

**Forest Service Handbook
National Headquarters - Washington Office
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**Forest Service Handbook 6509.18 – Financial Analysis Handbook
Chapter 10 - General Analysis Techniques**

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Responsible Staff:

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Digest: Following is an explanation of the changes throughout the directive by section.

11.1: Revises caption from “Timber Sale Activities” to “Timber Sale Activities Requiring Financial Analysis.”

11.2: Adds direction that a financial ability analysis must be conducted for requests by recreation concessionaire for a repayment agreement (para. 5).

12.41: Expands evaluations of finances to include additional situations and information requirements.

12.41a: Revises caption from “Basic Financial Information” to “Basic Financial Information Required for Financial Evaluations.”

12.42a: Revises caption from “Employment” to “Management and Other Financial Relationships that Determine Corporate Control Employment.”

13: Changes the caption from “Process” to “Analysis.”

13.1: Adds new ratios relevant to businesses operating on National Forest System lands.

13.11c - 13.11g: Establishes codes and captions for direction on Quick (Acid Test) Ratio (sec. 13.11c), Cash from Operating Activities to Current Liabilities (sec. 13.11d), Debt to Equity (sec. 13.11e), Total Asset Turnover (sec 13.11f), and Profit Margin on Sales (sec. 13.11g).

14.1 - 14.3: Establishes codes and captions for direction on Financial Ability Report (sec. 14.1), Report Designation (sec. 14.2), and Requests for Release Under the Freedom of Information Act (sec. 14.3).

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11 - When to Complete an Analysis

Request the assistance of a qualified accountant (an employee in the GS-510/511 series) when a decision is dependent upon the interpretation, analysis, or verification of accounting records or related financial information of parties external to the Forest Service. This analysis may involve a variety of circumstances, including, but not limited to, the following: timber sale activities (sec. 11.1), recreation concessionaires (sec. 11.2), procurement contracts (sec. 11.3), and other activities (sec. 11.4).

See chapter 20 for additional direction on conducting financial analyses related to timber sales and chapter 30 for special uses.

11.1 - Timber Sale Activities Requiring Financial Analysis

The following decisions related to timber sales require completion of a financial analysis:

1. Award of timber sales.
2. Settlement of damages in connection with defaulted timber sales (FSH 6509.11h, sec. 22.3).
3. Contract modification to defer timber sale contract payments for more than 5 years.
4. Timber sale appraisal based upon residual values. For this type of appraisal, follow the analysis guidance in FSH 6509.15, Collection and Analysis of Timber Purchasers' Cost and Sales Data, rather than the direction in this Handbook.
5. Requests by operators for a repayment agreement (FSH 6509.11h, sec. 21.33).

11.2 - Recreation Concessionaires

Conduct a financial ability analysis of the following:

1. Prospective special use applicants.
2. Existing permittees that are proposing an expansion of facilities.
3. Permittees in financial difficulty.
4. Bidders on negotiated contracts for concession campgrounds.
5. Requests by operators for a repayment agreement (FSH 6509.11h, sec. 21.33).

11.3 - Procurement Contracts

Conduct the following financial ability analysis related to procurement contracts:

1. Evaluation of financial ability of prospective contractors.

2. Evaluation of cost and price proposals on negotiated contracts.
3. Evaluation of contractor's claims for terminated contracts.

11.4 - Other Activities

Conduct a financial ability analysis in the following situations:

1. An allowance will be made for acceptance of installment payments for settlement with any debtor (excluding employees) (FSH 6509.11h, sec. 21.36).
2. A demonstration of financial ability or condition of another party is needed to adequately protect the interests of the Government.
3. A financial claim does not reflect the damages or economic loss actually sustained by the claimant and a validation or review of the propriety of the claim is needed to protect the interest of the Government.

12 - Financial Information Requirements

Request the following information for all financial analyses: financial statements (sec. 12.1), credit bureau reports (sec. 12.2), and data from State and local governments (sec. 12.3). Additional information specific to various kinds of analyses is described under the financial requirements described below.

12.1 - Financial Statements

Request a complete set of audited or reviewed financial statements for the last 3 fiscal years which includes:

1. Report by an independent Certified Public Accountant (CPA) on the financial statements.
2. Balance sheet.
3. Income statement.
4. Statement of cash flow.
5. Footnotes to the financial statements.
6. Report on internal control structure by the independent CPA completing the audited or reviewed statements (if prepared). When dealing with an individual, the size and materiality of the issue may justify accepting a personal financial statement (prepared on Form FS-6500-24, Financial Statement) and a complete set of Federal income tax returns for the last 3 years in substitution for audited or reviewed financial statements.

12.2 - Credit Bureau Reports

Obtain reports from credit bureaus covering the person or firm under examination.

Analyze each of the following:

1. Credit history.
2. Accounts payable activity.
3. Loan, lien, and notes payable activity.
4. Any other pertinent information contained in the reports.

12.3 - Data From State and Local Governmental Agencies

The size and materiality of the issue may justify using various data that is available from State and local governmental agencies in the analysis of financial ability. For instance:

1. Personal Property. Personal property or equipment claimed as assets may be subject to a security agreement or lien. Such data is usually available in the offices of the relevant secretary of state.
2. Land Records. Research of land records at the county seat may reveal a valuation by the county assessor for property tax purposes. If needed, contact Forest Service personnel in the lands staff for information on how to research land records.

12.4 - Affiliations

To determine affiliation, consider, as a minimum, common ownership, common management, and contractual relationships.

12.41 - Evaluating Finances

The documents listed in sections 12.41a through 12.41c are needed to complete a financial evaluation.

12.41a - Basic Financial Information Required for Financial Evaluations

1. Annual financial statements for the last 3 years (audited, if possible).
 - a. Balance sheet. It may be necessary to request consolidated financial statements, if the Forest Service believes funds or assets are being transferred among companies.
 - b. Income statement.
 - c. Source and use of funds statement.
 - d. Schedule of selling, general, and administrative expenses.

- e. Footnotes.
- 2. Annual income tax returns for the last three years.
- 3. Dividend payout schedule (or a schedule of any contributions made to the parent company).
- 4. Schedule of overhead allocations, if appropriate.
- 5. Schedule of officers' and directors' salaries and perquisites.
- 6. Identification and fair market value of non-operating assets.
- 7. Identification and magnitude of transactions among affiliated parties. It may be necessary to request financial statements for affiliated companies, too.

12.41b - Information When Companies Claim Financial Difficulty

When a company claims financial difficulty, request the following:

- 1. All of the information described in section 12.41a, paragraphs 1 through 7.
- 2. Name(s) and telephone number(s) of the company's lead bank and bonding company.
- 3. Name(s) and telephone number(s) of the independent and internal accounting officers.
- 4. Bankruptcy and/or liquidation plans.
- 5. The twelve most recent monthly financial statements.
- 6. Schedule of loans (advances) to officers, directors, employees, or affiliates.

12.41c - Information When Company Ownership is in Question

When ownership of the company is in question, request the following detailed information:

- 1. Name(s) and address(es) of all stockholders whose interest exceeds 10 percent.
- 2. Articles of incorporation and all amendments thereto.
- 3. Current and prior 3 years of board of directors' minutes. Research may require going back more than 3 years.

12.42 - Determining Corporate Control

Sources for determining affiliation include disclosures in annual audited or reviewed financial statements of the bidder or the accompanying Certified Public Accountant's opinion letter, the offices of the relevant secretary of state relative to corporation filings, or the disclosure on Form FS-6500-24, Financial Statement.

See sec. 12.42a for the list of management and financial documents, activities, and interrelationships that can be reviewed to determine corporate control.

12.42a - Management and Other Financial Relationships that Determine Corporate Control Employment

1. Employment packages.
2. Training programs.
3. Payment of salaries and expenses for the controlled corporation.
4. Approval of salary increases and bonuses.
5. Common pension funds.
6. Exchange and/or rotation of personnel.

12.42b - Shared Services

This includes sharing public relations, taxes, purchasing, finances, bookkeeping, computer systems, and general administration. Other examples include:

1. Mutual legal counsel.
2. Mutual independent public accountants.
3. Mutual insurance companies.

12.42c - Corporate Forms and Titles

Corporate forms and titles may include:

1. Common standard forms.
2. Common logos; common corporate names.
3. Common address, telephone numbers, and letterhead.

12.42d - Corporate Composition

Corporate composition may include:

1. Ownership of all or most of the capital stock of the controlled corporation.
2. Common officers and directors.
3. Selection method of the controlled corporation's officers and directors.

12.42e - Asset Verification

Asset verification may include:

1. Establishment of bank accounts, including the name(s) and title(s) of the partner who establishes bank accounts and the name and title(s) of the signatories.
2. Guarantees of loans or lines of credit.
3. Intercompany loans.
4. Commingling of funds.
5. Approval of capital budgets.
6. Approval of operating budgets.
7. Capital adequacy of the controlled corporation.

12.42f - Acquisition of Mergers Verification

Acquisition of mergers may include:

1. Involvement of the controlling corporation in the incorporation, acquisition, or purchase of the controlled corporation.
2. Payment by the subsidiary of a dividend to the parent.
3. Access of the parent to the subsidiaries' records and vice versa.
4. Forgiveness of any of the subsidiaries' debt by the parent.
5. Consolidation of the subsidiaries' financial statements into the parent's.
6. Warranties given by controlling company on the subsidiaries' products.

12.42g - Commonality

Commonality may include:

1. Common reporting procedures.
2. Common accounting procedures and financial reports.
3. Contributions to capital.
4. Common stockholder's meetings.
5. Common board of director's meetings.

6. Consolidated tax returns.

13 - Analysis

The characteristics of any financial analysis are dependent on the facts surrounding each case. Follow the direction in sections 13.1 and 13.2, which generally applies to all of the financial analyses procedures referred to in this handbook. Follow the direction in other sections of this handbook for additional requirements which pertain to the specific type of analytical assignment.

13.1 - Financial Ratios and Relationships

There are many financial ratios and relationships that can be used in financial analysis. In addition to those applicable to the particular assignment, compute and examine the ratios and comparisons in all cases as directed by sections 13.11 and 13.12.

13.11 - Ratios

13.11a - Current Ratio

The current ratio is reflected by dividing current assets by current liabilities. This ratio is an indicator of the ability to meet short-term debts. The ratio should be 1 or greater. A 1:1 ratio is minimal, 2:2 is healthy, and less than 1 is a warning. The higher the ratio, the healthier the company's finances should be.

13.11b - Owner's Equity to Total Assets

This ratio is the owner's equity divided by total assets. This percentage indicates the proportion of a firm's assets provided by its owners. A ratio of less than 50 percent indicates that the creditor's equity in the firm's assets exceeds that of the owner's. Related ratios are debt ratio and debt to equity ratio (sec. 13.11e).

13.11c - Quick (acid test) Ratio

The quick (acid test) ratio is assets, less inventories and prepaid assets, divided by current liabilities. This ratio measures the ability of an entity to discharge currently maturing obligations based on the most liquid (quick) assets. The quick ratio removes inventory from the current ratio test to reflect questionable value of inventory when it is liquidated. A ratio of 1:1 should be maintained, but a minimum ratio of 1.5:1 may be needed in some businesses.

13.11d - Cash from Operating Activities to Current Liabilities

This ratio is the net cash provided by operating activities divided by current liabilities and shows the extent to which a company has covered its current liabilities by generating cash from normal operations.

13.11e - Debt to Equity

This ratio is calculated by dividing the total liabilities by total assets or total equities. It indicates the extent of leverage used and creditor protection in case of insolvency. The denominator reflects historical costs and not current values.

13.11f - Total Asset Turnover

The total asset turnover ratio is the net sales divided by average total assets, and it measures how efficiently assets are used to produce sales. This ratio does not take into account that certain assets make no tangible contribution to sales. This assumes that an asset's participation in generating sales is relative to its recorded amount. The rate of return is based on historical asset cost which does not reflect current values.

13.11g - Profit Margin on Sales

This ratio reflects the net income divided by sales and measures efficiency of earnings income from sales.

13.12 - Financial Relationships

13.12a - Net Worth

Net worth is the amount by which total assets exceed total liabilities. This ratio is a key measure of the solvency of the firm. Firms with negative net worth are in a precarious financial position because there are not enough assets to satisfy the existing debts.

13.12b - Working Capital

Working capital is the amount by which current assets exceed current liabilities. It is a key measure of the amount of funds available to finance new or expanded activities. Lack of sufficient working capital to take on a new venture, while not fatal, requires the firm to acquire additional capital either through debt financing (loans) or equity financing (such as stock issuance or contribution of cash by owner). If a firm has a positive net worth, it may be able to generate additional working capital, but the accountant shall seek verification of sources and commitments for working capital extraneous to the firm, as well as detail from management on how additional working capital should be generated internally (such as sale of assets). Keep in mind that positive working capital does not necessarily indicate liquidity, if there is a negative net worth, nor does negative working capital necessarily indicate liquidity, if there is a positive net worth. Review and consider contingent liabilities in the analysis of working capital.

13.2 - Verification of Submitted Data

Verify assertions regarding the existence of assets and their valuation from third party sources, especially when working with personal financial statements or statements that have only been prepared "in house" or compiled (rather than reviewed or audited) by independent accountants.

Accomplish verification through inquiries, confirmation, and investigation. Consider that the market "value" of a particular asset often differs significantly from that suggested on the financial statement. Obtain written permission from the prospective contractor/permittee for verification of assets from third parties such as banks or brokers. When existence or valuation of an asset is in question, supporting documentation such as bank statements, appraisals, or stock and bond portfolio statements should be requested, reviewed, and verified. Critically review the value of: (1) stocks that are thinly traded or not listed on a National or Regional exchange; (2) shares in limited partnerships or land holdings; and (3) inventory, personal assets or property.

14 - Analysis Conclusions and Report

Document and support all conclusions relative to the financial ability or acceptability of financial data by sufficient working papers or corroborating evidential material. Ensure that work papers in support of conclusions meet standards established by the Comptroller General in "Government Auditing Standards" (Yellow Book, § 07), referenced in Chapter Zero Code.

14.1 - Financial Ability Report

As a minimum, ensure that the report on financial ability contains a description of the scope of work, the key findings, and conclusions.

14.2 - Report Designation

Entitle the internal working document "FOR OFFICIAL USE ONLY".

14.3 - Requests for Release Under the Freedom of Information Act

Release information as appropriate under the Freedom of Information Act (5 U.S.C. 552(b)(4)).