GAO

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General Accounting Office
Washington, D.C. 20548

Accounting and Information
Management Division

B-280811

January 29, 1999

The Honorable Frank H. Murkowski
Chairman, Committee on Energy
and Natural Resources
United States Senate

Subject: Forest Service: Accounting Treatment of Roadbed Costs

Dear Mr. Chairman:

This letter responds to your request that we review the Forest Service's change in accounting for roadbed costs recorded in its Timber Sales Program Information Reporting System (TSPIRS). The Forest Service changed its accounting treatment of timber roadbeds[1] due to its interpretation of Statement of Federal Financial Accounting Standard (SFFAS) No. 6, Accounting for Property, Plant, and Equipment, which it implemented in fiscal year 1997. SFFAS No. 6 requires that the costs associated with certain federally-owned land, including national forests, be expensed rather than capitalized. As a result of the Forest Service's interpretation of SFFAS No. 6, it reported an additional $53.9 million in costs for its timber sales program, which increased the program's fiscal year 1997 loss to a reported $89 million.

Because the accounting treatment of timber roadbeds can significantly impact reported annual net income or loss for the timber sales program, you asked us to answer the following questions: (1) How are federal accounting standards developed? (2) What is the rationale behind the treatment of stewardship land in federal accounting standards? (3) What is the rationale behind the Forest Service's accounting change? and (4) Did the Forest Service appropriately implement SFFAS No. 6 as it relates to timber roadbed costs? Enclosure 1 provides detailed information on our methodology used to answer these

[1]The Forest Service interchangeably uses the term "road prism" for roadbed, which is the underlying foundation of a road. To describe road prisms in this report, we will use the term "roadbed," which is consistent with the terminology used by the Federal Accounting Standards Advisory Board.

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questions. We performed our review from August 1998 through January 1999 in accordance with generally accepted government auditing standards.

BACKGROUND

The Forest Service, an agency of the United States Department of Agriculture (USDA), administers approximately 192 million acres of national forests and grasslands. Each year, the Forest Service sells billions of board feet[2] harvested from its forested land. For fiscal year 1997, the Forest Service reported that it sold 3.69 billion board feet of timber producing gross revenues of $577 million.

In order to have better information on the benefits and costs of selling timber, the Forest Service developed TSPIRS, which was fully implemented in 1989. TSPIRS consists of three components–the financial; economic; and employment, income, and program level components. The financial component displays annual revenues, expenses, and net profit associated with the harvesting of national forest timber in a financial report called the Statement of Revenues and Expenses. The economic component displays the long-term benefits and costs expected to result from a given year's timber harvesting activities. The employment, income and program level component displays timber-related employment and income, and the associated federal income tax generated by a given year's timber harvesting activities. Our report focuses on the financial component because it relates to the financial treatment of timber roadbeds.

Prior to fiscal year 1997, the Forest Service capitalized timber roadbeds in its land value and did not record any annual depreciation expense. The Forest Service adopted this accounting treatment based on recommendations from a 1989 consultant report[3] which explicitly addressed how the Forest Service should account for its timber roadbed costs. As expressed in that report, the rationale for this treatment was that the timber roadbeds were a permanent improvement to the land. In fiscal year 1997, the Forest Service changed its accounting treatment of roadbeds built to harvest timber in national forests when it undertook early implementation of SFFAS No. 6 and recorded all timber

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[2]A board foot is the equivalent of a piece of wood 1 inch thick, 1 foot wide, and 1 foot long.

[3]Brown and Company, 1989, Evaluation of Timber Sales Program Information Reporting System. Brown and Company recommended that TSPIRS, to better comply with generally accepted accounting principles, capitalize road preconstruction and some construction costs as an addition to permanent land value.

roadbed costs incurred in fiscal year 1997 as direct timber sale expenses for that year.

RESPONSES TO QUESTIONS ON THE ACCOUNTING TREATMENT OF FOREST SERVICE ROADBED COSTS

Our detailed answers to your questions follow.

1. *How are federal accounting standards developed?*

Federal accounting standards are developed under authority of 31 U.S.C. 3511(a) using a deliberative due process established in 1990 by the three agencies with responsibility for federal financial management--the Department of the Treasury, the Office of Management and Budget (OMB), and GAO (referred to as the principals).[4] The principals created the Federal Accounting Standards Advisory Board (FASAB) to consider and recommend accounting standards to the principals following rules of procedure developed to permit timely, thorough, and open study of financial accounting issues and encourage broad participation from the public and federal agencies. If the principals accept them, FASAB's recommendations are issued by OMB and GAO and become effective. Section 3511 requires executive agencies to follow these standards. OMB has directed that agencies must use these accounting standards in preparing financial statements and in developing financial management systems. A list of issued federal accounting standards currently in effect is included in enclosure 2.

FASAB is composed of nine members selected from a broad range of federal government entities as well as the nonfederal community. The composition of FASAB is: one GAO member, one OMB member, one Treasury member, one Congressional Budget Office member, one member from the defense and international agencies, one member from the civilian agencies, and three nonfederal members selected from the general financial community, the accounting and auditing community, and academia. One of the nonfederal members serves as the FASAB Chairman. To recommend an accounting standard to the principals requires a majority vote of FASAB.

Based on overall direction from the principals, FASAB has established detailed written rules of procedure to guide its deliberative process for considering and

[4] In 1990, the principals signed a memorandum of understanding which reflects the principals' agreement on the procedures to be followed in setting federal government accounting standards and the composition and operation of the Federal Accounting Standards Advisory Board.

recommending federal accounting standards. These rules generally require that FASAB (1) hold meetings open to the public, with notice of meeting times and locations published in the Federal Register, (2) release exposure drafts of proposed standards to the public for comment, (3) hold public hearings, at FASAB's discretion, to obtain oral public comment, (4) consider written and oral public comments on proposed standards, and (5) maintain a public file of all relevant documents supporting the development of each accounting standard.[5]

Our review of the public file for SFFAS No. 6 indicated that FASAB followed its rules of procedure in developing this standard. During the period 1991 through 1996, FASAB held various open meetings to discuss how to account for federal property, plant, and equipment. On February 28, 1995, FASAB issued an exposure draft, Statement of Recommended Accounting Standards, Accounting for Property, Plant, and Equipment, for public comment. Forty-one responses were received, mostly from the auditing and accounting offices of federal agencies. FASAB staff prepared a detailed schedule summarizing the responses to various issues and questions raised regarding the proposed standard. On May 24, 1995, FASAB also held a public hearing on the exposure draft and received comments from representatives of six federal agencies and one nonfederal agency. Advance notices of these meetings and requests for comments were provided in the Federal Register. FASAB issued its recommendation to its principals in September 1995.[6] After the principals had considered and adopted the recommendation, GAO and OMB issued SFFAS No. 6 on November 30, 1995.

2. *What is the rationale behind the treatment of stewardship land in federal accounting standards?*

SFFAS No. 6 defines stewardship land as federally-owned land that is not used in providing goods or services. Land acquired in connection with general property, plant, and equipment (PP&E), such as land supporting government

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[5]The public file is a collection of documents prepared or received by FASAB in connection with the development of its proposed accounting standards. These documents include reports by task forces, minutes of meetings, and exposure drafts and related comments on proposed standards.

[6]The Chief Financial Officers Act prohibits the adoption of any standard dealing with capital asset accounting until the standard has been submitted to the Congress and a period of 45 days of congressional session has expired. SFFAS No. 6 was submitted to the Congress and was adopted only after expiration of the 45-day period.

buildings, is excluded from the stewardship land category. Stewardship land does not include mineral deposits, timber, or other depletable or renewable resources. Examples of stewardship land given in SFFAS No. 6 include "forests and parks and land used for wildlife and grazing." A related standard, SFFAS No. 8, Supplementary Stewardship Reporting, provides guidance on the reporting of stewardship assets, including stewardship land.

According to SFFAS Nos. 6 and 8, the accounting treatment and reporting of stewardship land, including national forests and parks, is based on three related characteristics of federally-owned stewardship land: (1) the cost or monetary value of stewardship land is often uncertain or not determinable, (2) when cost is available, it is often not meaningful since it has been many years since the land's acquisition, and (3) stewardship land is held for the general welfare of the nation and is intended to be preserved and protected. Since the cost or monetary value of stewardship land is often not determinable, FASAB believed that reporting nonfinancial information on the existence and the condition of stewardship land in a separate supplementary report had more relevance to decisionmakers and other users of federal financial statements than uncertain or not meaningful monetary amounts reported on the balance sheet. For example, the Forest Service states in the accompanying footnotes to its fiscal year 1997 financial statements that it carries no asset amount on its financial statements for approximately 80 percent of national forest lands because they are public domain lands for which it incurred no cost when they were transferred to the Forest Service.

Based on FASAB's rationale for the accounting treatment of stewardship land, SFFAS No. 6 directs that (1) stewardship land should not be reported on the balance sheet, (2) the acquisition cost of additional stewardship land should be expensed in the period incurred,[7] and (3) stewardship land previously recognized as an asset for balance sheet reporting should be removed.

FASAB concluded that stewardship assets, such as stewardship land, warrant specialized reporting to highlight their importance and to portray them in ways other than provided by traditional financial accounting. For example, SFFAS No. 8 states that stewardship land should be reported in terms of physical units rather than cost, fair value, or other monetary values because (1) the cost or value of stewardship land is often not determinable and (2) the most relevant information about stewardship land is its existence, condition, and use. Therefore, FASAB designated a new category of reporting to highlight the

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[7]The acquisition cost of additional stewardship land should be recognized as a cost on the agency's Statement of Net Cost.

unique nature of stewardship reporting in SFFAS No. 8 in a new financial report section called Required Supplemental Stewardship Information.

3. *What is the rationale behind the Forest Service's accounting change?*

The Forest Service advised us that its decision to change its accounting treatment of roadbeds built to harvest timber is based primarily on paragraph 232 in appendix B of SFFAS No. 6, Roads on Public Lands, which states, "For land subject to stewardship reporting, the cost of establishing the roadbed would be expensed in the year incurred since the land improved by the roadbed is not capitalized on the balance sheet."

The Forest Service said it applied this principle to its timber sales operations because national forest lands are now classified as stewardship lands based on paragraph 68 of SFFAS No. 6, which states, "Land and land rights owned by the Federal Government and not acquired for or in connection with other general PP&E will be referred to as stewardship land and will not be reported on the balance sheet." Therefore, applying paragraph 232, the Forest Service concluded that the timber roadbeds are subject to the same accounting treatment as land.

4. *Did the Forest Service appropriately implement SFFAS No. 6 as it relates to roadbed costs?*

Based solely on the illustration in paragraph 232 of appendix B of SFFAS No. 6, Roads on Public Lands, the Forest Service's change in accounting for timber roadbed costs would appear justified. However, paragraph 24 of SFFAS No. 6 states that "For entities operating as business-type activities,[8] all PP&E shall be categorized as general PP&E whether or not it meets the definition of any other PP&E categories." All general PP&E is to be recorded on the balance sheet at cost under SFFAS No. 6. Because the Forest Service's timber sales program operates like a business-type activity, under paragraph 24, the timber roadbeds would be considered general PP&E and therefore capitalized on the balance sheet.

The application of paragraph 232 to roadbeds used for timber harvesting also appears to be inconsistent with SFFAS No. 4, Managerial Cost Accounting

[8]Business-type activity is defined as a significantly self-sustaining activity which finances its continuing cycle of operations through a collection of exchange revenue. Exchange revenue arises when a government entity provides something of value to the public or another government entity at a price.

Standards, which contains cost accounting concepts and standards for determining the cost of an entity's activities, programs, and outputs. SFFAS No. 4, as well as No. 6, requires that the consumption of general PP&E be recognized as depreciation expense. This accounting treatment, if applied to timber roadbeds, would more accurately measure the timber program's operating performance because it better allocates the cost of roadbeds over the periods that benefit from harvesting timber.

Because of the potential for different interpretations of SFFAS No. 6 as it relates to the accounting treatment of timber roadbeds, and the apparent conflict between the illustration in paragraph 232 and SFFAS Nos. 4 and 6, we requested in a November 16, 1998, letter that FASAB examine this issue. Specifically, we asked FASAB to determine whether the proper application of SFFAS No. 6 should be to treat the cost of constructing timber roadbeds as (1) a permanent improvement to stewardship land, annually expensed, (2) an inherent part of timber operations, capitalized and depreciated over the roadbed's useful life, notwithstanding specific language in appendix B of SFFAS No. 6, or (3) a capitalized asset, not depreciated.

In a letter dated January 5, 1999, the Chairman of FASAB responded to our letter regarding the Forest Service's accounting treatment of timber roadbeds. The Chairman suggested that FASAB's due process procedures must be followed to definitively and authoritatively answer the question asked. However, the Chairman provided an analysis of relevant portions of existing accounting literature that was prepared by the FASAB staff. In summary, based on this analysis, the letter stated that the staff believes that the body of authoritative literature taken as a whole would lead to capitalizing and depreciating the cost of roadbeds which provide access to timber. The letter further stated that the depreciable life should be based on the period of time for which the roadbeds were expected to be useful in accessing timber. The Chairman asked FASAB staff to prepare an interpretation for FASAB's consideration at its February 25 and 26, 1999, meeting and to consult with appropriate parties to ensure that FASAB is fully informed on the issues. Enclosure 3 includes a copy of the Chairman's letter.

In addition, FASAB has established a task force to study the accounting treatment of federal natural resources. The natural resource task force will shortly publish its research report. FASAB will then begin deliberating these natural resource issues and may choose to more fully address the accounting for timber in connection with the natural resource project. However, FASAB is not expected to issue an exposure draft before late 1999.

AGENCY COMMENTS

We requested comments on a draft of this report from the Secretary of Agriculture and the Executive Director of FASAB. On January 25, 1999, and January 22, 1999, respectively, we received oral comments from the Chief Financial Officer, USDA and the Chief Financial Officer, Forest Service. On January 21, 1999, we received oral comments from the Executive Director of FASAB. They generally agreed with the answers to the questions in this report. Forest Service staff indicated that they intend to have further discussions with FASAB to determine how to properly account for timber roadbed costs. The Executive Director of FASAB provided clarifying comments that we have incorporated into our report as appropriate.

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We are sending copies of this report to the Ranking Minority Member of your Committee; the Secretary of Agriculture; the Chief of the Forest Service; the Chief Financial Officer, USDA; the Director of the Office of Management and Budget; the Executive Director of FASAB; and other interested parties. Copies will also be made available to others upon request. If you or your staff need further information, please contact me at (202) 512-9508 or McCoy Williams, Assistant Director, at (202) 512-6906.

Sincerely yours,

Linda Calbom

Linda M. Calbom
Director, Resources, Community,
and Economic Development, Accounting
and Financial Management Issues

OBJECTIVES, SCOPE, AND METHODOLOGY

Our objectives were to provide answers to the specific questions you asked in connection with the Forest Service's implementation of SFFAS No. 6 as it relates to roadbeds built on national forests for use in harvesting timber.

To obtain information describing how FASAB standards were developed, we reviewed the October 1990 Memorandum of Understanding signed by the Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General of the United States; FASAB's Rules of Procedure; the FASAB Mission Statement; minutes of FASAB meetings; FASAB's public file for SFFAS No. 6; and various FASAB and GAO documents relating to FASAB's mission. All documents made available to, or prepared for, or by FASAB are part of the public file of FASAB. Documents in the public file include reports by task forces, minutes of meetings, and exposure drafts of proposed standards.

To obtain information explaining the rationale behind the treatment of stewardship lands, we reviewed SFFAS No. 6, including appendix A: Basis for Conclusions; and SFFAS No. 8, including appendix A: Basis for Conclusions. We also discussed the rationale behind the accounting standards for stewardship lands with FASAB staff and GAO's Chief Accountant.

To determine the rationale behind the Forest Service's changes in accounting for timber roadbed costs, we interviewed Forest Service program and financial staff, including the Forest Service official responsible for preparing the TSPIRS financial statement, which reports annual revenues and costs for Forest Service timber sales.

We also reviewed the Forest Service's written rationale, explaining why it expensed timber roadbed costs as part of its implementation of SFFAS No. 6, included in its fiscal year 1997 *Forest Management Program Report*.

To determine whether the Forest Service appropriately implemented SFFAS No. 6 as it relates to timber roadbeds, we reviewed SFFAS Nos. 4, 6, and 8. We discussed the interpretation of the federal accounting standards with Forest Service financial staff, FASAB staff, and GAO's Chief Accountant. To assist us in determining the proper application of SFFAS No. 6 to account for timber roadbeds built on national forests, we requested that FASAB determine the required accounting treatment for stewardship lands as it applies to roadbeds constructed to harvest timber on national forests in a November 16, 1998, letter to the FASAB Executive Director.

We performed our review from August 1998 through January 1999 in accordance with generally accepted government auditing standards. We requested comments on a draft of this report from the Secretary of Agriculture and the Executive Director of FASAB.

STATEMENTS OF FEDERAL FINANCIAL ACCOUNTING STANDARDS (SFFAS) AND THEIR EFFECTIVE DATES

Standards currently in effect	**Effective for fiscal year**
SFFAS No. 1, Accounting for Selected Assets and Liabilities	1994
SFFAS No. 2, Accounting for Direct Loans and Loan Guarantees	1994
SFFAS No. 3, Accounting for Inventory and Related Property	1994
SFFAS No. 4, Managerial Cost Accounting Concepts and Standards	1998
SFFAS No. 5, Accounting for Liabilities of the Federal Government	1997
SFFAS No. 6, Accounting for Property, Plant, and Equipment	1998
SFFAS No. 7, Accounting for Revenue and Other Financing Sources	1998
SFFAS No. 8, Supplementary Stewardship Reporting	1998
SFFAS No. 9, Deferral of the Effective Date of Managerial Cost Accounting Standards for the Federal Government in SFFAS No. 4	1998

JANUARY 5, 1999, LETTER FROM THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

Federal Accounting Standards Advisory Board

441 G Street, NW Suite 3B18
Washington, DC 20548
(202) 512-7350
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January 5, 1999

Ms. Linda Calbom
Director
Resources, Community, and Economic Development, Accounting and Financial Management Issues
Accounting and Information Management Division
General Accounting Office
Washington, DC 20548

Dear Ms. Calbom:

Your letter of November 16, 1998 requested that the Federal Accounting Standards Advisory Board (the Board) examine the accounting treatment for roadbeds constructed to harvest timber on national forests. Specifically, you asked whether the proper application of Statement of Federal Financial Accounting Standard No. 6, *Accounting for Property, Plant, and Equipment* (SFFAS No. 6) should be to treat the cost of constructing roadbeds as:

(1) a capitalized asset which is not depreciated,
(2) a permanent improvement to stewardship land which is expensed, or
(3) an inherent part of timber operations, capitalized and charged to depreciation expense over the roadbed's useful life.

My response is intended to clarify both the Board's due process procedures and to present the staff's analysis of the existing standards. It is not intended to establish new standards or to direct the Forest Service to one of the options you offered. The Board's due process procedures must be followed in order to establish new authoritative literature and to definitively answer the question that you asked.

In summary, staff believes that the body of authoritative literature taken as a whole would lead to capitalizing and depreciating the cost of roadbeds to provide access to timber. Depreciable life should be based on the period of time for which the roadbeds were expected to be useful in accessing timber. I have asked staff to prepare an Interpretation for the Board's consideration at its February 25 and 26, 1999 meeting and to consult with appropriate parties to ensure that the Board is fully informed on the issues.

DUE PROCESS

The Board is required to follow procedures that have long standing in the accounting community.

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For any new standards, the Board conducts extensive research, generally forming an inter-agency task force to support the effort. The Board deliberates the research findings and recommendations at public meetings before proposing accounting standards. The resulting proposals are then issued in an exposure draft requesting public comment. After comments are received, the Board may hold a public hearing. Additional deliberations take place in open meetings. The Board then prepares its recommended standards and submits these recommendations to its sponsors. For standards dealing with capital asset accounting, the CFO Act requires a 45-day Congressional review period. This process was followed for the standards now in question.

Preparers and auditors have a number of vehicles to use in seeking clarification from the Board. They may request an interpretation from the Board. Interpretations are intended to clarify the intent of existing standards. Alternatively, the Accounting and Auditing Policy Committee may address specific issues submitted by preparers and auditors. However, these vehicles are limited to clarification of existing standards created through due process. Prior to your request, the Board had not received any inquiries on the proper accounting for roads providing access to timber.

The Board is currently working on a project to address natural resources. Timber is included in this project. The Board specifically excluded natural resources from its definition of land. Paragraph 67 of SFFAS No. 6 states that "excluded from the definition of land are materials beneath the surface (i.e., depletable resources such as mineral deposits and petroleum), the space above the surface (i.e., renewable resources such as timber), and the outer-continental shelf resources." The Board's intent, which is being carried out in the current natural resources project, was to address the complex issues associated with natural resources in a project focusing solely on natural resources.

Presented below is a staff analysis of the relevant portions of the existing literature. It is this analysis that would form the basis for a proposed Interpretation to be presented by staff to the Board. Note that the natural resources project is soon to publish a research report. The Board will then begin deliberating issues but is not expected to issue an exposure draft before late 1999. The Board may choose to more fully address accounting for timber in connection with that project.

EXISTING STANDARDS

The Board's first eight standards make up a core body of accounting standards. While there is substantial detail in the eight standards, they do not address each unique federal activity. In practice, preparers may find that certain unusual circumstances do not fit a general standard and may seek alternatives that are consistent with broad principles. For example, private sector accounting literature offers industry specific guidance on transactions or events peculiar to those industries.

Despite the absence of specific standards for timber activities, there is much to draw on in the existing literature to guide preparers. The existing literature may not present an explicit answer

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to a specific question but it does provide guidance for the preparer to capture the economic substance of transactions and events. Specific references we will discuss are:

1. Paragraphs 229 - 232, Illustration 3B, Appendix B: Illustrations of Categories, SFFAS No. 6
2. Paragraph 23, General PP&E, SFFAS No. 6
3. Paragraphs 102 through 104, Full Cost, SFFAS No. 4, *Managerial Cost Accounting Standards for the Federal Government*

Illustrations of Categories

The Board provided the illustrations in order to clarify for users the appropriate categories for *actual* assets (see paragraphs 200-201). The illustrations are not intended to have the same authoritative standing as the standards included in the document. The Board's Codification of Federal Financial Accounting Standards states that appendices to the individual standards are "explanatory text."

Further evidence that the Board did not intend these illustrations to be binding is that in SFFAS No. 7, *Accounting for Revenue and Other Financing Sources*, the Board **explicitly** indicated that an Appendix addressing the categorization of revenues between exchange and nonexchange was authoritative. The illustrations included in SFFAS No. 6 were not intended to be comprehensive or to prevent the application of authoritative guidance found in the text of actual standards.

The illustration is undoubtedly confusing since it appears to explicitly address accounting for the roadbeds in question. However, the illustration relied on by the Forest Service is a general illustration for public lands and is appropriate for many uses of public lands. However, it is not specific to the case of roads constructed by Forest Service to provide access to timber. This function is part of a business-type activity while most uses of roads on public lands are not.

Roadbeds providing access to timber may differ from other roadbeds on public lands in two key aspects. One, the roadbeds may not be a permanent improvement to the land since the useful life of the roads relates to the need for access to an exhaustible resource, timber. Two, use of the roadbeds generates exchange revenue.

Unfortunately, taking the illustration alone--that is, absent consideration of more authoritative portions of SFFAS Nos. 4 and 6 as well as the unique aspects of these roadbeds--could lead one to perceive that the specific question of how to account for **all** roads on public lands was asked and answered.

Given its illustrative and general nature and the diverse uses of public lands, the illustration **does not** constrain the Forest Service in selecting an accounting treatment that is more appropriate in light of the underlying economics of its specific situation and authoritative accounting standards. As discussed below, staff believes that the accounting standards suggest different treatment than is indicated in the illustration.

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General PP&E Definition

The category "general property, plant, and equipment" is the only category of PP&E that is capitalized and depreciated per SFFAS No. 6. PP&E included in this category typically has one or more of the following characteristics:

> 1) it could be used for alternative purposes but is used to produce goods or services, or to support the mission of the entity, or
> 2) it is used in business-type activities, or
> 3) it is used by entities in activities whose costs can be compared to those of other entities performing similar activities.

The Board also provided that entities operating as business-type activities should categorize all PP&E as general PP&E whether or not it meets the definition of any other PP&E categories (SFFAS No. 6, Paragraph 24). Business-type activities are defined as "significantly self-sustaining activity which finances its continuing cycle of operations through collection of exchange revenue as defined in" standards for revenue and other financing sources (SFFAS No. 7).

The Board included this provision to support assessment of the operating results of business-type activities. That is, so that business-type entities would capture in their financial statements the full cost of operations.

Full Cost

The costs related to property, plant, and equipment are discussed in SFFAS No. 4. The relevant portions of that standard are presented below:

> 102. **Depreciation expense.** General property, plant, and equipment are used in the production of goods and services. Their consumption is recognized as depreciation expense. The depreciation expense incurred by responsibility segments should be included in the full costs of goods and services that the segments produce.
>
> 103. **Recognizing property acquisition costs as expenses.** The costs of acquiring or constructing federal mission and heritage property, plant, and equipment may be charged to expenses at the time the acquisition costs are incurred. Since the recognition of these expenses is **linked to property acquisition rather than production of goods and services, those expenses should not be included in the full costs of goods and services.** However, they are part of the costs of the entity or the program that makes the property acquisition. (Emphasis added.)

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Nonproduction costs

104. A responsibility segment may incur and recognize costs that are linked to events other than the production of goods and services. Two examples of these non-production costs were discussed earlier: (1) OPEB costs that are recognized as expenses when an OPEB event occurs, and (2) certain property acquisition costs that are recognized as expense at the time of acquisition. Other nonproduction costs include reorganization costs, and nonrecurring cleanup costs resulting from facility abandonments that are not accrued. Since these costs are recognized for a period in which a particular event occurs, **assigning these costs to goods and services produced in that period would distort the production costs.** In special purpose studies, management may have reasons to determine historical output costs by distributing some of these costs to outputs over a number of past periods. Such distribution would be appropriate when: (1) experience shows that the costs are recurring in a regular pattern, and (b) a nexus can be established between the costs and the production of outputs that may have benefited from those costs. (Emphasis added.)

SUMMARY

Taking SFFAS Nos. 6 and 8 as a whole, staff believes that the cost of roadbeds used in timber operations should not be expensed when incurred. Staff believes that roadbeds used in timber operations are more appropriately categorized as general PP&E. (Note that the Natural Resources project may result in other alternatives being considered.) This is based on the requirement that all PP&E used in business-type activities be categorized as general PP&E. In addition, staff believes that the roadbeds used in timber operations are not permanent improvements to the land. Rather, these roadbeds are an improvement needed to provide access to timber and thus the cost more closely relates to the timber than to the land.

With regard to the question of useful life, staff does not have enough information on which to address this question. We offer that depreciation is based on the useful life of an item of PP&E. While roadbeds generally may be considered permanent improvements to land, this may not hold true for roadbeds that provide access to timber. The Board defined useful life as "the normal operating life in **terms of utility to the owner.**" (Emphasis added.) If the roadbeds are not of permanent utility to the owner — that is, their economic life is less than their potential physical life — then we recommend that the roadbeds be depreciated based on their expected utility to the Forest Service in its programs (e.g., both timber harvesting and other uses).

The Board will consider this issue at its February meeting. Please provide any further input that you believe the Board would need on this matter as soon as possible.

Sincerely,

David Mosso
Chairman

Cc: Members of the Board

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