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Report to the Chief, Forest Service, U.S.
Department of Agriculture

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NATIONAL FORESTS

Financial Ability Reviews of Prospective Timber Purchasers Need Improvement





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

Resources, Community, and
Economic Development Division

B-232914

March 31, 1989

Mr. F. Dale Robertson
Chief, Forest Service
U.S. Department of Agriculture

Dear Mr. Robertson:

In conjunction with our review of the legislative and administrative assistance provided federal timber purchasers, requested by the Chairman, Subcommittee on National Parks and Public Lands, House Committee on Interior and Insular Affairs, we examined whether Forest Service Regions 1, 5, and 6 were performing financial ability reviews of prospective timber purchasers who had previously defaulted on timber sales contracts. Financial ability reviews of prospective purchasers help ensure that they will be able to successfully operate the sale. Without such assurance, the Forest Service is vulnerable to certain operational and legal problems, such as harvest delays, defaulted contracts, and the collection of damages.

Results in Brief

Required financial ability reviews of prospective timber purchasers were being done in Region 1 but not in Regions 5 or 6. The two regions awarded about \$43 million in timber sales contracts to purchasers who had defaulted within the prior 3 years. The required reviews were not conducted primarily because regional and forest personnel were not aware that the purchasers had defaulted on timber sale contracts in other national forest units or the Bureau of Land Management (BLM). No formal mechanism exists to assure that forest and regional personnel have access to information on purchasers' defaults occurring outside their regions. In addition, regional and forest personnel in all three regions said that the instructions regarding reviews were not clear, and they needed additional training to do financial ability reviews.

Background

During the past few years, the Forest Service has experienced a record number of defaults on timber sale contracts primarily as a result of timber operators holding large portfolios of high-priced timber sale contracts that they could not economically operate. Because of this situation, on April 10, 1987, you sent a directive to all Regional Foresters concerning the required performance of financial ability reviews of prospective timber sale purchasers that had defaulted on timber sale contracts within the prior 3 years. The directive stated that the award

While they completed a review in one instance, it should have been completed at the regional level because the purchaser operated in more than one forest within the region.

Inadequate Coordination and Exchange of Information

Regions 5 and 6 did not coordinate with, or provide information to, each other or BLM regarding the need for financial ability reviews of purchasers with default histories. For example, one purchaser that had defaulted contracts in Region 6 and with BLM within the last 3 years was awarded contracts in both Regions 5 and 6. BLM, in accordance with its procedures, requires purchasers with a default history to provide additional security. In accordance with these procedures, BLM currently requires this purchaser to provide a bond of 50 percent of the total purchase price at the time of contract award. Forest Service officials in Regions 5 and 6 were unaware of the defaults and BLM's special contract provision and awarded contracts totaling about \$20.8 million to this purchaser during the period of our review.

Similar coordination problems occurred among forests in Region 6. Forest contracting officers in Region 6 were only provided a list of purchasers with defaults in their forests. They were not provided with information regarding defaults in other forests, regions, or BLM. As a result, they not only awarded contracts to purchasers that had federal contract default histories in other regions and BLM, but also in other forests within their region.

Need for Additional Guidance and Training

Most of the forest and regional officials we contacted regarding financial ability reviews were not satisfied with the guidance provided in the April 10, 1987, directive and regional instructions. Several stated that the reviews may be inconsistent since each forest tends to conduct the reviews differently. Others admitted to being uncomfortable with their ability to do the reviews and expressed a desire for training or more specific guidance. As of January 1989, those responsible for financial ability reviews had not received any formal training or been provided with a manual.

According to Forest Service headquarters officials, a draft Financial Analysis Handbook had just been released for Service-wide comment at the close of our review. They told us that the final handbook should be issued in April 1989. In addition, they told us that in conjunction with the Service's national timber sale meeting in April 1989, formal training

reviews were performed, we obtained explanations of why they had not been done from responsible Forest Service regional and forest officials.

We discussed the contents of this report with responsible Forest Service officials, and their comments are incorporated where appropriate. Our work was conducted between September 1988 and January 1989 in accordance with generally accepted government auditing standards.

We would appreciate your comments regarding any action you intend to take regarding our recommendations. We wish to express our appreciation for the assistance and cooperation of Forest Service personnel during our review. Should you need further information, please call me at (202) 275-5138.

Major contributors to the report are listed in appendix I.

Sincerely yours,

A handwritten signature in cursive script that reads "John W. Harman". The signature is written in black ink and is positioned above the typed name.

John W. Harman
Director, Food and
Agriculture Issues

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will be given to timber sales administrators and accountants dealing with financial ability reviews of prospective timber sale purchasers.

Conclusions

Contracts are being awarded to purchasers who had defaulted on contracts within the prior 3 years without the required financial ability reviews. The primary reason for not performing the financial ability reviews was that the responsible officials were not aware that companies had default histories in other forests, regions, and BLM.

Recommendations

We recommend that the Chief of the Forest Service establish a formal mechanism to assure that information on purchasers who have defaulted on timber sales contracts is available to responsible officials at the forest and regional level. This could be done by providing contracting officers and regional reviewing officials with default listings and other information that they need to comply with your April 10, 1987, directive. Also, in an effort to standardize and improve the process, the Forest Service should assure that appropriate training is provided in conjunction with the issuance of its Financial Analysis Handbook.

Objectives, Scope, and Methodology

The objective of this review was to determine whether the required financial ability reviews were being conducted before awarding timber sale contracts to purchasers who had defaulted on other contracts within the past 3 years. We did not judge the quality or completeness of the reviews themselves. Our review was conducted in Region 1, Missoula, Montana; Region 5, San Francisco, California; and Region 6, Portland, Oregon.

To determine whether the regions were conducting the financial ability reviews, we utilized data collected on our review of legislative and administrative assistance provided federal timber purchasers. These data identified purchasers with defaults and which financial ability reviews should have been performed before awarding additional timber contracts.

We identified those purchasers that had been awarded contracts between April 10, 1987, and October 31, 1988, and which forests and regions were involved. After identifying the purchasers and number of forests, we contacted regional and forest officials to determine if financial ability reviews were conducted and, if so, who had done them. If no

of timber sales should only be made to responsible purchasers who have the financial ability to operate the sale. The directive supplemented existing Forest Service guidance and stressed coordination between Forest Service units and BLM. The directive provided instructions regarding the need for a review, the required coordination, what the review should entail, and the additional information or security required by the Forest Service if the purchaser's financial ability was lacking. It also specified that the reviews should normally be conducted at the forest level unless the purchaser operates in more than one forest or region. In those cases the reviews would be done at the regional level.

Required Reviews Not Performed

We identified seven companies in Regions 1, 5, and 6 that had defaulted on contracts within the 3 years prior to the April 10, 1987, directive and were subsequently awarded a contract between April 10, 1987, and October 31, 1988. All of the companies were awarded contracts in Region 6, two were also awarded contracts in Region 5, and one was also awarded a contract in Region 1.

Required financial ability reviews were conducted for two purchasers—one in Region 1 and one in Region 6. However, Regions 6 and 5 awarded five purchasers contracts totaling about \$30.9 million and \$12.5 million respectively, without conducting the required reviews. Three of the five should have been reviewed at the regional level because the companies either operated in more than one forest within a region or operated in two regions. The remaining two companies should have been reviewed at the forest level.

Region 5 and 6 officials responsible for financial ability reviews said that the required reviews were not done before awarding additional contracts for several reasons. According to Region 5 officials, they had not done financial ability reviews on the two purchasers operating in both their region and Region 6 because they were not aware that the purchasers had defaulted contracts in Region 6 and BLM. According to a Region 6 official, the required reviews had not been done because they were unaware that the purchasers had defaulted on other Forest Service and BLM timber sales contracts.

Forest officials in Region 6, responsible for financial ability reviews, said that they awarded contracts to purchasers because they were generally unaware of the purchasers' prior defaults within their region.

