July 14, 1992

Senator Glade Nielsen, Senate Co-chair
Representative Melvin R. Brown, House Co-Chair
Public School Trust Lands Task Force
State Capitol Building
Salt Lake City, UT 84114

Subject: **A Review of Costs and Revenues of the Division of State Lands and Forestry** (Report No. 92-04)

Dear Legislators:

This report is the first of two in response to your December 6, 1991 request for an audit of the Division of State Lands and Forestry and addresses the two issues regarding costs and revenues, namely:

> Determine whether revenues generated from Trust institutions are funding only trust activities.
>
> Determine the relationships between surface and subsurface activities relative to costs of management vs. returns. Determine if management resources are being appropriately applied to revenue generation from surface vs. subsurface activities.

We are continuing work on the above sub-issue regarding the appropriate application of management resources to revenue generation (i.e., are surface and subsurface administrative costs appropriate). We will report our findings on that, and the other issues of your request that we are addressing, in a final report to be made available by your November 1992 meeting.

Trust revenues are funding only trust activities, and mineral leases have higher revenue to cost ratios than surface leases. In addition to support from trust revenues, trust activities also receive General Fund support in excess of $300,000 per year.

The Division of State Lands and Forestry manages both state lands and forestry and fire control programs. State lands include those granted to Utah at statehood for the benefit of schools and other institutions; their management is funded mostly with trust revenues, supplemented with General Fund appropriations. Management activities include receiving applications for and approving leases and sales, monitoring leases, and auditing rental and royalty payments. In contrast, forestry and fire control programs pertain to forest programs not in national forests, both urban and rural, including private forests; these programs are funded with General Fund appropriations and some small federal grants. Management activities in this area include advising private and municipal forest managers in conservation practices and coordinating state-wide fire control with national forest and local governmental entities. At issue is whether trust revenues are funding non-trust activities within the division and how trust revenue produced by the division's various trust activities relates to the cost of producing those revenues. To address these issues, it is necessary to know the cost of division activities.

We found that the division's financial records can provide activity costs with reasonable accuracy. To do so, the division uses time sheets to allocate its personal service costs, which comprise the bulk of its total costs, to the various activities. Then the non-personal service costs, such as for telephones, office supplies, and transportation, are allocated in the same proportion as the personal service costs. The division's cost allocations were reviewed for logical construction and accuracy of calculations. The critical factor in the division's cost allocation is the time sheet data. To determine the validity of the time sheets, we compared the annual summaries of time sheets for numerous staff with our interviews and observations of those persons doing their work. We found no reason to believe that the time sheets are not being filled out correctly or that they do not reflect how staff time is being spent. Because the current time sheets include more definitive breakdowns of staff time by activity than in prior years, we used fiscal year 1992 time sheet, cost, and revenue information, projected through June 30, in addressing the issues of the audit request.

Trust Revenues Fund Only Trust Activities

Based on our review of fiscal year 1992 revenues and expenditures and their allocation, trust revenues are funding only trust activities. Not only does the trust finance only trust activities, trust activities were also funded by approximately $49,000 of the division's fiscal year 1992 General Fund appropriation. Further, since the trust activities' Triad Center office space is provided for by the Department of Natural Resources General Fund appropriation and Attorney General services are provided by the Attorney General's General Fund appropriation, neither of which is reimbursed by trust revenues, the trust activities are receiving a General Fund subsidy of between $300,000 and $400,000 per year, in addition to the above $49,000.

When comparing fiscal year 1992 allocated costs for trust activities with the division's charges to the Land Grant Management Fund, there is $49,000 more of allocated costs than charges.

Thus, the General Fund is subsidizing trust activities by this amount. When the office space and Attorney General costs described above are added, the General Fund subsidy is at least $349,000 for fiscal year 1992.

It is not inappropriate for Utah's General Fund to subsidize trust activities. Since net trust earnings fund education, any increase in trust fund earnings or reduction of expenses can reduce General Fund appropriations to education. Further, the Legislative Legal Counsel stated that it is not illegal for the General Fund to help fund trust activities. Also, three of the eight western states we contacted provide partial or full support of trust land activities from their general funds. Arizona and Montana representatives told us their trust activities are funded entirely from general fund appropriations. Idaho provides partial funding from their general fund. However, all of the other states' representatives told us that their trust activities are self-supporting.

Whether the trust activities should receive general fund support is a policy decision which the Legislature should make. The Legislature could leave the funding as it is, provide more or less General Fund support, or require the trust activities to be entirely self-supporting.

Mineral Leases Have Higher Revenue Ratios

Utah's mineral (subsurface) leases have higher revenue to cost ratios than its surface leases. The largest factor causing this disparity is the inherently higher value of mineral deposits as compared to surface resources. Another factor may be differences in cost effectiveness between the division's mineral and surface management programs, which will be addressed in our subsequent report.

As you requested, we have determined the relationships between surface and subsurface activities relative to revenue and costs of management. Figure I compares the various activities' revenues and management costs for fiscal year 1992. We believe that the direct cost figures and ratios are the most reliable. These are the division's figures as audited by us. The total cost figures, which include an allocation of indirect costs, and the related total cost ratios may be less reliable because of assumptions that had to be made when allocating the indirect costs.

Insert Figure I

As shown in the "revenue per dollar of *direct* cost" column of Figure I, minerals have higher ratios of revenue to management cost than surface activities. For example, the overall ratio of revenue to *direct* costs is $17.27 of revenue for each dollar of management expense. In contrast, surface activities provide only $2.44 of revenue for each dollar of direct expense. Special-use leases (e.g., land for a store or service station near a recreation area) have the highest revenue to cost ratio of all the surface activities, as shown by its ratio of $3.84 of revenue per dollar of cost. Three of the smaller surface revenue activities, "forest products, "rights of entry" and "other," with revenue of $0.92, $0.57 and $0.38 per dollar of cost, respectively, are losing money. When using the ratios for revenue per *total* costs, five of the surface activities appear to be losing money. A word of caution is that even if some of these small activities were eliminated, the indirect costs would not be saved, but merely allocated to other activities. For this reason, and because of the concern expressed above regarding the figures based on total costs, we suggest that management decisions be based on the direct cost ratios.

The last two activities shown in Figure I, land sales and land exchanges, also represent a portion of the division's land activities. Although land sales appear to have the highest revenue to cost ratio other than minerals, the proceeds from land sales should be higher. The proceeds from land sales represent the entire, complete value of the resource, whereas mineral and surface lease and royalty income represent but a portion of the resource value. Land exchanges provide no immediate revenue. Some of the land exchange costs relate to the current efforts to exchange trust land inholdings within federal forests, parks, and Indian reservations, which are anticipated to enhance future revenue.

Finally, we address a matter that stems from the passage of HB 47 during the 1992 Legislative Session. Effective July 1, 1993, the division will no longer receive 20 percent of the investment earnings from the permanent fund (comprised of land sale proceeds and 80 percent of royalties on non-renewable resources). It will receive only 20 percent of the revenue from the activities shown in Figure I, excluding land sale proceeds. There has been some discussion regarding how much additional funding the division might need for trust activities after fiscal year 1993.

The numbers in Figure I can be used to approximate the assessment rate necessary to fund the division's trust activities. By excluding the unusual $2,081,000 coal settlement revenue and the proceeds of land sales, the normal, assessable revenue for fiscal year 1992 is $11,517,500. It would have required a 23.2 percent assessment against this revenue to cover the $2,668,775 of total costs of the division's trust activities in fiscal year 1992. If the present 20 percent statutory rate continues, and using fiscal year 1992 as an example, the division would be short $369,000 (the difference between the above 23.2 percent and the existing 20 percent). Although the rate required will vary depending upon annual revenue and the authorized trust activity budget, unless the statutory rate is increased the division will either be underfunded or will have to experience significant trust activity reductions.

We hope this letter has provided the information you need on this issue. A letter of response from the Division of State Lands and Forestry is attached. If you have any questions or need additional information, please contact us.

Sincerely,

Wayne L. Welsh
Auditor General

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