whether the financial statements are in conformity with generally accepted accounting principles. For fiscal year 1989, the Forest Service released the first official TSPIRS reports after testing the system during the prior 2 years.

During the testing period, the Forest Service received a wide range of comments concerning TSPIRS from congressional sources, public interest groups, and GAO. In order to obtain further suggestions for improving the system, the Service hired a public accounting firm to conduct an independent review of TSPIRS. The objective of the public accounting firm study was to determine whether the system's accounting methodologies were in conformance with generally accepted accounting principles and whether alternative methodologies would provide a fairer presentation of

the timber sales program's financial results.

The public accounting firm completed its study in 1989, concluding that the design of TSPIRS appeared to be based on appropriate principles of cost accounting. However, the firm recommended specific improvements in certain TSPIRS accounting methodologies.

In response to this study, the Forest Service is changing some TSPIRS accounting methodologies in the sale and growth pool activity costs to better comply with generally accepted accounting principles. These changes will be implemented in fiscal year 1991.

The Forest Service recently analyzed the impact of these changes on TSPIRS financial results for 74 forests and concluded that 45 forests will report either a greater excess of revenues over expenses or a lesser excess of expenses over revenues. Based on our knowledge of TSPIRS, we agree that many of the changes will decrease the annual expenses shown in TSPIRS reports. However, it is expected that for the life cycle of the forest the effects of the changes in accounting methodologies will not alter the total amount of expense, with the exception of road costs.

Changes in Accounting for Sale Pool Costs

The first significant change involves the transfer of brush

disposal and reforestation costs from the sale activity cost pool to the growth activity cost pool. The sale activity cost pool was intended to accumulate costs directly related to specific timber harvests. Brush disposal and reforestation costs were accumulated in the sale activity cost pool because they relate to activities funded by purchasers who contract with the Forest Service to harvest timber.

However, on review the Service believes the objectives behind these activities were more closely related to growing rather than selling timber. Therefore, the Forest Service will begin accounting for brush disposal and reforestation costs in the growth activity cost pool.

Changes in Accounting for Growth Pool Costs

The second significant change relates to the accounting for costs accumulated in the growth activity pool. The Forest Service plans to change the method forests use to estimate the total volume of timber expected to be harvested during the timber life cycle. This volume is a component of the formula used to compute annual growth activity cost pool expense. The Forest Service also intends to remove road costs from the growth activity cost pool.

Based on an analysis, we noted that the Service could also explore other alternatives for estimating total volume expected to

be harvested. In this regard, the Forest Service believes that the most correct method of estimating total expected volume would be to count harvestable timber on representative tracts of forest land. Each year the projected volume on the forest would be reduced for volume actually harvested and increased for volume grown. The Service may adopt this method in future years as its estimation techniques improve.

In the interim, to compute the total volume of timber expected to be harvested over the timber life cycle, each forest will average several years' actual harvest volumes and multiply the average by the number of years in the timber life cycle. The Forest Service believes the revised method will provide a more realistic estimate of timber expected to be harvested than the current method, which involves certain assumptions that tend to overestimate the total volume expected to be harvested during the timber life cycle. Although these efforts will work to eliminate obvious errors, the Forest Service should continue efforts to ensure that the costs of growing timber are properly reflected and matched with the costs of timber actually harvested.

Timber road costs will also be removed from the growth activity cost pool. Since the Forest Service believes that roadbeds have an indefinite useful life, the costs of constructing them will be capitalized as an addition to land value in the Forest Service's balance sheet instead of being recognized as multiyear

expenses in the growth activity cost pool. Since road surfacing, culverts, and bridges depreciate over time, the Forest Service will remove them from the growth activity pool and depreciate them over their useful lives in a separate TSPIRS line item.

CHARGING COSTS MORE ACCURATELY

Next, I will discuss the Forest Service's efforts to more accurately charge the costs of resource operations to the applicable programs.

For a number of years, your Subcommittee has been concerned that the Service has charged labor, equipment, and overhead in ways which conformed more to budgeted amounts than to the ways resources were actually used. To address your concerns, the Forest Service issued a directive in 1988 which mandated that costs be charged to reflect the actual use of resources. The directive described managers' authority and responsibility for implementing the guidance and discussed control standards for charging costs to the appropriate activities.

Implementation Problems

The directive, along with subsequent measures, increased employee awareness of the need to accurately record cost information. However, during our review we identified some

problems in the Forest Service's implementation of the charged-as-worked policy.

For example, some Forest Service units detail employees to work on projects occurring on another unit. The fiscal year 1988 directive mandated that field units generally should charge the costs for detailed employees to the unit where the project was occurring rather than the employee's home unit. However, implementation of this guidance varied in the nine Forest Service regions we visited. Some charged costs to the benefiting unit if the detail was longer than 2 weeks, while others did so only if the detail was longer than 1 week. Still others charged all costs to the benefiting unit regardless of the length of detail.

In addition, not all units were charging identical costs to the same accounting codes. For example, one region charged costs for computer services to general administration, timber, and recreation activities, while another charged computer costs entirely to general administration activities.

If units charge identical costs differently, the total cost of certain activities and programs will be overstated and others will be understated.

Some Procedures Inhibit Compliance

With Charged-As-Worked

During our review, we also found that some Forest Service budget and accounting procedures may inhibit compliance with the charged-as-worked policy. These include procedures used to reprogram funds.

For example, units may need to reallocate funds from completed projects to projects needing additional funds. Field staff indicated that they do not always receive timely responses to their reprogramming requests due to the number of approvals required at higher management levels. If the requests are not approved when needed, the costs of completing required work would have to be charged to other work activities. As a result, cost information does not accurately reflect the actual use of resources.

MINIMUM BID ANALYSIS

At your request, we examined two issues regarding the Forest Service appraisal process. First, we determined whether the current Forest Service appraisal methods set minimum advertised timber prices that are adequate to cover the costs of preparing these sales.

Of the 3,030 fiscal year 1988 sales we reviewed, we found that

40 percent were advertised for prices that, if accepted, would not have covered the preparation and administration costs. The potential unrecovered costs would have totaled \$62 million. Because competition resulted in higher actual selling prices, the unrecovered costs in our sample totalled \$22 million. This figure, however, did not consider the additional costs associated with growing the timber or with timber program overhead, which would have made the unrecovered cost even higher.

The Forest Service believes that there are cases which justify below-cost sales. Currently it has undertaken three initiatives utilizing TSPIRS data which deal with sales that do not recover all costs.

We believe the Forest Service needs to consider all related costs before awarding sales contracts. If the Service's costs exceed the estimate of the timber's values, a formal decision needs to be made to either (1) raise the advertised price to cover the costs, (2) not proceed with the sale, or (3) sell the timber but document the reasons for doing so.

The second issue we examined was the effectiveness of the Service's appraisal methods in ensuring that the government receives fair market value for the timber it sells. To make this evaluation, we developed an economic model which explained the relationships between fair market value, government advertised

prices, appraisal methods, and other factors. Using the Service's fiscal year 1988 sales data, we estimated the parameters of the model with regression analysis. These estimates then served as our basis for comparing the two appraisal methods the Service uses to arrive at advertised prices that approach fair market value.

These two methods are called the "transaction evidence" and "residual value" methods. The first establishes an appraisal price based on an average for comparable timber sales, while the second establishes an appraisal price that would enable a purchaser of average efficiency to harvest and process the timber at a "reasonable profit." Three Forest Service regions use the residual value method, while the remaining six regions use the transaction evidence method.

Our analyses of fiscal year 1988 Forest Service timber sales data suggest that if the transaction evidence method is used consistently, it results in advertised prices that range from 14 to 37 percent higher than those determined by the residual value method. This means that the government may be able to sell its timber for more money in cases where there is only one bidder and the Service uses the transaction evidence method of appraisal.

Six of the nine Service regions have switched to transaction evidence appraisal, citing not only data problems with the other method, but also their perception that the new method better

estimates fair market value and costs less. Nonetheless, the Service's two main timber-producing regions continue to use the residual value method. Officials in these regions cite limited staff resources and historic use as the primary reasons for not changing their appraisal method.

Since Service regions have received limited guidance or oversight from headquarters in developing the transaction evidence appraisal method, they have developed differing approaches to implementation. One appreciable difference we identified was in the "rollback" or reduction the regions made to appraisal estimates in arriving at advertised prices that will stimulate competition and compensate for any inaccuracies in those estimates. One region reduced the appraised price by an average of 47 percent in 1988 and sold 18 offerings at advertised prices in single-bidder auctions. If a smaller percentage rollback had been applied in this region, the government might have received more money on these sales. The other regions reduced their prices only 5 to 25 percent.

Finally, we found that the Service does not exercise adequate internal control over the timber appraisal process. For example, headquarters does not routinely monitor how well regional appraisal systems are establishing bid prices that approximate fair market value. We believe that the Service needs to provide better guidance and oversight to improve the timber appraisal process. This should include discontinuing the use of the residual value

appraisal method when sufficient comparable sales data exist and developing and using the transaction evidence method in all regions.

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In conclusion, the Forest Service has spent a good deal of time focusing on financial management issues during the past year. The Service (1) finished and began testing the preliminary design of a system to report the cost and revenues of its natural resource programs, (2) continued its efforts to refine TSPIRS, and (3) began to take the steps necessary to ensure that its cost information reflects the actual use of financial resources. More work needs to be done in the area of minimum bid analysis to assure the government receives the highest value for timber sold. We believe the Service is committed to a stronger financial management environment, and we will continue to monitor its progress in designing and implementing the all-resource reporting system.

Mr. Chairman, that concludes my statement. I will be happy to answer any additional questions you may have.