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UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D C 20548

RESOURCES AND ECONOMIC DEVELOPMENT DIVISION

JAN 29 1973

Dear General Clarke

We have completed a review of certain financial activities of the Southwestern Federal Power System and the overall results of our review were included in a separate report to the Congress (B-125031, dated November 22, 1972)

During our review at the Corps' district offices, we noted several problem areas which we believe should be brought to your attention for appropriate corrective action. These matters--not included in our report to the Congress--involve (1) inconsistencies in the classification of Corps operation and maintenance (O&M) expenses as specific expenses or as joint-use expenses and (2) substantial differences between estimated O&M expenses allocated to power operations in the cost allocations studies as compared with actual expenses allocated to power operations in the accounting records.

These inconsistencies and differences are important because they can have significant effect on the amount of expenses allocated to power operations for recovery in power rates.

INCONSISTENCIES IN THE CLASSIFICATION OF O&M EXPENSES AS SPECIFIC EXPENSES OR JOINT-USE EXPENSES

The classification of Corps O&M expenses is important because specific expenses are charged entirely to a particular project purpose whereas joint-use expenses are allocated among the various project purposes.

During our review we noted that Corps districts were inconsistent in classifying O&M expenses in the accounting records for fiscal year 1970. Expenses similar to those charged as specific recreation expenses by the Vicksburg District were charged as joint-use expenses, or other than specific recreation expenses, by other Corps districts. The following are examples of types of expenses charged to specific recreation expenses by the Vicksburg District but not by the other districts.

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- Real estate management expenses including compliance inspections of grants and utilization of real property, were allocated to specific recreation expenses for two Vicksburg projects at 50 percent and 40 percent. The remainder on both projects was charged to joint-use expenses.
- Expenses for condition and operation studies of the two Vicksburg projects were allocated 10 percent to specific recreation expense and 90 percent to joint-use expense.
- All O&M expenses of project-owned operating equipment were charged to specific recreation expense at Vicksburg.
- Some expenses to maintain buildings, grounds, and utilities were charged to specific recreation expense at Vicksburg.

Vicksburg personnel informed us that Corps guidelines for the classification of such O&M expenses did not preclude their allocation to specific recreation expenses. We estimate that the allocations of these types of expenses to specific recreation reduced power O&M expenses by \$15,653, as compared with what power expenses would have been if Vicksburg had followed the same practice as the other districts.

The Vicksburg District allocated all engineering and design expenses in fiscal year 1970 to joint-use expenses but the Tulsa and Little Rock Districts allocated some engineering and design expenses to specific purposes, including recreation. The different methods of allocating such expense can have a substantial impact upon the total O&M costs charged to a reimbursable project purpose. For example, we estimated that the O&M expenses charged to power during fiscal year 1970 would have been about \$42,154 greater if the engineering and design expenses for the Tulsa and Little Rock Districts had been charged as joint-use expenses as was done in the Vicksburg District.

The Fort Worth and Tulsa Districts charged expenses for stream gaging and reservoir regulation studies and for sedimentation surveys as specific flood control expenses in fiscal year 1970. The Little Rock District, however, charged expenses for such studies and surveys to joint-use expenses and the Vicksburg District did not identify these types of expenses. These inconsistencies contributed to the flood control expenses differing substantially between districts, as follows:

	<u>Tulsa</u>	<u>Fort Worth</u>	<u>Little Rock</u>	<u>Vicksburg</u>
Total specific flood control expenses - 1970	\$135,852	\$57,138	\$2,371	\$2,978
Number of projects	6	2	5	2
Average flood control expenses per project	\$ 22,642	\$28,569	\$ 474	\$1,489

Our review did not disclose any justification for the inconsistencies between districts in the classification of O&M expenses

This problem was previously noted by us in a report to the Corps (B-125031, dated May 25, 1960) In response to a recommendation in that report, the Corps' Director of Civil Works advised us in a letter dated September 1, 1960, that

"We concur in your recommendation that additional instructions are needed to govern the classification of operation and maintenance expenses as specific and joint use, especially where recreation expenses are involved Such instructions are being prepared "

In our opinion, the instructions are still inadequate because they do not provide adequate criteria for obtaining uniformity in charging O&M expenses as either specific expenses or joint-use expenses

Recommendation to the Chief of Engineers

We recommend that the Corps supplement and clarify existing instructions to the district offices for the classification of O&M expenses in a manner designed to avoid inconsistencies in the classification of such expenses In addition, we recommend that the Washington headquarters office of the Corps institute a follow-up review of the districts' implementation of such instructions and take appropriate action to ensure that they are applied in a uniform manner

DIFFERENCES BETWEEN ESTIMATED EXPENSES
IN COST ALLOCATION STUDIES AND ACTUAL
EXPENSES IN ACCOUNTING RECORDS

Corps joint-use O&M expenses allocated to power operations in the Southwestern Federal Power System totaled about \$6,292,100 during the 11 fiscal years ended June 30, 1970. The percentage of joint-use O&M expenses allocated to power operations varied substantially among projects--from a low of 11 percent to a high of 72.92 percent.

The percentages used for allocating joint-use O&M expenses are determined on the basis of estimated costs used in the cost allocation study for the project in question. Because of the manner in which they are developed, the joint-use percentages are significantly affected by the Corps' estimate of the O&M expenses to be charged to specific power purposes, and they differ from those used to allocate joint construction costs. For example, the Corps' cost allocation study for the Fort Gibson project shows that the percentage used for allocating joint construction costs to power--10.79 percent--was increased to 48.05 percent for allocating joint-use O&M expenses for power operations as shown by the following table:

	<u>Power expenses</u>	<u>Total project expenses</u>
1. Estimated annual separable O&M (incremental) expenses	\$172,400	\$222,500
2. Allocation of estimated annual joint O&M expenses (10.79 percent to power on the basis of remaining benefits)	<u>5,200</u>	<u>48,400</u>
3. Total	177,600	270,900
4. Less estimated specific O&M expenses	<u>99,300</u>	<u>107,900</u>
5. Estimated joint-use O&M expenses	<u>\$ 78,300</u>	<u>\$163,000</u>
6. Percentage for allocating joint-use expenses (ratio of power expenses to total expenses in line 5)	48.05%	100.00%

Although the percentages used to allocate joint-use expenses are developed on the basis of estimated expenses, the estimates are not later adjusted to recognize the extent to which actual O&M expenses may differ from estimated O&M expenses. We noted, for example, that fiscal year 1970 O&M expenses charged to power operations were substantially different than estimates of such annual expenses used in cost allocation studies for the purpose of determining the percentage of joint-use expenses that would be charged to power operations. Comparison of the actual expenses charged for fiscal year 1970 with estimates used in the allocation studies, as adjusted for price and wage escalation, follows:

<u>District</u>	<u>Operation and maintenance expenses - power</u>		<u>Increase (decrease)</u>
	<u>Actual</u>	<u>Cost study as adjusted^{1/}</u>	
	(_____ 000 omitted _____)		
Little Rock - Six projects	\$2,474	\$1,950	\$ 524
Tulsa - Five projects ^{2/}	1,081	1,372	(289)
Vicksburg - Two projects	409	471	(62)
Fort Worth - Two projects	335	442	(107)

^{1/} Adjusted using applicable construction cost indexes as shown in Engineering News Record

^{2/} Does not include one project in service 5 months in 1970

The Little Rock District experienced significantly higher power expenses than estimated in the cost allocation studies even after those estimates were adjusted for price and wage escalation. Other districts experienced much less actual expenses. Some of the differences are due to inconsistencies between allocation procedures used for recording expense in the accounting records as compared with procedures used in estimating the expenses in the cost allocation studies.

For example, all administrative and general expenses were allocated as joint-use expenses in 10 cost allocation studies before the procedures were changed to allocate some of these expenses as specific expenses. In the accounting records, however, administrative and general expenses were allocated to specific and

joint-use expenses on a pro rata basis. If the estimated administrative and general expenses had been allocated in the cost allocation studies on the same basis as they were recorded in the accounting records, the percentages used for allocating joint-use expenses to power operations would have been less in each case. We estimate that it would have reduced O&M expenses charged to power operations on the 10 projects about \$84,000 in fiscal year 1970.

There were also significant differences between estimates for specific flood control expenses for some items in the cost allocation studies and the actual specific flood control expenses for the same items in the accounting records. The Little Rock District estimated, in studies for five projects, an annual average of \$4,000 to operate and maintain the feature designated "other dam facilities" for flood control, but no expenses were actually recorded for this activity in fiscal year 1970. In fact, the district's computer system does not provide for such charges. For five projects in the Tulsa District, an average of \$8,400 was estimated in the cost allocation studies for specific annual flood control expenses to operate and maintain "other dam facilities," but an average of only \$1,000 was charged in fiscal year 1970. If the estimates for these items in the cost allocation studies had been adjusted to reflect the actual expenses, the tendency would have been to decrease the joint-use expenses allocated to power operations.

Specific power expenses estimated in the cost allocation studies to operate the power intake works were different than the same type of expenses charged to power operations in fiscal year 1970. The Little Rock District estimated an average annual specific expense of \$4,500 to operate power intake works but actually charged about \$1,900, the Vicksburg District estimated no specific power expenses to operate power intake works at two projects but charged an average of \$2,100, and the Fort Worth District estimated specific expenses of \$3,400 to operate power intake works for one project but actually charged nothing for such purpose in fiscal year 1970.

At three projects in the Tulsa District, which included fish and wildlife as project purposes, a total of \$14,800 was charged to specific fish and wildlife expenses in fiscal year 1970 although no specific expenses were estimated for this purpose in the cost allocation studies.

Recommendation to the Chief of Engineers


We recommend that the Corps periodically compare the specific O&M expenses actually incurred with estimated specific O&M expenses used in the cost allocation studies and--where significant variations are found--consider the need for adjusting the percentages used in allocating joint-use O&M expenses to the various project purposes

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We would appreciate receiving your comments on these matters and being advised of any corrective actions that you plan to take. We wish to express appreciation for the cooperation extended to our staff during our review.

Copies of this report are being sent to the Corps' Division Engineers of the Southwestern Division, Lower Mississippi Valley Division, and Missouri River Division.

Sincerely yours,


Wilbur D. Campbell
Assistant Director

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Lieutenant General F. J. Clarke
Chief of Engineers
Corps of Engineers
Department of the Army