

# OFFICE OF SURFACE MINING

Fiscal Year 2006

## Annual Financial Report

Celebrating 16 years of unqualified  
audit opinions

U.S. DEPARTMENT OF THE INTERIOR



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## A MESSAGE FROM THE ACTING DIRECTOR

### Brent Wahlquist



In December of 2005, Interior Secretary Gail Norton asked me to serve as Acting Director of the Office of Surface Mining (OSM) until the President could nominate (and the Senate confirm) a new Director. During this past year, I've had the opportunity to lead an organization that does a remarkable job of protecting the public and the environment during and after coal mining while doing an extraordinary job of managing its financial resources. In the three decades that OSM has been meeting its obligations, coal production in the United States has doubled. Increasing production at a time of increased protection may seem surprising, but it actually fulfills one of the stated purposes of the Surface Mining Control and Reclamation Act of 1977 (SMCRA) - to strike a balance between protecting the environment and meeting the Nation's demand for coal as an essential energy source.

While this success is worth celebrating as we approach the 30<sup>th</sup> anniversary of the law that created OSM, we recognize that it is not our success alone. We share this achievement with states and tribes - those that have chosen to become our partners in carrying out the important responsibilities given to us by Congress.

The attached report provides financial information on OSM's operations, as well as performance data. OSM has the distinction of 16 successive years of unqualified or "clean" audit opinions. This record, the best within the Department of the Interior, reflects OSM's commitment to providing timely, accurate, and consistently reliable information. The Discussion and Analysis of the Financial Statements will help you to understand the major changes in OSM's financial position. It also explains some of the key financial reporting requirements for a Federal organization and describes some of the differences between commercial and governmental accounting.

.... Continued on next page.



TAYLOR CREEK IMPOUNDMENT, WEST VIRGINIA

# A MESSAGE FROM THE ACTING DIRECTOR

A separate report - our annual report to the President and Congress required by SMCRA - describes current activities carried out under the Surface Mining Law as well as historical data on mining and reclamation accomplishments, year-by-year, state-by-state, and tribe-by-tribe. The easiest way to access these documents is on OSM's web site at [www.osmre.gov](http://www.osmre.gov).

OSM's accomplishments are impressive for a small Federal bureau. This financial report and our annual report to Congress describe various initiatives and activities where we are working with Federal and state agencies, local and regional groups, and private citizens to improve the quality and productivity of mine land reclamation across this country. The reports describe developments in the areas of applied science, technology transfer and technical training, electronic filing of coal production data, the redesign and operation of our Applicant/Violator System, and the return of regulatory authority to the State of Missouri, and other highlights of 2006. All of this is accomplished in the context of sound financial management and accountability.

I urge you to review these documents and learn more about our programs, activities, and accomplishments.

Sincerely,

A handwritten signature in blue ink that reads "Brent Wahlquist". The signature is fluid and cursive, with the first name "Brent" and last name "Wahlquist" clearly legible.

Brent Wahlquist  
Acting Director



U.S. DEPARTMENT OF THE INTERIOR  
OFFICE OF SURFACE MINING

**Management's Discussion and  
Analysis**

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## Overview of the Report

Again this year, OSM is presenting the FY 2006 Office of Surface Mining Annual Financial Report as a separate report from OSM's 2006 Annual Report which is required by Section 706 of the Surface Mining Control and Reclamation Act of 1977. The Annual Financial Report describes the financial results of OSM's operations for the period October 1, 2005 to September 30, 2006 (FY 2006), and meets reporting requirements established for Federal agencies.

This report was compiled to provide OSM specific financial and performance information similar to that required of the Department of the Interior under the Chief Financial Officers Act of 1990 (CFO) and the Government Management Reform Act of 1994 (GMRA). Our report includes a summary of results required by the Government Performance and Results Act of 1993 (GPRA). As required by the Office of Management and Budget (OMB) Circular A-136, this document combines OSM's financial and performance reports for fiscal year 2006.

A number of states report program performance information on a Julian year basis (July 1 to June 30). To ensure consistency with Federal fiscal year reporting (October 1 to September 30), first quarter data for these states is adjusted on a recurring basis each year. All calculated statistics reported are clearly identified and footnoted.

OSM's 2006 Annual Report describes our programs and accomplishments in more detail. You may access this report in the future on OSM's website at [www.osmre.gov](http://www.osmre.gov) or obtain a copy by contacting our Office of Communications, 1951 Constitution Ave., NW, Washington, DC 20240.

### PHOTO CREDITS:

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NAVAJO RESERVATION, MONUMENT VALLEY,  
NEW MEXICO



GOLDEN EAGLE MINE, COLORADO



INDIAN HEAD MINE, NORTH DAKOTA

COVER:  
(1) BIG BROWN MINE, TEXAS  
(2) ROSE BUD MINE, MONTANA  
(3) CANE BRANCH MINE, VIRGINIA  
(4) LONG FORK SEDIMENTATION PROJECT, VIRGINIA

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## Overview of OSM's Mission and Organizational Structure

OSM was created by Public Law 95-87, the Surface Mining Control and Reclamation Act of 1977 (SMCRA). This Act established a framework for developing uniform environmental controls for surface coal mining and reclamation. It also sought to correct damage at abandoned coal mines. SMCRA mandated that a coordinated effort between the state, Indian tribes and the Federal Government would serve as the mechanism for meeting the requirements of the Act.

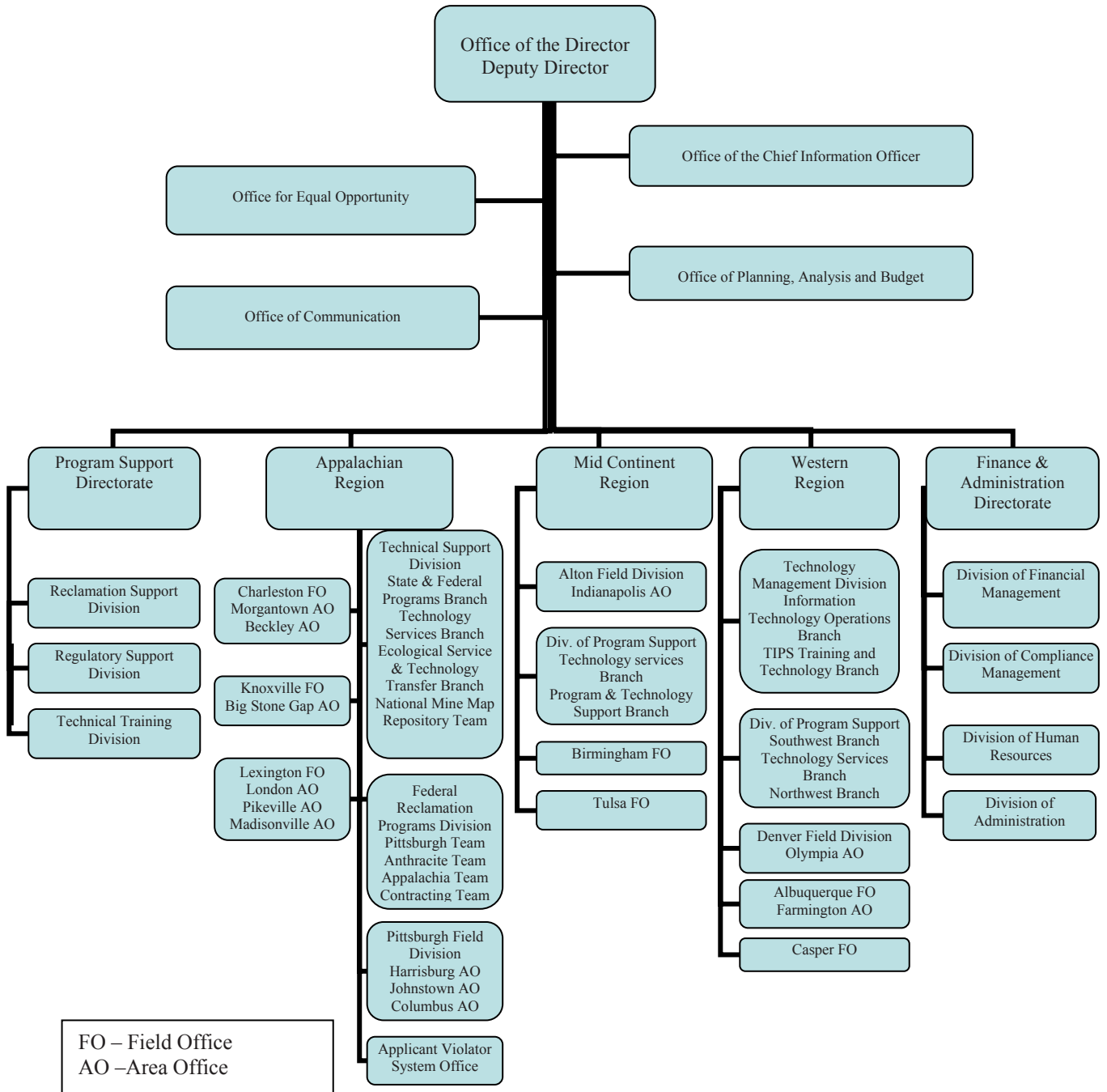
OSM's mission is organized around two requirements: regulating active coal mining and reclaiming abandoned coal mines. OSM also operates programs to eliminate impacts of acid mine drainage from abandoned coal mines, encourage reforestation of reclaimed mine land, develop techniques that ensure reclamation of prime farmland soils, and publicly recognize outstanding reclamation.

OSM is field-oriented, with headquarters in Washington, D.C. Three regional offices in Pittsburgh, Pennsylvania; Alton, Illinois; and Denver, Colorado respond to AML emergencies, and provide technical oversight assistance to the field offices, states, and tribes. Seven field offices (Albuquerque, New Mexico; Birmingham, Alabama; Casper, Wyoming; Charleston, West Virginia; Knoxville, Tennessee; Lexington, Kentucky; and Tulsa, Oklahoma) and 12 area offices (Big Stone Gap, Virginia; Beckley, West Virginia; Columbus, Ohio; Farmington, New Mexico; Harrisburg, Pennsylvania; Indianapolis, Indiana; Johnstown, Pennsylvania; London, Kentucky; Madisonville, Kentucky; Morgantown, West Virginia; Olympia, Washington; and Pikeville, Kentucky) are located where coal mining is most active, and are responsible for on-the-ground regulation and oversight.

OSM also maintains a financial management office in Denver, Colorado; an Applicant/Violator System (AVS) Office in Lexington, Kentucky; an Anthracite Office in Wilkes-Barre, Pennsylvania; and an Appalachia Abandoned Mine Land Office in Ashland, Kentucky.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## Office of Surface Mining Organization



# MANAGEMENT'S DISCUSSION AND ANALYSIS

## Overview of OSM's Programs

### Budget & Appropriations

OSM receives its appropriations from two sources. The Regulation and Technology Appropriation comes from the Treasury General Fund. The reclamation program is funded from the Abandoned Mine Reclamation Fund (AML) which is comprised of receipts from coal mining companies and interest earned on the investment of the AML fund and a separate appropriation.

Some of OSM's major programs are identified in this section. More in-depth analysis and performance information is included in the section entitled Report on Performance Goals and Results.

**Table 1**  
**Appropriations**  
**For the Years Ended September 30, 2006 and 2005**

| (dollars in thousands)                          | FY 2006           | FY 2005           |
|---|-------------------|-------------------|
| <b>Regulation &amp; Technology</b>              |                   |                   |
| Environmental Restoration                       | \$ 156            | \$ 159            |
| Environmental Protection                        | 78,615            | 79,820            |
| Technology Dev. & Transfer                      | 14,683            | 13,300            |
| Financial Management                            | 481               | 485               |
| Executive Dir. & Admin                          | 14,875            | 14,504            |
| <b>Subtotal</b>                                 | <b>108,810</b>    | <b>108,268</b>    |
| <b>Abandoned Mine Reclamation Fund</b>          |                   |                   |
| Environmental Restoration                       | 167,609           | 169,319           |
| Environmental Protection                        |                   |                   |
| Technology Dev. & Transfer                      | 3,864             | 3,021             |
| Financial Management                            | 6,142             | 8,444             |
| Executive Dir. & Admin                          | 7,633             | 7,422             |
| <b>Subtotal</b>                                 | <b>185,248</b>    | <b>188,206</b>    |
| Legislated OSM Budget                           | 294,058           | 296,474           |
| Legislated Transfer to United Mine Workers Fund | 59,004            | 66,533            |
| <b>Total</b>                                    | <b>\$ 353,062</b> | <b>\$ 363,007</b> |

*Note: The appropriation figures include reprogramming and rescissions for FY 2005 and FY 2006. The figures do not include available receipt collections included in the budget authority on the Statements of Budgetary Resources.*

## Abandoned Mine Land Programs

Title IV of SMCRA establishes the Abandoned Mine Land Reclamation Program, which provides for the restoration of lands mined and abandoned or left inadequately restored before August 3, 1977. The program is implemented through states and tribes with approved programs (primacy) using grants administered by OSM. OSM is responsible for carrying out the Abandoned Mine Lands Program in states that do not have primacy.

### Abandoned Mine Reclamation

This program is funded from the collection of fees from active mining operations. The fees are deposited in the Abandoned Mine Reclamation Fund, which is used to pay the costs of abandoned mine land reclamation projects. From January 30, 1978, when the first fees were paid, through September 30, 2006, the fee collections totaled \$7.8 billion. For the same period, appropriations from the Fund totaled \$5.9 billion.

### Abandoned Mine Land Fee Reauthorization

Under the provisions of the SMCRA, the authority to collect AML fees was limited in time. Over the years, Congress has extended this authority on several occasions. Although the issue is not yet resolved, President Bush signed into law H.R. 4939, the Emergency Supplemental Appropriations Act for Defense, the Global War on Terror, and Hurricane Recovery 2006, containing an extension of the authority to collect AML fees through September 30, 2007.

**Table 2**  
**Abandoned Mine Reclamation Fund Status**  
**Cash Basis (Includes Investments)**  
**For the Years Ended September 30, 2006 and 2005**

| (dollars in thousands)                   | FY 2006        | FY 2005        |
|--|----------------|----------------|
| Balance, Start of Year                   | \$ 2,133,969   | \$ 2,043,080   |
| Fees, debts, and interest collected      | 302,992        | 293,604        |
| Interest earned on investments           | 95,687         | 75,017         |
| <b>Total Earnings</b>                    | <b>398,679</b> | <b>368,621</b> |
| Less:                                    |                |                |
| Disbursements                            | 208,995        | 211,199        |
| Transfers to the United Mine Workers     | 59,004         | 66,533         |
| <b>Total Disbursements and Transfers</b> | <b>267,999</b> | <b>277,732</b> |
| Balance, End of the Year                 | \$ 2,264,649   | \$ 2,133,969   |

*Note: The information presented in this table is on a cash basis and therefore will not reconcile to accrual based financial data presented elsewhere in this report.*

# MANAGEMENT'S DISCUSSION AND ANALYSIS

For the past several years, reauthorization of AML reclamation fee collections has been OSM's primary policy objective. Although Congress has extended OSM's current fee collection authority until September 30, 2007, it has not yet resolved the difficult long-term issues associated with reauthorization of the fee.

The Administration continues to focus on the priorities outlined in the initial reauthorization proposal developed in 2003: Directing more money to the reclamation of high priority coal related health and safety problems; honoring commitments made to states and tribes; addressing funding for the unassigned beneficiaries of the United Mine Worker's Combined Benefit Fund (UMWA-CBF) while protecting the integrity of the AML fund; and, providing for enhancements, efficiencies and the effective use of the AML fund.

## Electronic Filing (E-Filing) Coal Production Reports

OSM collects coal reclamation fees from coal mine operators through an efficient and effective reporting, audit and debt collection program. We take a proactive approach to collecting fees, by working cooperatively with coal mining companies' needs to simplify reporting and payment requirements, increase efficiency and provide guidance on technical issues, whenever needed. Specific steps taken include: contacting all new operators to explain the reporting and payment requirements; sending pre-populated forms to all active coal mining companies; offering Internet based reporting and payment options; and by providing guidance through handbooks, an (800) telephone line, email, and during audits. This proactive approach has been highly successful.

E-Filing helps maintain OSM's high collection rate of coal reclamation fees. E-File is a website used by coal companies to report coal production tonnage, file quarterly Coal Reclamation Fee Reports and pay reclamation fees using the Internet. E-File offers an option of paying fees on-line through the Treasury Department's Pay.gov website. In 2006, 64 percent of coal mining permits nationwide were reported through OSM's E-File website. In fact, 92 percent of total fees were reported to OSM using E-File.

## Regulation and Technology Programs

OSM provides states, Indian tribes, Federal agencies, and the coal industry with the technical assistance and tools they need to carry out their responsibilities under SMCRA. The goal is to help stakeholders develop the skills needed for solving problems on their own. In recent years, OSM has been supplementing its traditional oversight presence with an increased emphasis on providing technical assistance, training, technology transfer and advanced technical software tools to support state and tribal programs.

While the focus of OSM is to help state and tribal partners do their jobs, the ultimate goal is to improve the health, safety, and the environment for our primary customers—the people who live and work in coalfield communities.

### Increased Emphasis on Technology

OSM continues to advance through the development and transfer of science and technologies that support more efficient and improved regulation and reclamation of coal mined lands. The FY 2006 Budget included a \$2.5 million increase over the 2005 level for funding increases in the National Technical Training Program (NTTP), the Technical Innovation and Professional Services Program (TIPS) and applied science studies. In addition, OSM continues to refocus existing resources toward activities that result in quality reclamation and leveraging of resources through activities such as the Reforestation Initiative and the national and regional Technology Transfer Teams.

OSM's NTTP makes job-related scientific and technical training available to all OSM, state, and tribal personnel to ensure consistent and quality evaluation of mine permits, inspection of active mines and the reclamation of abandoned sites. This training program, which is unique in the nation, helps provide the "level playing field" across the country that both the mining industry and coalfield citizens desire in the regulation of our most plentiful energy resource.

During FY 2006, OSM enhanced its applied science program and continued to improve its technology transfer program. OSM, in 2006, solicited 60 applied science proposals, resulting in the selection and funding of 12 projects. An additional 12 underground mine mapping projects were funded in 11 states. The grand total for both efforts was \$1.3 million for applying proven technology toward active and abandoned coal mining reclamation and supporting state abandoned underground mine mapping archive initiatives. These studies will develop and demonstrate the use of modern technologies and scientific practices that will improve the reclamation and regulation of coal mined lands. This will result in future reclamation that will continue to protect the health, safety, environmental and economic resources of the coal fields both during and after the completion of coal mining at enhanced level.

TIPS was founded on the premise of providing a common set of technology tools for all SMCRA agencies to use in fulfilling the mandates of the Act. This approach produces scientific and engineering analyses of mining and reclamation at a high level of technical accuracy, with uniformity on a national scale, and at considerable cost savings from Federal enterprise purchasing. Since its founding, TIPS has provided technology tools, expert assistance, and customized training classes to state, tribes, and OSM offices nation wide.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

TIPS embraces the more advanced technologies of geographical information systems (GIS), remote sensing and mobile computing, through collaborative work with states and other federal partners. OSM technical assistance to state programs on complex regulatory and abandoned mine land issues provided states with augmented expertise in areas such as hydrologic impacts, blasting, revegetation, endangered species, stability, subsidence, erosion and sediment control and many other specialized reclamation science and engineering techniques. These technologies have demonstrated considerable worth in SMCRA field application after TIPS began evaluating their applicability in limited use.

## Regulatory Stability

OSM continues to develop regulations that will promote better mining and reclamation practices to establish a stable regulatory framework.

During FY 2006, OSM published in the Federal Register, one proposed rule, the Tennessee Federal Program, which will provide operators with additional options for bonding and promote reforestation (71 FR 17682; April 6, 2006). OSM also published three final permanent program rules: Revisions to the State Program Amendment Process which added flexibility in our dealings with state regulatory authorities (70 FR 61194; October 20, 2005); Civil Penalty Adjustments which adjusted the amount of our civil penalties to keep pace with inflation (70 FR 70698; November 11, 2005); and, Topsoil Replacement and Revegetation Success Standards which encourages species diversity on reclaimed lands (71 FR 51684; August 30, 2006).

OSM is also developing rules for publication in the near future that will govern permit issuance (Ownership and Control rulemaking), minimize the impacts of mountaintop mining (Placement of Excess Spoil and Stream Buffer Zone rulemaking), facilitate the removal or reprocessing of coal refuse piles by private industry (Abandoned Coal Refuse rulemaking), and establish standards for the use of coal combustion by-products in the reclamation of coal mining operations (Coal Combustion By-Products rulemaking).

## Oversight - Missouri Regains Regulatory Authority over Surface Coal Mining Operations in the State.

After more than two years of direct Federal enforcement by OSM, the State of Missouri reassumed regulatory authority over surface coal mining operations in the state. On February 1, 2006, OSM returned full responsibility to the state. Previously, OSM awarded funding so the state could work cooperatively with OSM to restart the Missouri Regulatory Program. OSM will continue to provide technical assistance to support the state in its implementation of its Regulatory Program. Approval of Missouri's Regulatory Program made it once again eligible for AML funding. On February 1, 2006 OSM also awarded Missouri an AML grant of \$939 thousand for reclamation of abandoned mine hazards.



## Reforestation Initiative

The Appalachian Regional Reforestation Initiative (ARRI) began with seven Appalachian states, local governments, universities, mining operators and conservation groups pledging to work toward restoration of hardwood forests on mined lands. An academic team of 24 reforestation researchers from 10 universities across the country was established, providing scientific credibility for needed changes in reclamation practices that are supported by environmental and industry groups. An awards program was also established to honor operators who exemplify the provisions of the Forestry Reclamation Approach.

ARRI expanded efforts in FY 2006 to establish high quality hardwood forests on reclaimed coal mined lands. The academic team published two of the first in a series of Forest Reclamation Advisories, written at a high school level, as education tools for use by regulators, landowners, and mine employees in implementing proper forestry reclamation. The ARRI conducted field tours and seminars during June 2006 visiting reforestation sites in Pennsylvania, Maryland, West Virginia, and Kentucky. This collective effort is an example of how OSM is working with our partners to bring down barriers and develop new and better ways to grow trees successfully.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## Other OSM Programs

### Single Source Coal Reporting (SSCR)

The Office of Surface Mining and its partner agencies: the Mine Health and Safety Administration; the state governments of Pennsylvania and Virginia; and the Internal Revenue Service, implemented the Single Source Coal Reporting system on March 31, 2006. The project is a culmination of work with OSM's partners. The subject matter experts from each partner agency formed a working group and collaborated on the data requirements, design and testing of the system. Funding for the project was provided by the Small Business Administration and the Department of the Interior.

The Single Source Coal Reporting system allows the coal mining industry to submit production and safety data one-time, using a secure web-based system, and the Federal and state agencies share that data. The system consolidates reporting to multiple agencies, reduces the burden of redundant reporting for the industry and ensures consistent information with fewer data entry errors. It expands the use of electronic services for government compliance.

Beginning in April 2006, five pilot companies evaluated the system and provided feedback to the partners. The pilot companies' feedback resulted in planned changes to improve the system. The current pilot companies consist of larger coal companies reporting on multiple permits. A pilot test with smaller companies is planned for January 2007.

The Single Source Coal Reporting project was selected as a finalist for one of the 2006 Intergovernmental Solutions Awards, presented each year by the American Council for Technology at its annual Management of Change Conference.

### Information Technology (IT)

During FY 2006, OSM remained focused upon continuous OSM security program improvement. Bureau-wide informational memoranda related to communicating Federal and departmental IT security mandates, rules, and regulations were issued providing documentation artifacts enforcing the OSM IT Security Program. Additional informational and implementation guidance is anticipated to be needed at OSM in the future to assure full compliance with: Federal A-123 Internal Control Review (ICR) requirements; IT security Plan of Action and Milestone (POAM) Reporting corrective actions; and Federal Information Security Management Act (FISMA) requirements.

Also continuing during FY 2006, is the integration of sound project management capabilities into all information technology business cases through project manager team-building sessions of coaching, counseling, and on-demand training slide-shows. Building strong project management knowledge, skills and capabilities is planned to move beyond the investment business-case level, through individual maturity model developments of strategic plans, into an Integrated Program Management Office (IPMO) capability across OSM program and functional areas such as budget, human resources, facilities management, asset management, acquisition, e-Government and contracting. This will help assure citizen friendly and efficient mission delivery of services to OSM stakeholders.

OSM is also continuing to improve programmatic applications as well. The Applicant/Violator System (AVS), a relational database used by OSM and state regulatory authorities to assist with making permit eligibility decisions required by Section 510(c) of SMCRA, was redesigned and will be deployed in early FY 2007. The redesigned effort involved transforming the current system to a more user-friendly, web-based application and allows for ease in performing future enhancements.

OSM revised its approach to acquiring the Coal Fee Collection Management System (CFCMS) during FY 2006 and completed extensive planning to develop the system in two phases. The CFCMS system will replace three outdated legacy systems with one system that uses contemporary technology and commercial-off-the-shelf software. The system will support OSM's fee compliance program and civil penalty enforcement program. OSM will begin developing the first phase of the system in October 2006. The system will reduce the risk of current system failures, reduce maintenance cost, help avoid future cost increases, and improve efficiency.

During FY 2006 OSM geared up for the transition to the new Financial Business Management System (FBMS). FBMS is an enterprise management initiative that will integrate financial management, acquisition, property management, grants administration and other subsidiary systems and will revamp administrative processes throughout the Department of the Interior. The transition for OSM to FBMS is anticipated in mid-November 2006.

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U.S. DEPARTMENT OF THE INTERIOR  
OFFICE OF SURFACE MINING

**Report on Performance Goals  
and Results**

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## Report on Performance Goals and Results

OSM's mission and vision is to carry out the requirements of the Surface Mining Control Act of 1977 (SMCRA) in cooperation with states and tribes (see Figure 1). The primary objectives are to ensure that coal mines are operated in a manner that protects citizens and the environment during mining, and that the land is restored to beneficial use following mining, and to mitigate the effects of past coal mining by aggressively pursuing reclamation of abandoned coal mines.

In accordance with the Government Performance and Results Act of 1993 (GPRA) and associated Office of Management and Budget guidance, OSM prepares an annual performance plan as part of its "Budget Justifications and Performance Information" document. OSM's annual performance plan and related performance measures have been revised to align with the Department's "Strategic Plan for Fiscal Years 2003-2008" published on September 30, 2003. The Department's plan can be found at [www.doi.gov/ppp/strat\\_plan\\_fy2003\\_2008.pdf](http://www.doi.gov/ppp/strat_plan_fy2003_2008.pdf).

The primary goals of programs funded through OSM are to protect society and the environment from the adverse environmental effects of surface coal mining operations. Federal and state regulatory programs establish mining and reclamation requirements for current coal mining operations. Federal, state and tribal Abandoned Mine Land programs address public health, safety and environmental hazards at abandoned mines.

The annual performance plan emphasizes on-the-ground program accomplishments primarily by our partners, the states and tribes. In addition to regulating mining in states without approved programs, OSM activities focus on technical assistance. In addition, OSM seeks improved management efficiencies through implementation of the President's Management Agenda. These initiatives complement GPRA and focus on program performance in five key management areas: strategic management of human capital, competitive sourcing, electronic government, financial management, and budget and performance integration.

In carrying out the mandates of SMCRA, OSM continues to seek input from state and tribal partners, industry, citizens, and citizen groups. The development of the initial suite of goals and measures was completed after extensive consultations with these partners and stakeholders in the mid-1990s. Since that time, the measures have been further developed and revised to better reflect program performance.

OSM activities support three of the four departmental mission areas - Resource Protection, Resource Use, and Serving Communities. The reclamation program supports both the Resource Protection and Serving Communities goals. Reclamation activities protect the environment by abating health and safety problems and serve communities by protecting people and property. The reclamation technical activities generally support the Resource Protection goal. Reclamation program administration activities support the Serving Communities goal. OSM's regulatory program supports the Resource Use goal by ensuring that coal extraction operations are conducted in an environmentally responsible manner, and that the land is reclaimed during and following the mining process. Regulatory program administration and technical activities generally support the Resource Use goal.

**Figure 1**  
**OSM Vision and Mission**

## **Mission**

Our mission is to carry out the requirements of the Surface Mining Law in cooperation with states and tribes. Our primary objectives are to ensure that coal mines are operated in a manner that protects citizens and the environment during mining and assures that the land is restored to beneficial use following mining, and to mitigate the effects of past mining by aggressively pursuing reclamation of abandoned coal mines.

## **Vision**

- In regulating active coal mining, we will maintain compliance at high levels and ensure that all mines are properly operated and promptly reclaimed to the standards established under the law. We will emphasize prevention and ensure that long-term environmental problems do not occur. We will ensure that the premining productivity of the land is restored.
- In reclaiming abandoned mine lands, we will aggressively pursue reclamation with a primary emphasis on correcting the most serious problems related to public health, safety, and the general welfare. We will ensure maximum public benefit through the prompt and fair distribution of public funds.
- In cooperating with state regulatory authorities, the primary enforcers of the Surface Mining Law, and with tribes, we will promote a shared commitment to the goals of the Law. We will develop a comprehensive understanding of the fairness, effectiveness, and efficiency of the Surface Mining Law programs. We will provide constructive program reviews, oversight monitoring, and technical assistance that focus on results. We will act independently to protect the public interest in situations of imminent harm or when a state does not implement an approved regulatory program.
- In dealing with those who are affected by mining and reclamation, we will ensure the protection of citizens from abusive mining practices, be responsive to their concerns, and allow them full access to information needed to evaluate the effect of mining on their health, safety, general welfare and property.
- In our relations with the coal industry, we will have clear, fair, and consistently applied policies and will respect the importance of coal production as a source of our Nation's energy supply.
- In all communications, we will maintain open, courteous, constructive, and timely dialogue and will use information to understand and improve our programs and those of our state and tribal partners.
- In demonstrating leadership in mining and reclamation, we will promote the development of the highest quality technical information and research and will seek the transfer of technology to those who would benefit.
- In meeting our responsibilities, we will be a diverse, competent, innovative, and highly-trained work force. We will serve with integrity, and demonstrate technical, legal, administrative, and professional excellence at all times. We will constantly strive to create a more responsive, efficient, and effective process for achieving the objectives of Surface Mining Law.



## **Resource Protection: Abandoned Mine Reclamation**

**Strategic Goal:** Improve health of watersheds, landscapes, and marine resources that are Department of the Interior managed or influenced in a manner consistent with obligations regarding the allocation and use of water.

The reclamation program supports Resource Protection by influencing Federal, state, and tribal activities to improve the health of watersheds and landscapes by correcting problems caused by past mining. Federal grants enable states and tribes to reclaim land and water adversely impacted by past coal mining. Technical assistance, training and technology development is provided to the states and tribes through OSM's technology development and transfer program.

### **Measuring Performance Results**

One of the highest goals of Federal, state and tribal programs is to ensure that land and water resources disturbed by mining are reclaimed. The amount of reclamation that occurs is a key factor in the success of both regulatory and AML programs. For abandoned mines, OSM measures this desired outcome in terms of the number of acres reclaimed or the number of miles of degraded streams that have been improved. See Figure 2.

## **Resource Use: Control of the Environmental Impacts of Surface Coal Mining**

**Strategic Goal:** Manage or influence resource use to enhance public benefit, promote responsible use, and ensure optimal value.

SMCRA requires that coal mining operations be conducted in an environmentally responsible manner and that land and water resources be adequately reclaimed during and following the mining process. State and federal regulatory programs are designed to promote and monitor compliance with these requirements. The technology development and transfer program provides technical assistance, training, and technology development resources to states and tribes.

### **Measuring Performance Results**

In the case of regulated mining operations, annual success is measured by the number of permitted acres that have met the highest long-term reclamation standards required for release of "Phase III" performance bonds. Because of the importance of preventing mining operations from adversely affecting land or water resources outside of the permitted area, OSM also measures the percent of operations that are free of any offsite impacts. See Figure 2.

# PERFORMANCE GOALS AND RESULTS

## Serving Communities

**Strategic Goal:** Protect lives, resources and property.

The Abandoned Mine Land Reclamation Program (AML) addresses health and safety problems and serves communities by protecting the lives and property of citizens interacting in the coal field area. As a way of linking reclamation success at abandoned mines with the overriding purpose of protecting public health and safety, OSM also presents reclamation data in terms of reductions in the number of people exposed to the hazards of such mines. This is done with a calculation of the number of people interacting within one-mile of a high-priority abandoned mine and, thus, potentially at risk. As the number of hazardous mines is reduced through reclamation, the number of people at risk from those mines is also reduced.

## **Measuring Performance Results**

In FY 2006, OSM is reporting on six performance measures (See Figure 2) which are identified as end outcome performance measures for the Department of the Interior's Strategic Plan. It is the Department's policy to report a measure as met if the actual or estimated performance result is from 95 percent to 105 percent of the performance target. OSM met three of its measures, exceeded two, and did not meet the target for one. Explanations for those exceeded are noted in Figure 2. For the goal not met, the number of surface acres of water for which degradation from coal mining has been improved, this was due to the fact that projects vary and the size is not always a known factor. OSM is proposing to combine this target with the number of land acres reclaimed in FY 2007 to better represent all reclamation accomplishments.

**Figure 2**  
**OSM/DOI Strategic Plan Measures**  
**For the Year Ended September 30, 2006**

| <b>Measure</b>  | <b>Target</b> | <b>Results</b>             |
|---|---------------|----------------------------|
| <b><i>Mission Area: Resource Protection</i></b>   |               |                            |
| Number of land acres reclaimed or mitigated from the effects of degradation from past mining. (Calculated equivalent acres) | 6,900         | 6,984 <sup>1</sup>         |
| Number of stream-miles for which degradation from past surface coal mining has been improved.                               | 35            | 69 <sup>1&amp;2</sup>      |
| Number of surface acres of water for which degradation from coal mining has been improved.                                  | 35            | 32 <sup>3</sup>            |
| <b><i>Mission Area: Resource Use</i></b>  |               |                            |
| Percent of active sites that are free of offsite impacts.   | 93            | 91.5% <sup>4</sup>         |
| Number of acres where reclamation goals are achieved as evidenced by release from Phase III Performance Bonds.              | 50,000        | 49,796 <sup>4</sup>        |
| <b><i>Mission Area: Serving Communities</i></b>   |               |                            |
| Number of people with reduced exposure potential to safety risks from abandoned mine lands.                                 | 160,000       | 393,728 <sup>1&amp;5</sup> |

<sup>1</sup> Information calculated from projects reported with completion dates of 10/1/05 – 9/30/06 and entered in the Abandoned Mine Land Inventory System as of 10/3/06. Data are recorded, processed, and summarized to permit the preparation of performance information in accordance with criteria stated by management and agreed to by the participating states.

<sup>2</sup> Results based on 44 projects ranging from 0.02 miles to 5 miles, and 1 project accounting for 35 miles. The Audenreid Mine Drainage Tunnel AML Treatment Project in Pennsylvania attributed to the clean-up of 35 miles of aquatic stream habitat.

<sup>3</sup> Results based on 12 projects ranging from 1 to 17 acres.

<sup>4</sup> Calculated values: State programs provide data on a July 1, 2005 – June 30, 2006, timeframe to accommodate the accelerated publishing requirements. Results are calculated by subtracting the 2005 quarter data (July 1 – September 30, 2005) and adding the 2006 quarter data (July 1 – September 30, 2006). Federal data is on the federal fiscal year.

<sup>5</sup> Data anomalies: Of the 393,728 people with reduced exposure, 93,922 were reported for 1 project in Alaska. An additional 144,375 people were reported on 5 projects in Wyoming due to the sites' proximity to communities, recreational areas, schools, and a portion of a national park. States are provided the option of using data other than the calculated Census data due to site conditions that may impact more people such as those identified above, or less people as appropriate. If only the Census data calculation was used for all acres reclaimed in FY 2006, the total number of people associated with those acres would be 161,297. This is in line with our target.

# PERFORMANCE GOALS AND RESULTS

## United Mine Workers Combined Benefit Fund Program

Under Public Law 102-486, OSM is required to transfer annually a portion of the interest earned from the AML fund to the United Mine Workers of America Combined Benefit Fund (see Figure 3).

The annual transfers began in 1996. Funds earned in 1993 through 1995 were earmarked to establish a reserve pool to support transfers of up to \$70 million, where the interest collected was not sufficient to meet the shortfalls of health benefits provided to “orphaned” miners under the United Mine Workers Combined Benefit Fund Program. This reserve was exhausted in 2003.

### Measuring Performance Results

OSM determined that meaningful performance measures for this transfer are not possible. Once the transfer is made (within five business days of the request by the United Mine Workers of America Combined Benefit Fund), OSM has no authority over how the transferred money is used.

**Figure 3**  
**United Mine Workers of America Combined Benefit Fund**  
**(Cash Basis)**  
**For the Year Ended September 30, 2006**

(dollars in thousands)

| Fiscal Year of Interest Collection | Number of Unassigned Beneficiaries | Annualized Rate of Interest Earned | Interest Collected | Transfers Through FY 2004 | FY 2005 Transfer | FY 2006 Transfer | Use of FY93-95 Pool | Transfer to Date  | Interest Balance  |
|------------------------------------|------------------------------------|------------------------------------|--------------------|---------------------------|------------------|------------------|---------------------|-------------------|-------------------|
| 1992                               | N/A                                | 3.52%                              | \$ 32,328          | \$ 32,328                 | \$ -             | \$ -             |                     | \$ 32,328         | \$ -              |
| 1993-1995                          | N/A                                | 3.85%                              | 132,453            | 91,320                    | -                | -                | 41,133              | 132,453           | -                 |
| 1996                               | 21,442                             | 5.07%                              | 69,384             | 48,932                    | 229              | (1,540)          |                     | 47,621            | 21,763            |
| 1997                               | 13,764                             | 5.03%                              | 81,006             | 67,906                    | 241              | (1,591)          |                     | 66,556            | 14,450            |
| 1998                               | 15,469                             | 5.00%                              | 67,031             | 59,916                    | 377              | (1,588)          |                     | 58,705            | 8,326             |
| 1999                               | 19,663                             | 4.48%                              | 82,830             | 77,978                    | 280              | (1,748)          |                     | 76,510            | 6,320             |
| 2000                               | 16,972                             | 5.15%                              | 94,369             | 76,527                    | 304              | (2,364)          |                     | 74,467            | 19,902            |
| 2001                               | 17,411                             | 4.82%                              | 103,496            | 66,060                    | 237              | (3,125)          |                     | 63,172            | 40,324            |
| 2002                               | 16,770                             | 1.86%                              | 43,278             | 70,000                    | -                | (3,927)          | (21,374)            | 44,699            | (1,421)           |
| 2003                               | 15,562                             | 1.22%                              | 23,620             | 38,032                    | -                | 3,926            | (19,759)            | 22,199            | 1,421             |
| 2004                               | 17,934                             | 2.76%                              | 45,695             | 49,869                    | (4,174)          | -                |                     | 45,695            | -                 |
| 2005                               | 16,502                             | 3.61%                              | 75,017             | -                         | 69,040           | 960              |                     | 70,000            | 5,017             |
| 2006                               | 15,349                             | 4.35%                              | 95,687             | -                         | -                | 70,000           |                     | 70,000            | 25,687            |
| <b>Total</b>                       |                                    |                                    | <b>\$ 946,194</b>  | <b>\$ 678,868</b>         | <b>\$ 66,534</b> | <b>\$ 59,003</b> | <b>\$ -</b>         | <b>\$ 804,405</b> | <b>\$ 141,789</b> |

## Program Assessment Rating Tool (PART)

Improving programs by focusing on results is an integral component of the President's budget and performance integration initiative. The PART is a series of questions designed to provide a consistent approach to rating programs throughout the Federal government. Programs are rated in four distinct areas: purpose and design, strategic planning, program management, and program results. OSM conducted PART reviews of its Abandoned Mine Land Grants Program (conducted in 2002 for the FY 2004 budget process), Regulation of Surface Coal Mining Activities (conducted in 2003 for the FY 2005 budget process), and Federal Regulatory and Abandoned Mine Land Program (conducted in 2004 for the FY 2006 budget process). With the completion of the FY 2006 PART, all of OSM's major programs have been reviewed under the PART process.

Actions to date on OSM's three PART reviews are as follows:

The PART review of the Abandoned Mine Lands Grants Program for FY 2004 identified three recommendations for the program. The first and second recommendations required (1) the proposal of legislative changes to the AML program's authorization to increase the rate of pre-1977 abandoned coal mine land reclamation and (2) the extension of the coal fee, which was initially to expire on September 30, 2004. In response to these recommendations, OSM worked diligently with the Department of the Interior and Office of Management and Budget (OMB) officials in drafting legislative changes to the AML program. Legislation was presented in both the House (H.R. 3778) and Senate (S.2049 & S.2086). In part, the legislative changes seek to extend the authorization of fee collection authority while balancing the interests of all coal states and focusing on the need to accelerate the cleanup of dangerous abandoned coal mines by directing funds to the highest priority areas so that reclamation can occur at a faster rate, thereby removing the risks to those who live, work and recreate in the coalfields as soon as possible. Although the legislation was not passed, OSM continues to work with Congress to review current bills for AML reauthorization. For the fee extension, after several provisions to extend the fee for limited timeframes, the fee is now extended until September 30, 2007.

(3) The third recommendation was to develop long-term measures that are more outcome oriented and develop at least one efficiency measure. OSM, states and tribes developed more meaningful performance measures and collected data from states and tribes for those measures in FY 2004. The measures are:

- Number of stream-miles for which degradation from past surface coal mining has been improved.
- Number of surface acres of water for which degradation from coal mining has been improved.
- Number of active partnering and leveraging agreements.
- The amount of increased funds derived from active partnering and leveraging agreements.
- Number of people with reduced exposure potential to safety risks from abandoned mine lands.
- Percentage of declared emergencies abated within six months.
- Number of people directly affected (emergency abatements).
- Percent of AML grant funds obligated nationally by states and tribes.

# PERFORMANCE GOALS AND RESULTS

Note: Baseline data has been reviewed for several measures, however, OSM continues to review data and refine its data collection to ensure that it is consistent with the intent of the goal.

For the FY 2005 PART review, OSM reviewed the regulation of surface coal mining activities. The principal findings from that review are:

- The purpose of the regulatory program is clear, as articulated in SMCRA.
- An independent auditor has not reviewed the regulatory program. However, states and Indian tribes assess implementation of the program through meetings and conferences held throughout the year.
- Measurable outcome-based performance goals are needed to effectively and efficiently guide management of the program.

In response to the third finding above, OSM has held several meetings in 2003 - 2004 with state representatives to develop new measures. OSM considered recommended measures from those meetings in its development of final measures. Furthermore, as a result of a review by DOI's Office of Inspector General issued October 2004, OSM initiated a study using trend data and ratios of past mining and reclamation of mined sites to identify data elements, determine availability of data, and further develop a measure for its regulatory accomplishments. OSM's new proposed measure is the ratio of "cumulative reclaimed (restored) acres to cumulative mined acreage (represented by bonded acreage)." This measure is presented in our FY 2007 Budget Justification.

For the FY 2006 budget process, OSM's Federal Regulatory and Abandoned Mine Land Programs were evaluated. The scope of this review included the components of Federal regulation of mining operations in 12 states and on Indian lands, recommendations on mining plans on Federal lands; Federal reclamation of abandoned mined lands through high priority and emergency projects; and associated support costs such as technology development and training. Results showed that the program is needed and well run. Performance measures for the regulatory program need further development as previously indicated in the FY 2006 PART (see status above). In addition, the PART recommended that FY 2006 funding be targeted to increase the technical capacity of OSM staff and inspectors. The FY 2006 budget is consistent with that recommendation and provides for funding increases in OSM's National Technical Training program and Technical Innovation and Professional Services programs. The FY 2007 Budget proposal also supports this request.

We also note that during FY 2006, OSM and OMB conducted a review of the programs for the FY 2005 and FY 2006 Budget processes. The results will be presented in the FY 2008 Budget.



**U.S. DEPARTMENT OF THE INTERIOR  
OFFICE OF SURFACE MINING**

**Financial Statements**

**As of and for the Years Ended  
September 30, 2006 and 2005**

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## Compliance with Legal and Financial Requirements

The following provides information on OSM's compliance with:

- Federal Managers' Financial Integrity Act (FMFIA)
- Federal Financial Management Improvement Act (FFMIA)
- Other key legal and regulatory requirements

### Federal Managers' Financial Integrity Act (FMFIA)

The FMFIA requires agencies to annually provide a statement of assurance of the effectiveness of internal controls in achieving reliability of financial reporting, compliance with applicable laws and regulations, and reliability of performance reporting.

#### Assurance Statement

Based upon OSM's comprehensive management control program, I am pleased to certify, with reasonable assurance, that OSM's systems of management, accounting, and administrative control achieve the objectives of Section 2 of the FMFIA. OSM can also provide reasonable assurance that its accounting and financial systems generally conform to the Comptroller General's principles, standards, and related requirements and achieve the objectives of Section 4 of the FMFIA.



Brent Wahlquist  
Acting Director

### Management Control Review

The Office of Surface Mining conducted its annual assessment of agency programs and systems in accordance with the Federal Managers' Financial Integrity Act (FMFIA) and Office of Management and Budget Circular A-123. FMFIA requires us to conduct periodic reviews of our programs and systems to provide reasonable assurance that management controls are in compliance with the applicable laws, regulations, and policies.

For FY 2006, we conducted assessments of selected programs and administrative functions that were sufficient to ensure the adequacy of controls in place. Areas for improvement were identified and corrective actions are being implemented. In general, we found our management controls adequate to safeguard our programs and systems against waste, fraud, abuse, and mismanagement. No material weaknesses were identified (see Figure 4).

### Federal Financial Management Improvement Act (FFMIA)

This law requires agencies to report on their substantial compliance with federal financial management systems requirements, federal accounting standards, and the U.S. Government Standard General Ledger. It also requires agencies to provide full disclosure of financial data, which is accomplished through the financial statements included in this report.

**Figure 4  
2006 Internal Control Reviews**

| <b>Review</b>                           | <b>Scope</b>   | <b>Results</b>  |
|---|--|---|
| Equal Employment Opportunity (EEO)      | To review the Mid-Continent Region's compliance with the Equal Employment Opportunity laws and regulations and to assess the effectiveness of the EEO program in achieving goals and objectives in that Region.            | No material weaknesses identified. Improvements were recommended and are being implemented. |
| Telecommunications                      | To review the controls and polices for OSM's telecommunications systems in Headquarters.   | No material weaknesses identified. Improvements were recommended and are being implemented. |
| Federal Programs                        | To evaluate the compliance of the Knoxville Field Office's bond release program with Section 519 of SMCRA and with 30 CFR 800.40.  | No material weaknesses identified. Improvements were recommended and are being implemented. |
| Indian Lands Program                    | To assess controls for permitting, inspection and enforcements, and bond release of mining operations; and the administration of the grant funding for the Indian Lands Program.   | No material weaknesses identified. Improvements were recommended and are being implemented. |
| State Program Oversight                 | To evaluate the criteria for measuring reclamation success established by Directive REG-8, Part II.C.2.  | No material weaknesses identified.  |
| Sensitive Automated Information Systems | To certify that all prescribed controls or alternative controls are in place and effective for systems in each Region, Denver Financial Management, and Headquarters.  | No material weaknesses identified. Improvements were recommended and are being implemented. |
| Acquisition Management                  | Review of the Appalachian Region's Pittsburgh and Wilkes-Barre contracting offices, and review of compliance with the Federal Acquisition Regulation (FAR), DOI Regulations and OSM Directives.                            | No material weaknesses identified. Improvements were recommended and are being implemented. |
| Personal Property Management            | To evaluate the Appalachian Region's Pittsburgh, Harrisburg, Johnstown and Wilkes-Barre offices and the Mid-Continent Region's offices compliance with Federal Management Regulations, DOI Regulations and OSM Directives. | No material weaknesses identified. Improvements were recommended and are being implemented. |
| Financial Assistance                    | To determine if the appropriate required procedures are being followed with respect to awarding, monitoring and closing out grants for administering and enforcing the coal mining regulatory program.                     | No material weaknesses identified. Improvements were recommended and are being implemented. |

OSM concludes that it is in substantial compliance with FFMA. OSM received an unqualified opinion on the balance sheets, no material weaknesses in the report on internal controls and no identified significant instances of non-compliance with laws and regulations including FFMA that could have a direct and material effect on the determination of financial statement amounts.

### **Other Key Legal and Financial Regulatory Requirements**

#### **Improper Payments Information Act (IPIA) of 2002**

OSM is in substantial compliance with the Improper Payments Information Act (IPIA).

OSM took the following steps to ensure compliance with the plan:

- Reviewed all programs we administer
- Conducted a review to determine whether any programs were susceptible to significant erroneous payments
- Estimated the amount of potential erroneous payments in the programs
- Reported on the estimates and progress annually, beginning with the FY 2004 Performance and Accountability Report

OSM performed its review of all programs, by conducting the required Risk Assessment Rating. We also participated in the Departmental Function Reviews (DFR) of various payment processes. It was determined that OSM did not identify any programs as “High Risk” during this assessment.

#### **Prompt Payment Act**

OSM substantially complies with the Prompt Payment Act as evidenced by the fact that 99.5 percent of its payments are made on time. OSM took the following steps to ensure that this continues:

- Charge cards were used to cut through red tape and expedite payment. Almost 92 percent of purchase transactions were made with charge cards in FY 2006, and the agency continues to promote their increased use, and
- Electronic funds transfer (EFT) was used to make 99.8 percent of the agency’s vendor payments (including the charge card payments) covering 99.9 percent of the dollar amount paid.

#### **Debt Collection Improvement Act**

OSM’s largest debt collection program is the Abandoned Mine Land Reclamation Fee Compliance Program. OSM collected over 99.91 percent of the fees due this year, a total of \$303 million. This is the result of an integrated fee compliance program that works with the coal mining industry to provide clear guidance on fee payment and reporting issues, as well as active follow-up through audits and several other compliance activities.

OSM is in substantial compliance with the Debt Collection Improvement Act and routinely refers its eligible, uncollected debts to the Department of the Treasury for collection.

## Civil Monetary Penalty Act

To comply with the Civil Monetary Penalty Act, OSM has increased the assessment amounts of civil monetary penalties. The agency issues these penalties for violation of the Surface Mining Control and Reclamation Act.

## Discussion and Analysis of the Financial Statements

OSM received, for the 16th consecutive year, an unqualified or “clean” audit opinion on its audited financial statements. OSM received 14 unqualified opinions on the full set of financial statements from 1991 to 2004. During FY 2005, the Department of the Interior provided guidance that certain bureaus could reduce their audit requirements to Consolidated Balance Sheet only audits. Qualifying bureaus must have received unqualified audit opinions and no material weaknesses or reportable condition findings in the preceding year. OSM was the only bureau in the Department to meet these requirements for both the FY 2006 and FY 2005 audits. OSM’s financial statements are prepared in accordance with established federal accounting standards and the balance sheet is audited by the independent accounting firm of KPMG LLP.

### Objectives of Financial Reporting

Financial reporting is important in any business or government organization. Though the financial statements are different, the objectives of a government organization are much the same as the objectives in a commercial organization:

- Budgetary integrity (accounting for resources obtained and resources spent)
- Operating performance (the cost of programs and the results achieved for the dollars spent)
- Systems and controls (the presence of cost-effective systems and controls to adequately safeguard assets)

To meet these reporting objectives, OSM is presenting the following financial statements in this Annual Financial Report:

#### Consolidated Balance Sheets

These statements report on the operating assets and liabilities related to the delivery of goods and services. They display the dollar value of unspent funds, assets (such as accounts receivable, inventory, investments, and property, plant and equipment), and liabilities (such as accounts payable and various accrued liabilities).

#### Consolidated Statements of Net Cost and the Consolidated Statements of Changes in Net Position

These two statements report the cost of providing governmental goods, services, and benefits, and provide information on the changes in financial position from one year to the next. They contain the total cost of operations, revenue generated from operations, and appropriations (dollars) used to fund the net cost of operations.

#### Combined Statements of Budgetary Resources and the Consolidated Statements of Financing

The Combined Statements of Budgetary Resources show the budgetary resources made available through appropriations and other sources, obligations incurred against those resources and the dollar amount of cash outlays. The Consolidated Statements of Financing explain and reconcile the relationship of budgetary obligations to the net cost of operations.

OSM believes the financial statements are a fair and accurate presentation of its financial position, net cost of operations, changes in net position, and budgetary resources, as well as details regarding financing. This is reflected in the unqualified (clean) audit opinion rendered on OSM’s FY 2006 and FY 2005 Consolidated Balance Sheets by its independent auditors. Sound financial management is a top priority for OSM at all levels of the organization.

## Limitations of the Financial Statements

The financial statements have been prepared pursuant to the requirements of the Chief Financial Officers Act of 1990 and the Government Management Reform Act of 1994. While the statements have been prepared from OSM's books and records in accordance with the guidance provided by the Office of Management and Budget, the financial statements differ from financial reports used to monitor and control budgetary resources that are prepared from the same books and records.

The financial statements should be read with the realization that they are for a component of a sovereign entity, that liabilities not covered by budgetary resources cannot be liquidated without enactment of an appropriation that provides the resources and the legal authority to do so.

## Consolidated Balance Sheets

Investments are OSM's primary asset making up 98% of our total assets in FY 2006. Since 1992, OSM has been allowed to invest Abandoned Mine Land (AML) fee receipts and balances until these receipts are disbursed for program costs. Only the AML fee receipts and unused investment collections are available for investment. All other cash received is unavailable for investment by OSM. See Note 4 for further information related to our investment program. OSM's investments increased by \$131 million over FY 2005 because, as shown by the components in Table 2, OSM's cash earnings were higher than our cash disbursements and transfers by that amount.

Accounts and Interest Receivable, Net, Public, line shows a difference of \$9.5 million between FY 2006 and FY 2005. The majority of this difference is caused by the annual adjustment process with the United Mine Workers of America Combined Benefit Fund (UMWA-CBF) which is reflected on our Unbilled Accounts Receivable line in Note 6. On September 30, 2006, the UMWA-CBF estimated they owed OSM a \$1 million refund for prior year transfers. This refund is due mainly to court cases. On September 30, 2005, the UMWA-CBF owed OSM an \$11 million refund based on court cases and an adjustment of estimates to actual expenses, resulting in reduction to OSM's unbilled accounts receivable of more than \$9 million from FY 2005 to FY 2006. These are annual adjustments recorded at the end of each fiscal year. In some cases, the adjustments create a payable to the UMWA-CBF. In FY 2005 and FY 2006, the adjustments created receivables.

Advances and Deferred Revenue Liabilities changed by just over \$200 thousand between FY 2006 and FY 2005. This difference is caused by a single reimbursable advance where in FY 2005 OSM had agreed to develop a single source coal reporting E-Filing site for multiple agencies. OSM completed this project in FY 2006 and therefore properly used these funds on the project.

Contingent Liabilities were \$2.5 million lower at September 30, 2006 than at September 30, 2005. During FY 2006, a case was closed and paid in the amount of \$2.5 million, removing this as a potential liability from our statements. Other small dollar changes also took place during FY 2006. Please see Note 10 for additional information.

## Consolidated Statements of Net Cost

OSM's costs increased by \$86 million in FY 2006 over FY 2005. This increase was caused by several factors. The Consolidating Schedules of Net Cost by Responsibility Segment (Note 12) show that our operating expenses increased by \$66 million in FY 2006 because in FY 2005 the U.S. Court of Appeals

for the Federal Circuit reversed a Court of Federal Claims' finding of a physical taking, causing our FY 2005 expenses to be reduced by \$68 million. OSM did not have a similar reduction in FY 2006. Grant expenses also increased by \$12 million in FY 2006 because several states were able to close out their grants prior to the end of the fiscal year. Finally, our expenses related to the UMWA-CBF were also \$8 million more in FY 2006 because of the large accounts receivable for the UMWA-CBF discussed above under Accounts and Interest Receivable, Net, Public.

### Combined Statements of Budgetary Resources

OSM's Appropriation and Total Budgetary Resources decreased by \$10 million in FY 2006 because the UMWA-CBF repaid \$10 million in outstanding accounts receivable as of FY 2005. This returned the entire \$10 million to our budgetary resources. (The change listed in the Consolidated Statements of Net Cost is reduced by the FY 2006 outstanding accounts receivable of \$1 million.) The Direct - Obligations Incurred were lower in FY 2006 because of the same \$10 million reduction.

Total, Unpaid Obligated Balance, Net, End of Year, decreased by \$29 million in FY 2006. The majority of this \$29 million decrease took place in FY 2005 and affected the Total Unpaid Obligated Balances, Net, Beginning of Fiscal Year for \$24 million. Of the \$14 million decrease in Obligations Incurred, Net, the UMWA-CBF reduction discussed in the paragraph above is again displayed. Additional smaller changes in Gross Outlays and Recoveries of Prior Year Unpaid Obligations, Actual increased our Total, Unpaid Obligated Balance, Net, End of Year, to the \$29 million change.

Our Distributed Offsetting Receipts increased by \$20 million because of additional investment earning collections (during FY 2006) as a result of increased interest rates and an increased investment balance.

### Consolidated Statements of Financing

Offsetting Receipts under the Resources Used to Finance Activities section is \$20 million higher during FY 2006 than FY 2005 because investment earnings were higher. See related discussion above under Combined Statements of Budgetary Resources.

The Total Resources Used to Finance Items Not Part of the Net Cost of Operations was \$99 million more in FY 2006 than it was in FY 2005. The primary reason for this variance is a \$68 million reduction in contingency expenses in FY 2005 which we did not have in FY 2006 which is displayed on Resources That Fund Expenses Recognized in Prior Periods. This is discussed under the Consolidated Statements of Net Cost. Since this was a Contingent Liability only, it represents a cost that will not be funded by our Budgetary Resources. Offsetting Receipts Not Part of the Net Cost of Operations, as discussed directly above, account for an additional \$20 million of this variance. An additional \$14 million of the \$99 million variance is reflected in the Change in Budgetary Resources Obligated for Goods, Services, and Benefits Ordered but Not Yet Provided. This \$14 million consists of grants from several states and tribes which were closed out prior to the end of the fiscal year.

## AML Fee Reauthorization

OSM is authorized to collect fees through the Surface Mining Control and Reclamation Act (SMCRA). This authorization was to expire on September 30, 2004. Although the issue is not yet resolved, Congress has extended OSM's current fee collection authority until September 30, 2007. OSM will publish a Final Rule which would extend the fee to a level sufficient to meet the requirements of the UMWA-CBF transfer as required by SMCRA after September 30, 2007, if no additional legislation is passed. The balance of the AML Fund as of September 30, 2006, would allow OSM to operate at FY 2006 appropriation levels through FY 2012.



**Department of the Interior  
Office of Surface Mining  
Consolidated Balance Sheet**

**As of September 30, 2006**

| (dollars in thousands)                                       | <b>FY 2006</b>      |
|--|---------------------|
| <b>ASSETS</b>  |                     |
| <b>Intragovernmental Assets:</b>                             |                     |
| Fund Balance with Treasury (Note 3)                          | \$ 46,487           |
| Investments, Net (Notes 4 and 19)                            | 2,272,961           |
| Accounts and Interest Receivable (Note 5)                    | 19                  |
| Other  | 130                 |
| <b>Total Intragovernmental Assets</b>                        | <b>2,319,597</b>    |
| Accounts and Interest Receivable, Net (Note 6)               | 1,970               |
| General Property, Plant and Equipment, Net (Note 7)          | 2,537               |
| Other  | 840                 |
| <b>TOTAL ASSETS (Note 2)</b>                                 | <b>\$ 2,324,944</b> |
| <br>   |                     |
| <b>LIABILITIES</b>   |                     |
| <b>Intragovernmental Liabilities:</b>                        |                     |
| Accounts Payable   | \$ 89               |
| Other  |                     |
| Advances and Deferred Revenue                                | 4                   |
| Other Liabilities  | 1,588               |
| <b>Total Intragovernmental Liabilities</b>                   | <b>1,681</b>        |
| Accounts Payable   | 7,850               |
| Federal Employee and Veteran Benefits                        | 3,543               |
| Other  |                     |
| Contingent Liabilities (Note 10)                             | 100                 |
| Other Liabilities  | 7,759               |
| <b>TOTAL LIABILITIES (Note 8)</b>                            | <b>20,933</b>       |
| Commitments and Contingencies (Note 11)                      |                     |
| <b>Net Position</b>  |                     |
| Unexpended Appropriations - Other Funds                      | 39,828              |
| Cumulative Results of Operations - Earmarked Funds (Note 19) | 2,270,954           |
| Cumulative Results of Operations - Other Funds (Note 9)      | (6,771)             |
| <b>Total Net Position</b>                                    | <b>2,304,011</b>    |
| <b>TOTAL LIABILITIES AND NET POSITION</b>                    | <b>\$ 2,324,944</b> |

The accompanying notes are an integral part of these financial statements.

# FINANCIAL STATEMENTS

Department of the Interior  
Office of Surface Mining  
Consolidated Balance Sheet

As of September 30, 2005

(dollars in thousands)

FY 2005

## ASSETS

### Intragovernmental Assets:

|   |    |           |
|---|----|-----------|
| Fund Balance with Treasury (Note 3)       | \$ | 49,332    |
| Investments, Net (Note 4 and 19)          |    | 2,141,599 |
| Accounts and Interest Receivable (Note 5) |    | 34        |
| Other                                     |    | 44        |

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|                                       |    |                  |
|---------------------------------------|----|------------------|
| <b>Total Intragovernmental Assets</b> | \$ | <b>2,191,009</b> |
|---------------------------------------|----|------------------|

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|   |  |        |
|---|--|--------|
| Accounts and Interest Receivable, Net (Note 6)      |  | 11,439 |
| General Property, Plant and Equipment, Net (Note 7) |  | 2,417  |

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|                              |    |                  |
|------------------------------|----|------------------|
| <b>TOTAL ASSETS (Note 2)</b> | \$ | <b>2,204,865</b> |
|------------------------------|----|------------------|

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## LIABILITIES

### Intragovernmental Liabilities:

|                               |    |       |
|-------------------------------|----|-------|
| Accounts Payable              | \$ | 52    |
| Other                         |    |       |
| Advances and Deferred Revenue |    | 208   |
| Other Liabilities             |    | 1,576 |

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|  |  |              |
|--|--|--------------|
| <b>Total Intragovernmental Liabilities</b> |  | <b>1,836</b> |
|--|--|--------------|

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|                                       |  |       |
|---------------------------------------|--|-------|
| Accounts Payable                      |  | 7,098 |
| Federal Employee and Veteran Benefits |  | 3,867 |
| Other                                 |  |       |
| Contingent Liabilities (Note 10)      |  | 2,570 |
| Other Liabilities                     |  | 7,151 |

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|                                   |  |               |
|-----------------------------------|--|---------------|
| <b>TOTAL LIABILITIES (Note 8)</b> |  | <b>22,522</b> |
|-----------------------------------|--|---------------|

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Commitments and Contingencies (Note 11)

### Net Position

|                                  |  |           |
|----------------------------------|--|-----------|
| Unexpended Appropriations        |  | 41,544    |
| Cumulative Results of Operations |  | 2,140,799 |

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|                           |  |                  |
|---------------------------|--|------------------|
| <b>Total Net Position</b> |  | <b>2,182,343</b> |
|---------------------------|--|------------------|

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|   |    |                  |
|---|----|------------------|
| <b>TOTAL LIABILITIES AND NET POSITION</b> | \$ | <b>2,204,865</b> |
|---|----|------------------|

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The accompanying notes are an integral part of these financial statements.

**Department of the Interior  
Office of Surface Mining  
Consolidated Statements of Net Cost (Unaudited)**

**For the Years Ended September 30, 2006 and 2005**

| (dollars in thousands)                          | FY 2006           | FY 2005           |
|---|-------------------|-------------------|
| <b>Resource Protection</b>                      |                   |                   |
| Costs   | \$ 74,435         | \$ 60,113         |
| Less: Earned Revenue                            | 5                 | 1                 |
| Net Cost  | 74,430            | 60,112            |
| <b>Resource Use</b>                             |                   |                   |
| Costs   | 115,258           | 67,649            |
| Less: Earned Revenue                            | 1,574             | 1,522             |
| Net Cost  | 113,684           | 66,127            |
| <b>Serving Communities</b>                      |                   |                   |
| Costs   | 135,182           | 118,744           |
| Less: Earned Revenue                            | 330               | 87                |
| Net Cost  | 134,852           | 118,657           |
| <b>UMWA - CBF Transfer</b>                      |                   |                   |
| Costs   | 69,824            | 61,684            |
| Less: Earned Revenue                            | -                 | -                 |
| Net Cost  | 69,824            | 61,684            |
| <b>Total</b>                                    |                   |                   |
| Costs   | 394,699           | 308,190           |
| Less: Earned Revenue                            | 1,909             | 1,610             |
| <b>Net Cost of Operations (Notes 12 and 19)</b> | <b>\$ 392,790</b> | <b>\$ 306,580</b> |

The accompanying notes are an integral part of these financial statements. These statements are unaudited. See accompanying independent auditors' report.

# FINANCIAL STATEMENTS

Department of the Interior  
Office of Surface Mining  
Combined Statements of Changes in Net Position (Unaudited)

For the Years Ended September 30, 2006 and 2005

| (dollars in thousands)                                   | Earmarked<br>Note 19 | All Other  | FY 2006      | FY 2005      |
|--|----------------------|------------|--------------|--------------|
| <b>UNEXPENDED APPROPRIATIONS</b>                         |                      |            |              |              |
| <b>Beginning Balance</b>                                 | \$ -                 | \$ 41,544  | \$ 41,544    | \$ 38,490    |
| <b>Budgetary Financing Sources</b>                       |                      |            |              |              |
| Appropriations Received, General Funds (Note 13)         | -                    | 110,435    | 110,435      | 109,804      |
| Appropriations-Used                                      | -                    | (109,298)  | (109,298)    | (104,439)    |
| Other Adjustments  | -                    | (2,853)    | (2,853)      | (2,311)      |
| <b>Net Change</b>  | -                    | (1,716)    | (1,716)      | 3,054        |
| <b>Ending Balance - Unexpended Appropriations</b>        | \$ -                 | \$ 39,828  | \$ 39,828    | \$ 41,544    |
| <b>CUMULATIVE RESULTS OF OPERATIONS</b>                  |                      |            |              |              |
| <b>Beginning Balance</b>                                 | \$ 2,149,986         | \$ (9,187) | \$ 2,140,799 | \$ 1,967,879 |
| <b>Budgetary Financing Sources</b>                       |                      |            |              |              |
| Appropriations-Used                                      | -                    | 109,298    | 109,298      | 104,439      |
| Non-Exchange Revenue                                     | 399,467              | 26         | 399,493      | 368,899      |
| Other Adjustments  | (393)                | 393        | -            | -            |
| <b>Other Financing Sources</b>                           |                      |            |              |              |
| Imputed Financing from Costs Absorbed by Others          | -                    | 7,762      | 7,762        | 6,828        |
| Transfers In/(Out) without Reimbursement                 | -                    | (379)      | (379)        | (666)        |
| <b>Total Financing Sources</b>                           | 399,074              | 117,100    | 516,174      | 479,500      |
| <b>Net Cost of Operations</b>                            | (278,106)            | (114,684)  | (392,790)    | (306,580)    |
| <b>Net Change</b>  | 120,968              | 2,416      | 123,384      | 172,920      |
| <b>Ending Balance - Cumulative Results of Operations</b> | \$ 2,270,954         | \$ (6,771) | \$ 2,264,183 | \$ 2,140,799 |

The accompanying notes are an integral part of these financial statements. These statements are unaudited.  
See accompanying independent auditors' report.

## Department of the Interior Office of Surface Mining Combined Statements of Budgetary Resources (Unaudited)

### For the Years Ended September 30, 2006 and 2005

| (dollars in thousands)   | <b>Total Budgetary Accounts</b> |             |
|--|---------------------------------|-------------|
|  | <b>2006</b>                     | <b>2005</b> |
| <b>Budgetary Resources:</b>  |                                 |             |
| Unobligated Balance, Beginning of Fiscal Year:   | \$ 41,030                       | \$ 36,198   |
| Recoveries of Prior Year Unpaid Obligations  | 40,452                          | 45,774      |
| Budget Authority:  |                                 |             |
| Appropriation (Note 13)  | 357,623                         | 367,290     |
| Spending Authority from Offsetting Collections:  |                                 |             |
| Earned:  |                                 |             |
| Collected  | 1,866                           | 1,582       |
| Change in Receivables from Federal Sources   | (15)                            | (11)        |
| Change in Unfilled Customer Orders:  |                                 |             |
| Without Advance from Federal Sources   | 72                              | 239         |
| Total Budget Authority   | 359,546                         | 369,100     |
| Temporarily Not Available Pursuant to Public Law   | (2,768)                         | (2,658)     |
| Permanently Not Available  | (2,854)                         | (2,311)     |
| Total Budgetary Resources  | \$ 435,406                      | \$ 446,103  |
| <b>Status of Budgetary Resources:</b>  |                                 |             |
| Obligations Incurred (Note 14):  |                                 |             |
| Direct   | \$ 389,580                      | \$ 403,171  |
| Reimbursable   | 2,033                           | 1,902       |
| Total Obligations Incurred   | 391,613                         | 405,073     |
| Unobligated Balance Available:   |                                 |             |
| Apportioned  | 36,524                          | 33,698      |
| Unobligated Balance Not Available  | 7,269                           | 7,332       |
| Total Status of Budgetary Resources  | \$ 435,406                      | \$ 446,103  |
| <b>Obligated Balance:</b>  |                                 |             |
| Obligated Balance, Net:  |                                 |             |
| Unpaid Obligations, Brought Forward, Beginning of Fiscal Year  | \$ 338,653                      | \$ 362,883  |
| Less: Uncollected Customer Payments from Federal sources,<br>Brought Forward, Beginning of Fiscal Year | (437)                           | (211)       |
| Total Unpaid Obligated Balances, Net, Beginning of Fiscal Year   | 338,216                         | 362,672     |
| Obligations Incurred, Net (Note 14)  | 391,613                         | 405,073     |
| Less: Gross Outlays  | (379,952)                       | (383,529)   |
| Less: Recoveries of Prior Year Unpaid Obligations, Actual  | (40,452)                        | (45,774)    |
| Change in Uncollected Customer Payments from Federal Sources   | (57)                            | (226)       |
| Total, Unpaid Obligated Balance, Net, End of Year  | \$ 309,368                      | \$ 338,216  |
| <b>Obligated Balance, net, end of period - by component:</b>   |                                 |             |
| Unpaid Obligations   | \$ 309,863                      | \$ 338,653  |
| Less: Uncollected Customer Payments from Federal Sources   | (495)                           | (437)       |
| Total, Unpaid Obligated Balance, Net, End of Year  | \$ 309,368                      | \$ 338,216  |
| <b>Net Outlays:</b>  |                                 |             |
| Gross Outlays  | \$ 379,951                      | \$ 383,531  |
| Less: Offsetting Collections   | (1,866)                         | (1,582)     |
| Less: Distributed Offsetting Receipts (Note 15)  | (95,723)                        | (75,246)    |
| Net Outlays(Receipts)  | \$ 282,362                      | \$ 306,703  |

The accompanying notes are an integral part of these financial statements. These statements are unaudited. See accompanying independent auditors' report.

# FINANCIAL STATEMENTS

## Department of the Interior Office of Surface Mining Consolidated Statements of Financing (Unaudited)

For the Years Ended September 30, 2006 and 2005

| (dollars in thousands)  | 2006              | 2005              |
|---|-------------------|-------------------|
| <b>Resources Used to Finance Activities:</b>  |                   |                   |
| Budgetary Resources Obligated:  |                   |                   |
| Obligations Incurred  | \$ 391,613        | \$ 405,073        |
| Less: Spending Authority From Offsetting Collections/Recoveries   | (42,375)          | (47,583)          |
| Obligations Net of Offsetting Collections and Recoveries  | 349,238           | 357,490           |
| Less: Offsetting Receipts (Note 15)   | (95,723)          | (75,246)          |
| Net Obligations   | 253,515           | 282,244           |
| Other Resources   |                   |                   |
| Transfers In/(Out) Without Reimbursement  | (379)             | (666)             |
| Imputed Financing From Costs Absorbed by Others   | 7,762             | 6,828             |
| Net Other Resources Used to Finance Activities  | 7,383             | 6,162             |
| <b>Total Resources Used to Finance Activities</b>   | <b>260,898</b>    | <b>288,406</b>    |
| <b>Resources Used to Finance Items Not Part of the Net Cost of Operations</b>                                       |                   |                   |
| Change in Budgetary Resources Obligated for Goods, Services, and Benefits Ordered but Not Yet Provided              | 28,717            | 14,216            |
| Increase (Decrease) in Unfilled Customer Orders   | 72                | 238               |
| Resources That Fund Expenses Recognized in Prior Periods  | (1,997)           | (66,659)          |
| Budgetary Offsetting Collections and Receipts That Do Not Affect Net Cost of Operations:                            |                   |                   |
| Offsetting Receipts Not Part of the Net Cost of Operations (Note 15)  | 95,749            | 75,260            |
| Resources That Finance the Acquisition of Assets  | (715)             | (501)             |
| Allocation Transfer Account Reconciling Item, Parent (Note 17)  | -                 | (100)             |
| Total Resources Used to Finance Items Not Part of the Net Cost of Operations  | 121,826           | 22,454            |
| <b>Total Resources Used</b>   | <b>382,724</b>    | <b>310,860</b>    |
| <b>Components of Net Cost of Operations That Will Not Require or Generate Resources in the Current Period:</b>      |                   |                   |
| Components Requiring or Generating Resources in Future Periods:   |                   |                   |
| Change in UMWA-CBF Receivable   | 9,771             | (4,849)           |
| Other   | (301)             | (75)              |
| Total Components of Net Cost of Operations That Will Require or Generate Resources in Future Periods                | 9,470             | (4,924)           |
| Components Not Requiring or Generating Resources:   |                   |                   |
| Depreciation and Amortization   | 596               | 644               |
| <b>Total Components of Net Cost of Operations That Will Not Require or Generate Resources in the Current Period</b> | <b>10,066</b>     | <b>(4,280)</b>    |
| <b>Net Cost of Operations</b>   | <b>\$ 392,790</b> | <b>\$ 306,580</b> |

The accompanying notes are an integral part of these financial statements. These statements are unaudited. See accompanying independent auditors' report.



**U.S. DEPARTMENT OF THE INTERIOR  
OFFICE OF SURFACE MINING**

**Notes to the Financial  
Statements**

**As of and for the Years Ended  
September 30, 2006 and 2005**

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## Note 1. Summary of Significant Accounting Policies

### A. Reporting Entity

The Office of Surface Mining (OSM) was established as a Bureau of the U.S. Department of the Interior by Public Law 95-87, also known as the Surface Mining Control and Reclamation Act of 1977 (SMCRA). SMCRA was passed by Congress on August 3, 1977, and has since undergone several revisions, the most recent being the Energy Policy Act of 1992 (Public Law 102-486). Although SMCRA initially empowered OSM with the authority to collect a statutory coal reclamation fee through FY 1992, a 1992 revision extended this authority through September 30, 2004. The main purpose of this fee is to fund the reclamation of abandoned mine lands.

On September 30, 2004, the authority to collect this standard fee expired. The fee has been extended by various special laws through September 30, 2007. If no extension is granted by the expiration date, section 402(b) of SMCRA requires OSM to establish a new fee at a rate sufficient to continue to provide for the needs of certain beneficiaries of the United Mine Workers Combined Benefit Fund (UMWA-CBF), a non-governmental entity. OSM provides an annual transfer to the UMWA-CBF to help defray the health care costs of mine workers and their beneficiaries for which no current mining company is responsible. SMCRA allows an annual transfer of up to \$70 million to fulfill this requirement. In the event that the AML fee is not extended past September 30, 2007, OSM will issue a Final Rule establishing a fee rate which will provide \$70 million for the UMWA-CBF annually unless Congress passes further extensions or an amendment to the fee.

OSM's mission is further defined by SMCRA to include the administration of programs designed to (1) protect society and the environment from the effects of coal mining operations, (2) reclaim existing and future mined areas which pose both a hazard to public health and safety and affect the quality of the nation's natural resources, and (3) provide technical and financial assistance to states with primary regulatory authority over jurisdictional coal mining activities.

Budget authority of funds appropriated for SMCRA is vested in OSM, which is also responsible for the administrative oversight and policy direction of the program. OSM is required by the U.S. Department of the Treasury (Treasury), the General Accountability Office (GAO), and the Office of Management and Budget (OMB) to report on the accounting of SMCRA funds. The Treasury acts as custodian over all monies appropriated and collected by OSM.

In fulfilling its mission, the OSM administers a variety of funds:

1. **General Funds:** These funds consist of expenditure accounts used to record financial transactions arising from congressional appropriations as well as receipt accounts. The principal general fund expenditure and receipt accounts maintained are:

- a. **Regulation and Technology** - These funds consist of expenditure accounts used to record financial transactions arising from congressional appropriations to spend general revenue. These funds support the financing of state regulatory grants, oversight of state regulatory programs, research and development facilitating the transfer of reclamation expertise to states, and the partial financing of all OSM operations and maintenance costs. Funding is appropriated on an annual basis.

# NOTES TO THE FINANCIAL STATEMENTS

- b. Bond Forfeitures - This fund consists of receipt and expenditure accounts. Monies collected on bonds forfeited by coal operators are used to reclaim the mine sites secured by the bonds.

2. Special Funds: These funds consist of special fund receipt, expenditure, and investment accounts and include the following:

- a. Abandoned Mine Land (AML) Funds - These funds were established by SMCRA for the deposit of coal reclamation fees, related late payment interest, and administrative charges recovered in pursuing collections. Available reclamation fees are used solely to finance the AML reclamation program. However, before AML funds can be used, a Congressional appropriation is necessary to authorize yearly spending limits. Available AML special fund balances, in excess of current cash requirements, are regularly invested in non-marketable federal securities as authorized under Public Law 101-508.
- b. Civil Penalties - This fund consists of receipt and expenditure accounts used to collect penalties levied against operators who violate any permit condition or provision of Title 30 U.S.C. 1268. Funds from these assessments are used to reclaim lands adversely affected by coal mining practices on or after August 3, 1977.

3. Deposit Funds: These funds are maintained to account for receipts awaiting proper classification or receipts held in escrow until ownership is established, at which time proper distribution can be made. Additionally, OSM collects miscellaneous interest, judicial service and administrative fees which are credited to Treasury's general fund. In the billing and collection of these funds, OSM is merely acting as an agent for the Treasury.

Government Performance and Results Act (GPRA) Program Activities - GPRA requires that Federal agencies formulate strategic plans, identify major strategic goals, and report performance and costs related to these goals. OSM's 2006 GPRA program activities are:

1. Resource Use - This program is responsible for ensuring that the Surface Mining Law's goals are achieved, primarily through the States and Indian Tribes. It includes OSM rule making, grants to States and Indian Tribes to conduct and develop their regulatory programs, OSM regulatory operations in non-primacy states, and OSM state program evaluations and oversight.
2. Resource Protection - This is a component of the OSM reclamation program which is responsible for the reclamation of abandoned mine land affected by mining that took place before the Surface Mining Law was passed in 1977. The resource protection activities are primarily conducted through grants given to states and tribes; and by technical assistance, training and technology development provided to states and tribes. The financial management of Abandoned Mine Land fees and investments, and bond forfeiture and civil penalty reclamation projects are included in this goal.
3. Serving Communities - This reclamation activity protects the lives and property of citizens living in proximity to coal fields, primarily through grants to states and tribes. It also includes federal reclamation work in emergency situations and the AML state oversight and grants administration activities.

4. United Mine Workers of America Combined Benefit Fund Transfer (UMWA-CBF) - This program is for the transfer of funds to the United Mine Workers of America Combined Benefit Fund. This is an annual transfer required by the Energy Policy Act of 1992. The transfer is used to pay for health care benefits for certain coal miners and their beneficiaries.

## **B. Basis of Accounting and Presentation**

These financial statements have been prepared to report the financial position, the net cost of operations, the changes in net position, the budgetary resources, and the reconciliation of budgetary obligations to the net cost of operations of OSM, in accordance with the guidelines set forth by the Chief Financial Officers Act of 1990 and the Government Management Reform Act of 1994. These financial statements have been prepared from the books and records of OSM in accordance with generally accepted accounting principles (GAAP), OMB Circular A-136, "Financial Reporting Requirements". GAAP for Federal entities are the standards prescribed by the Federal Accounting Standards Advisory Board (FASAB), which is the official standard-setting body for the Federal Government. In certain instances prior year amounts have been reclassified to conform to the current year presentation. These financial statements present proprietary and budgetary information while other financial reports also prepared by OSM pursuant to OMB directives are used to monitor and control OSM's use of budgetary resources.

OMB financial statement reporting guidelines require the presentation of comparative financial statements for all of the principal financial statements. OSM has presented comparative FY 2006 financial statements for the Balance Sheet, Statement of Net Cost, Statement of Changes in Net Position, Statement of Budgetary Resources, and Statement of Financing. These are the financial statements of a component of the United States Government, a sovereign entity. One implication of this is that liabilities cannot be liquidated without legislation that provides the resources and the legal authority to do so.

Certain assets, liabilities, earned revenue, and costs have been classified as intragovernmental throughout the financial statements and notes. Intragovernmental is defined as exchange transactions made between two reporting entities within the Federal government.

The accounting structure of OSM is designed to reflect both accrual and budgetary accounting transactions. Under the accrual method of accounting, revenues are recognized when earned, and expenses are recognized when incurred, without regard to receipt or payment of cash. The budgetary accounting principles, on the other hand, are designed to recognize the obligation of funds according to legal requirements, which in many cases is prior to the occurrence of an accrual-based transaction. The recognition of budgetary accounting transactions is essential for compliance with legal constraints and controls over the use of Federal funds.

## **C. Revenues and Financing Sources**

OSM receives most of the funding needed to support its programs through appropriations authorized by Congress. OSM receives annual and no-year appropriations that may be used within statutory limits, for operating and capital expenditures.

# NOTES TO THE FINANCIAL STATEMENTS

The AML program is funded by a reclamation fee assessed on coal mine operators. The fee is based on the type and volume of coal produced for sale, transfer, or use. As appropriated by Congress, monies received and deposited in this special fund are used to reclaim lands adversely affected by past mining. Fees collected, but not yet appropriated, are held for future appropriations. Payments to the United Mine Workers of America Combined Benefit Fund are funded through earnings on investments of undisbursed AML fund balances. See Notes 1.G and 4 for additional information on investments.

Additional amounts are obtained through reimbursements for services performed for other Federal agencies. These revenues may be used to offset the cost of producing products or furnishing services and to recover overhead costs. Additionally, OSM receives imputed financing from the Office of Personnel Management (OPM) for current and future pension and retirement benefits paid by OPM on behalf of OSM, and from the Treasury Judgment Fund for payment of any settlements resulting from litigation against OSM.

## **Advances and Deferred Revenue:**

Advances and deferred revenue received from Federal agencies represents cash advances to the National Business Center (NBC). NBC provides shared administrative services and commonly provided products to Federal agencies. Advances and deferred revenue from the public represents Bond and escrow payments held by OSM until final resolution is determined.

## **Imputed Financing Sources:**

In certain instances, operating costs of OSM are paid out of funds appropriated to other Federal agencies. For example, the Office of Personnel Management (OPM), by law, pays certain costs of retirement programs, and certain legal adjustments against OSM are paid from the Judgment Fund maintained by Treasury. When costs that are identifiable to OSM and directly attributable to OSM's operations are paid for by other agencies, OSM recognizes these amounts as operating expenses. In addition, OSM recognizes an imputed financing source on the Consolidated Statement of Changes in Net Position to indicate the funding of OSM's operations by other Federal agencies.

## **D. Distribution of AML Appropriation for Reclamation Grants**

OSM distributes the Congressional appropriation from the collections of AML fees through grants to states and tribes. The distribution contains three main components: state-share distribution, federal-share distribution, and emergency program distribution. The state-share portion is based on the percentage of each state's balance in the AML Special Fund. All states or tribes with a participating state or tribal reclamation program receive state-share distributions on an annual basis if they have a balance in the fund. OSM distributes additional monies from the federal-share portion of the AML appropriation based upon state historical coal production prior to 1978. Under the minimum program provision, OSM distributes at least \$1.5 million to states or tribes with qualifying reclamation projects. This provides additional funding for Priority 1 and Priority 2 AML coal projects. OSM also distributes monies to be used only for qualifying emergency programs from the federal-share portion of the appropriation.

## **E. Grant Expenditures**

OSM awards grants to states and Indian tribes to facilitate the accomplishment of its overall mission. To meet immediate cash needs, grantees draw down funds that are disbursed through an automated payment system. OSM records these draw downs as expenditures because they are either reimbursements or the state or tribe immediately disburses the money for its program. All of OSM disbursements are made by the Treasury.

## **F. Fund Balance with Treasury**

OSM maintains all cash accounts with the Treasury. The account "Fund Balance with Treasury" represents appropriated and special fund balances, both available and unavailable. Cash receipts and disbursements are processed by Treasury. OSM reconciles its records with those of the Treasury on a monthly basis. Note 3 provides additional information on Fund Balances with Treasury.

## **G. Investments**

OSM invests excess cash from AML fee collections in Treasury notes and certificates. OSM intends to hold long-term notes to maturity and therefore our values do not fluctuate with market fluctuations. Note 4 provides additional information concerning investments. Some of the earnings from these investments are transferred to the United Mine Workers of America Combined Benefit Fund.

The Federal Government does not set aside assets to pay future benefits or other expenditures associated with earmarked funds. The cash receipts collected from the public for an earmarked fund are deposited in the U.S. Treasury, which uses the cash for general Government purposes. Treasury securities are issued to OSM as evidence of its receipts. Treasury securities are an asset to OSM and a liability to the U.S. Treasury. Because OSM and the U.S. Treasury are both parts of the Government these assets and liabilities offset each other from the standpoint of the Government as a whole. For this reason, they do not represent an asset or a liability in the U.S. Government-wide financial statements. Treasury securities provide OSM with authority to draw upon the U.S. Treasury to make future benefit payments or other expenditures. When OSM requires redemption of these securities to make expenditures, the Government finances those expenditures out of accumulated cash balances, by raising taxes or other receipts, by borrowing from the public or repaying less debt, or by curtailing other expenditures. This is the same way the Government finances all other expenditures.

## **H. Allowance for Doubtful Accounts**

OSM uses two different methodologies to recognize bad debts arising from uncollectible accounts receivable, the net of the allowance method and the specific analysis method. The net of the allowance method is used for special and civil penalty funds accounts receivable. Under this method, an allowance for doubtful accounts is calculated based upon OSM's past experience in successfully collecting delinquent accounts receivable by aging category. OSM's allowance methodology is representative of the collectability of delinquent accounts. For all other types of receivables, the allowance is based on an analysis of each account receivable.

# NOTES TO THE FINANCIAL STATEMENTS

## **I. Personnel Compensation and Benefits**

Annual leave is accrued as it is earned by employees. The accrual is reduced as leave is taken. Each year, the balance of accrued annual leave is adjusted to reflect current pay rates. Appropriations do not provide for leave as it is earned, only as it is used. Consequently, OSM has a liability for unused annual leave which is considered unfunded. Sick leave and other types of non-vested leave are expensed as used.

Workers compensation costs and unemployment compensation insurance are funded from current appropriations when paid. An unfunded liability is recognized for benefits received by employees, but not yet paid by OSM.

OSM employees participate in the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS), which became effective on January 1, 1984. Most OSM employees hired after December 31, 1983 are automatically covered by FERS and Social Security. Employees hired prior to January 1, 1984, could elect to either join FERS and Social Security or remain in CSRS.

OSM employees may contribute up to seven percent of their gross pay to CSRS. OSM makes matching contributions to CSRS on behalf of CSRS employees. Employees covered by CSRS are not subject to Social Security taxes, nor are they entitled to accrue Social Security benefits for wages subject to CSRS. CSRS employees, however, do contribute to Medicare. FERS employees are subject to Social Security and Medicare taxes. OSM also contributes an amount equal to one percent of the employee's basic pay to the tax deferred thrift savings plan and matches employee contributions up to an additional four percent of pay for FERS employees. FERS employees can contribute up to one hundred percent of their gross earnings to the plan, but a maximum of \$15,000 per year is the limit allowed to contribute. CSRS employees have the option of contributing to the thrift savings plan up to ten percent of their gross salary with no additional government matching.

These financial statements also reflect CSRS or FERS accumulated plan benefits and unfunded retirement liabilities, if any. These figures are calculated and provided to OSM by the Office of Personnel Management.

Pursuant to OMB guidance, the presentation of Federal Employees' Compensation Act actuarial liability is based on Department of Labor computations. This liability includes the expected future liability for death, disability, medical, and other approved costs relating to current compensation act claims.

## **J. Income Taxes**

As an agency of the U.S. Government, OSM is exempt from all income taxes imposed by any governing body, whether it is a federal, state, or commonwealth of the United States or a local or foreign government.

## **K. Use of Estimates**

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amount of assets, liabilities, revenues, and expenses during the reporting period. Actual results will invariably differ from those estimates.

## **L. Earmarked Funds**

OSM adopted the provisions of Statement of Federal Financial Accounting Standards No.27, Identifying and Reporting Earmarked Funds effective October 1, 2005. In accordance with SFFAS No. 27, OSM reported earmarked nonexchange revenue and other financing sources, including appropriations, and net cost of operations separately on the fiscal year 2006 Statement of Changes in Net Position and separately reported the portion of net position (i.e., cumulative results of operations and unexpended appropriations) attributable to earmarked funds on the fiscal year 2006 Statement of Changes in Net Position and on the fiscal year 2006 Balance Sheet, and disclosed in the notes to the financial statements a description of the purpose of the earmarked funds, accounting and reporting of the funds, sources of revenue or other financing and an explanation of the extent to which they are inflows of resources to the Government or the result of intragovernmental flows, authority to use revenues and other financing sources of the funds, changes in legislation significantly impacting the funds and condensed financial information for earmarked funds. In accordance with the federal accounting and reporting standards, Interior did not apply the provisions of SFFAS No 27. to fiscal year 2005 statements and note disclosures and therefore the fiscal year 2005 balance sheet, statement of changes in net position, and earmarked fund note disclosure are not comparable to the fiscal year 2006 balance sheet, statement of changes in net position, and earmarked fund note disclosure.

# NOTES TO THE FINANCIAL STATEMENTS

## Note 2. Asset Analysis

Assets can be classified as entity or non-entity and restricted or unrestricted. Entity assets are those that OSM has the authority to use in its operations. Non-entity assets include certain accounts and interest receivable that will be forwarded to the Treasury upon collection. OSM's non-entity receivables were less than two thousand dollars for fiscal year 2005. In general, large trust funds that are outside the scope of bureau day-to-day operations are further classified by the Department of Interior as restricted. OSM does not hold any Entity restricted assets.

### Asset Analysis As of September 30, 2006 and 2005

| (dollars in thousands)                     | Entity<br>Unrestricted | Non Entity<br>Restricted | FY 2006             |
|--|------------------------|--------------------------|---------------------|
| <b>Intragovernmental Assets:</b>           |                        |                          |                     |
| Fund Balance with Treasury                 | \$ 46,487              | -                        | \$ 46,487           |
| Investments, Net                           | 2,272,961              | -                        | 2,272,961           |
| Accounts and Interest Receivable           | 19                     | -                        | 19                  |
| Other                                      |                        |                          |                     |
| Advances and Prepayments                   | 130                    | -                        | 130                 |
| <b>Total Intragovernmental Assets</b>      | <b>2,319,597</b>       | <b>-</b>                 | <b>2,319,597</b>    |
| Accounts and Interest Receivable, Net      | 1,970                  | -                        | 1,970               |
| General Property, Plant and Equipment, Net | 2,537                  | -                        | 2,537               |
| Other                                      |                        |                          |                     |
| Advances and Prepayments                   | 840                    | -                        | 840                 |
| Subtotal                                   | 840                    | -                        | 840                 |
| <b>TOTAL ASSETS</b>                        | <b>\$ 2,324,944</b>    | <b>-</b>                 | <b>\$ 2,324,944</b> |

| (dollars in thousands)                     | Entity<br>Unrestricted | Non Entity<br>Restricted | FY 2005             |
|--|------------------------|--------------------------|---------------------|
| <b>Intragovernmental Assets:</b>           |                        |                          |                     |
| Fund Balance with Treasury                 | \$ 49,332              | -                        | \$ 49,332           |
| Investments, Net                           | 2,141,599              | -                        | 2,141,599           |
| Accounts and Interest Receivable           | 34                     | -                        | 34                  |
| Other                                      |                        |                          |                     |
| Advances and Prepayments                   | 44                     | -                        | 44                  |
| <b>Total Intragovernmental Assets</b>      | <b>2,191,009</b>       | <b>-</b>                 | <b>2,191,009</b>    |
| Accounts and Interest Receivable, Net      | 11,437                 | 2                        | 11,439              |
| General Property, Plant and Equipment, Net | 2,417                  | -                        | 2,417               |
| <b>TOTAL ASSETS</b>                        | <b>\$ 2,204,863</b>    | <b>2</b>                 | <b>\$ 2,204,865</b> |



## Note 3. Fund Balance with Treasury

The Treasury performs cash management activities for all government agencies. The Fund Balance with Treasury represents the right of OSM to draw on the Treasury for allowable expenditures. The Fund Balance with Treasury represents OSM's unexpended, uninvested account balances. All funds reported on these statements are entity funds.

The status of the fund balance may be classified as unobligated available, unobligated unavailable, and obligated not yet disbursed. Unobligated funds, depending on budget authority, are generally available for new obligations associated with current operations. Unavailable authority includes amounts appropriated in prior fiscal years, which may not be used for current operations. Obligated funds represent amounts designated for payment of goods and services ordered, but not received.

Obligated and unobligated balances reported for the status of fund balance with Treasury do not agree with obligated and unobligated balances reported on the Statement of Budgetary Resources because: (1) the budgetary balances include amounts supported by other than fund balance with Treasury, such as investments in Treasury Securities and allocation transfers (transferring agency); and (2) the fund balance with Treasury amounts include items for which budgetary resources are not recorded, such as deposit funds and unavailable collections and allocation transfers (receiving agency). Allocation transfers result in differences for both the transferring and receiving agency because the budgetary amounts are reported by the agency transferring the funds but the proprietary amounts are reported by the receiving agency.

### Fund Balance with Treasury by Fund Type As of September 30, 2006 and 2005

| (dollars in thousands)                               | FY 2006          | FY 2005          |
|--|------------------|------------------|
| General Funds  | \$ 44,301        | \$ 46,591        |
| Special Funds  | 1,253            | 1,627            |
| Other Fund Types                                     | 933              | 1,114            |
| <b>Total Fund Balance with Treasury by Fund Type</b> | <b>\$ 46,487</b> | <b>\$ 49,332</b> |

### Status of Fund Balance with Treasury As of September 30, 2006 and 2005

| (dollars in thousands)  | FY 2006          | FY 2005          |
|---|------------------|------------------|
| Unobligated   |                  |                  |
| Available   | \$ 1,553         | \$ 2,518         |
| Unavailable   | 7,071            | 5,455            |
| Obligated Not Yet Disbursed                                   | 36,930           | 40,245           |
| Subtotal  | 45,554           | 48,218           |
| Fund Balance with Treasury Not Covered by Budgetary Resources |                  |                  |
| Clearing and Deposit Accounts                                 | 933              | 1,114            |
| Subtotal  | 933              | 1,114            |
| <b>Total Status of Fund Balance with Treasury</b>             | <b>\$ 46,487</b> | <b>\$ 49,332</b> |

# NOTES TO THE FINANCIAL STATEMENTS

## Note 4. Investments, Net

Effective October 1, 1991, OSM was given authority to invest the balance of the AML Fund in non-marketable federal securities under Public Law 101-508. The Bureau of Public Debt is the sole issuer of authorized non-marketable Federal securities, which are purchased by OSM directly from the Treasury. OSM may invest in bills, notes, bonds, and one-day certificates. There are no restrictions on federal agencies as to the use or convertibility of Treasury non-marketable securities. During FY 2005 and FY 2006 OSM was invested in both notes and one-day certificates. OSM intends to hold the 10-year T-Notes to maturity. The Market Value Disclosure reflects the sell value of the security on September 30<sup>th</sup> of each fiscal year.

### Investments, Net As of September 30, 2006 and 2005

| (dollars in thousands) | Investment Type                     | Cost                | Net Amortized (Premium)/Discount | FY 2006 Investments, Net | Market Value Disclosure |
|------------------------|-------------------------------------|---------------------|----------------------------------|--------------------------|-------------------------|
|                        | U.S. Treasury Securities            |                     |                                  |                          |                         |
|                        | Non-Marketable, market-based        | \$ 2,263,900        | \$ 594                           | \$ 2,264,494             | \$ 2,230,790            |
|                        | Accrued Interest                    | 8,467               | -                                | 8,467                    | 8,467                   |
|                        | <b>Total Non-Public Investments</b> | <b>\$ 2,272,367</b> | <b>\$ 594</b>                    | <b>\$ 2,272,961</b>      | <b>\$ 2,239,257</b>     |

| (dollars in thousands) | Investment Type                     | Cost                | Net Amortized (Premium)/Discount | FY 2005 Investments, Net | Market Value Disclosure |
|------------------------|-------------------------------------|---------------------|----------------------------------|--------------------------|-------------------------|
|                        | U.S. Treasury Securities            |                     |                                  |                          |                         |
|                        | Non-Marketable, market-based        | \$ 2,132,892        | \$ 376                           | \$ 2,133,268             | \$ 2,122,530            |
|                        | Accrued Interest                    | 8,331               | -                                | 8,331                    | 8,331                   |
|                        | <b>Total Non-Public Investments</b> | <b>\$ 2,141,223</b> | <b>\$ 376</b>                    | <b>\$ 2,141,599</b>      | <b>\$ 2,130,861</b>     |

## Note 5. Intragovernmental Accounts and Interest Receivable

There is no allowance for doubtful accounts recorded for receivables with other government agencies because such amounts are deemed fully collectible. All intragovernmental accounts receivable are aged as current.

### Intragovernmental Accounts and Interest Receivable from Federal Agencies As of September 30, 2006 and 2005

| (dollars in thousands)                                  | FY 2006      | FY 2005      |
|---|--------------|--------------|
| Accounts and Interest Receivable from Federal Agencies  |              |              |
| Unbilled  | 19           | 34           |
| <b>Total Accounts and Interest Receivable - Federal</b> | <b>\$ 19</b> | <b>\$ 34</b> |

## Note 6. Accounts and Interest Receivable, Net, Due from the Public

Accounts receivable with the public are recorded net of the allowance for doubtful accounts. These receivables represent uncollected Abandoned Mine Land, civil penalty and audit fees, including related interest receivables and receivables from the United Mine Workers of America Combined Benefit Fund.

An aging of OSM's accounts receivable with the public is displayed below for both fiscal years. Following that is an analysis of OSM's Accounts and Interest Receivable, Net of an Allowance for Doubtful Accounts.

### Accounts and Interest Receivable, Net, Due from the Public As of September 30, 2006 and 2005

| (dollars in thousands)  | FY 2006         | FY 2005          |
|---|-----------------|------------------|
| Accounts and Interest Receivable from the Public                        |                 |                  |
| Current   | \$ 673          | \$ 309           |
| 1 - 180 Days Past Due   | 465             | 295              |
| 181 - 365 Days Past Due   | 156             | 47               |
| 1 to 2 Years Past Due   | 78              | 307              |
| Total Billed Accounts and Interest Receivable - Public                  | 1,372           | 958              |
| Unbilled Accounts Receivable  | 1,050           | 10,820           |
| Total Accounts and Interest Receivable - Public                         | 2,422           | 11,778           |
| Allowance for Doubtful Accounts - Public                                | (452)           | (339)            |
| <b>Total Accounts and Interest Receivable - Public Net of Allowance</b> | <b>\$ 1,970</b> | <b>\$ 11,439</b> |

# NOTES TO THE FINANCIAL STATEMENTS

## Note 7. General Property, Plant and Equipment, Net

OSM does not own any real estate or buildings; however, OSM capitalizes tenant improvements to office space as leasehold improvements. Leasehold improvements are capitalized when the acquisition cost is \$100 thousand or more. They are depreciated using straight-line depreciation over the useful life according to GSA schedules.

Personal property and equipment are valued at historical cost and are capitalized whenever the initial acquisition cost is \$15 thousand or greater and the estimated useful life is two years or longer. Personal property and equipment are depreciated using the straight-line method and an asset's useful life is determined using OMB guidance.

Internal use Software in Development costs are capitalized when the preliminary design phase is complete and management commits to pursue the project. Depreciation will begin when software is moved to production.

### General Property, Plant and Equipment, Net As of September 30, 2006 and 2005

| (dollars in thousands)                      | Acquisition<br>Cost | Accumulated<br>Depreciation | Net Book Value<br>FY 2006 |
|---|---------------------|-----------------------------|---------------------------|
| Leasehold Improvements                      | \$ 599              | \$ 261                      | \$ 338                    |
| Equipment, Vehicles, and Aircraft           | 4,835               | 2,889                       | 1,946                     |
| Internal Use Software:                      |                     |                             |                           |
| In Development                              | 253                 | -                           | 253                       |
| <b>Total Property, Plant, and Equipment</b> | <b>\$ 5,687</b>     | <b>\$ 3,150</b>             | <b>\$ 2,537</b>           |

| (dollars in thousands)                      | Acquisition<br>Cost | Accumulated<br>Depreciation | Net Book Value<br>FY 2005 |
|---|---------------------|-----------------------------|---------------------------|
| Leasehold Improvements                      | \$ 599              | \$ 211                      | \$ 388                    |
| Equipment, Vehicles, and Aircraft           | 4,934               | 2,999                       | 1,935                     |
| Internal Use Software:                      |                     |                             |                           |
| In Development                              | 94                  | -                           | 94                        |
| <b>Total Property, Plant, and Equipment</b> | <b>\$ 5,627</b>     | <b>\$ 3,210</b>             | <b>\$ 2,417</b>           |

## Note 8. Liabilities

Liabilities covered by budgetary resources and liabilities not covered by budgetary resources are combined and presented together in the balance sheets. Liabilities covered by budgetary resources are liabilities to be paid with existing appropriation authority. Liabilities not covered by budgetary authority represent those liabilities for which Congressional action is needed before budgetary resources can be provided. Current liabilities are expected to be liquidated during the subsequent fiscal year.

### Liabilities Analysis As of September 30, 2006

| (dollars in thousands)                     | Covered by<br>Budgetary<br>Resources |               | Not Covered by<br>Budgetary<br>Resources |           | FY 2006       |
|--|--------------------------------------|---------------|--|-----------|---------------|
|  | Current                              | Current       | Non-Current                              |           |               |
| <b>Intragovernmental Liabilities:</b>      |                                      |               |  |           |               |
| Accounts Payable                           | \$ 89                                | \$ -          | \$ -                                     | \$        | 89            |
| Other                                      |                                      |               |  |           |               |
| Advances and Deferred Revenue              | 4                                    | -             | -  |           | 4             |
| Other Liabilities                          |                                      |               |  |           |               |
| Accrued Employee Benefits                  | 388                                  | -             | 180                                      |           | 568           |
| Unfunded FECA Liability                    | -                                    | 252           | 378                                      |           | 630           |
| Other Miscellaneous Liabilities            | 24                                   | -             | 366                                      |           | 390           |
| Total Other Liabilities                    | 412                                  | 252           | 924                                      |           | 1,588         |
| Total Other Intragovernmental Liabilities  | 416                                  | 252           | 924                                      |           | 1,592         |
| <b>Total Intragovernmental Liabilities</b> | <b>505</b>                           | <b>252</b>    | <b>924</b>                               |           | <b>1,681</b>  |
| <b>Public Liabilities:</b>                 |                                      |               |  |           |               |
| Accounts Payable                           | 7,850                                | -             | -  |           | 7,850         |
| Federal Employee and Veterans' Benefits    |                                      |               |  |           |               |
| FECA Actuarial Liability                   | -                                    | -             | 3,543                                    |           | 3,543         |
| Other                                      |                                      |               |  |           |               |
| Contingent Liabilities                     | -                                    | -             | 100                                      |           | 100           |
| Other Liabilities                          |                                      |               |  |           |               |
| Accrued Payroll and Benefits               | 2,322                                | -             | -  |           | 2,322         |
| Unfunded Annual Leave                      | -                                    | -             | 4,507                                    |           | 4,507         |
| Deposit Fund                               | -                                    | 5             | 925                                      |           | 930           |
| Total Other Liabilities                    | 2,322                                | 5             | 5,432                                    |           | 7,759         |
| Total Other Public Liabilities             | 2,322                                | 5             | 5,532                                    |           | 7,859         |
| Total Public Liabilities                   | 10,172                               | 5             | 9,075                                    |           | 19,252        |
| <b>Total Liabilities</b>                   | <b>\$ 10,677</b>                     | <b>\$ 257</b> | <b>\$ 9,999</b>                          | <b>\$</b> | <b>20,933</b> |

# NOTES TO THE FINANCIAL STATEMENTS

## Note 8. Continued

### Liabilities Analysis As of September 30, 2005

| (dollars in thousands)                     | Covered by<br>Budgetary<br>Resources |           | Not Covered by<br>Budgetary<br>Resources |                 | FY 2005          |
|--|--------------------------------------|-----------|--|-----------------|------------------|
|  | Current                              |           | Current                                  | Non-Current     |                  |
| <b>Intragovernmental Liabilities:</b>      |                                      |           |  |                 |                  |
| Accounts Payable                           | \$ 52                                | \$        | -  | \$              | 52               |
| Other                                      |                                      |           |  |                 |                  |
| Advances and Deferred Revenue              | 208                                  |           | -  | -               | 208              |
| Other Liabilities                          |                                      |           |  |                 |                  |
| Accrued Employee Benefits                  | 378                                  |           | -  | 159             | 537              |
| Unfunded FECA Liability                    | -                                    |           | 251                                      | 376             | 627              |
| Other Miscellaneous Liabilities            | 2                                    |           | 43                                       | 367             | 412              |
| Total Other Liabilities                    | 380                                  |           | 294                                      | 902             | 1,576            |
| Total Other Intragovernmental Liabilities  | 588                                  |           | 294                                      | 902             | 1,784            |
| <b>Total Intragovernmental Liabilities</b> | <b>640</b>                           |           | <b>294</b>                               | <b>902</b>      | <b>1,836</b>     |
| <b>Public Liabilities:</b>                 |                                      |           |  |                 |                  |
| Accounts Payable                           | 7,098                                |           | -  | -               | 7,098            |
| Federal Employee and Veterans' Benefits    |                                      |           |  |                 |                  |
| FECA Actuarial Liability                   | -                                    |           | -  | 3,867           | 3,867            |
| Other                                      |                                      |           |  |                 |                  |
| Contingent Liabilities                     | -                                    |           | 2,500                                    | 70              | 2,570            |
| Other Liabilities                          |                                      |           |  |                 |                  |
| Accrued Payroll and Benefits               | 2,267                                |           | -  | -               | 2,267            |
| Unfunded Annual Leave                      | -                                    |           | -  | 3,978           | 3,978            |
| Deposit Funds                              | -                                    |           | 11                                       | 895             | 906              |
| Total Other Liabilities                    | 2,267                                |           | 11                                       | 4,873           | 7,151            |
| Total Other Public Liabilities             | 2,267                                |           | 2,511                                    | 4,943           | 9,721            |
| Total Public Liabilities                   | 9,365                                |           | 2,511                                    | 8,810           | 20,686           |
| <b>Total Liabilities</b>                   | <b>\$ 10,005</b>                     | <b>\$</b> | <b>2,805</b>                             | <b>\$ 9,712</b> | <b>\$ 22,522</b> |

## Note 9. Cumulative Results of Operations - Other Funds

The balance in Cumulative Results of Operations - Other Funds on the Consolidated Balance Sheet is negative because the liabilities included in this fund exceed assets. Assets in the fund include capitalized property, net of its associated accumulated depreciation. Liabilities in the fund include current and long term accrued annual leave, accrued workman's compensation, and contingent liabilities. These liabilities will be funded when the in the future with appropriations when disbursements are made.

## Note 10. Contingent and Environmental Liabilities

There have been claims filed against OSM with adjudications pending. As of September 30, 2006, a liability has been accrued in the financial statements for cases in which payment has been deemed probable and for which the amount of potential liability is estimable. The U.S. Treasury's Judgment Fund would likely bear most of the costs incurred to pay any judgments or settlements and the resultant outcomes should not materially affect OSM's future financial condition. During FY 2005, the U.S. Court of Appeals for the Federal Circuit reversed the Court of Federal Claims' finding of a physical taking, which changed OSM's estimate on this case from \$68,500 thousand to zero in FY 2005.

In addition to the amounts disclosed above, OSM has adjudications pending where the likelihood of an unfavorable outcome is reasonably possible. No amounts have been accrued in the financial records for claims where the probability is less than probable or amount of judgment is not estimateable.

OSM has another case where the risk of an unfavorable outcome is probable, but, at this time, it is not possible to estimate the amount of potential liability with any degree of certainty. The issue in this case is whether the Abandoned Mine Land (AML) reclamation fee OSM collects from coal operators violates the Export Clause of the United States Constitution to the extent it is collected on exported coal. Though a trial court has ruled against OSM on the issue of liability, significant issues pertaining to damages (i.e., the amount of any refunds) remain unresolved in the case and is not estimateable; as such, final judgment has not been entered by the trial court. Given the large number of plaintiffs, the total amount of potential refunds could be significant.

### Contingent Liabilities As of September 30, 2006 and 2005

| (dollars in thousands) | FY 2006             | 2006 Estimated Range of Loss |                    |
|------------------------|---------------------|------------------------------|--------------------|
|                        | Accrued Liabilities | Lower End of Range           | Upper End of Range |
| Contingent Liabilities |                     |                              |                    |
| Probable               | \$ 100              | \$ 100                       | \$ 300             |
| Reasonably Possible    |                     | 215                          | 555                |

| (dollars in thousands) | FY 2005             | 2005 Estimated Range of Loss |                    |
|------------------------|---------------------|------------------------------|--------------------|
|                        | Accrued Liabilities | Lower End of Range           | Upper End of Range |
| Contingent Liabilities |                     |                              |                    |
| Probable               | \$ 2,570            | \$ 2,570                     | \$ 2,725           |
| Reasonably Possible    |                     | 110                          | 410                |

## Note 10. Continued

### Environmental Liabilities:

The Congress has identified the reclamation of abandoned mine sites as an objective of providing for the general health and safety of the people. In order to finance the reclamation, OSM collects a fee for coal sold or used from current mining operations into a fund called the Abandoned Mine Land Fund. The purpose of this fee is to support, among other things, the reclamation of abandoned mine lands. Congress authorizes the funding for these projects on an annual basis through appropriations from this fund.

Although OSM's mission includes the administration of programs designed to protect society from the effects of coal mining operations, OSM has no liability for future environmental cleanup. OSM does not own land or contribute to environmental contamination. However, OSM provides some funding, through grants for states and tribes and through contracting in states or tribal lands that do not have approved abandoned mine land programs, in order to reclaim eligible abandoned mine sites or to work on other qualified projects. All costs associated with these projects are accrued in the accompanying financial statements as the grantee incurs them.

## Note 11. Commitments and Contingencies

OSM does not have any significant loss contingencies other than those disclosed in Note 10 related to pending litigation. Additionally, OSM does not have obligations related to canceled appropriations or contractual arrangements, which may require future financial obligations.

## Note 12. Net Cost by Segment (Unaudited)

OSM's net cost is presented below by responsibility segment and program activity with intragovernmental and public disclosures. The Office of Surface Mining Operations segment accounts for those net costs required to operate OSM and its Federal programs that are not transferred to states and tribes in the form of grants. Intragovernmental gross costs approximate intragovernmental revenues with the addition of a pro rata share of imputed costs. The FY 2005 Resource Use - Public Costs shows a negative balance because the Stearns case allocated more reduction of net costs than was charged during FY 2005. See Note 10.



# NOTES TO THE FINANCIAL STATEMENTS

## Note 12. Continued

### Consolidating Schedule of Net Cost by Responsibility Segment For the Year Ended September 30, 2006

| (dollars in thousands)           | Operating        | Grants            | UMWA             | FY 2006           |
|----------------------------------|------------------|-------------------|------------------|-------------------|
| <b>Resource Protection</b>       |                  |                   |                  |                   |
| Intragovernmental Costs          | \$ 746           | \$ -              | \$ -             | \$ 746            |
| Public Costs                     | 15,079           | 58,610            | -                | 73,689            |
| <b>Total Costs</b>               | <b>15,825</b>    | <b>58,610</b>     | <b>-</b>         | <b>74,435</b>     |
| Public Earned Revenue            | 5                | -                 | -                | 5                 |
| <b>Total Earned Revenue</b>      | <b>5</b>         | <b>-</b>          | <b>-</b>         | <b>5</b>          |
| <b>Net Costs</b>                 | <b>15,820</b>    | <b>58,610</b>     | <b>-</b>         | <b>74,430</b>     |
| <b>Resource Use</b>              |                  |                   |                  |                   |
| Intragovernmental Costs          | 17,300           | -                 | -                | 17,300            |
| Public Costs                     | 38,858           | 59,100            | -                | 97,958            |
| <b>Total Costs</b>               | <b>56,158</b>    | <b>59,100</b>     | <b>-</b>         | <b>115,258</b>    |
| Intragovernmental Earned Revenue | 1,411            | -                 | -                | 1,411             |
| Public Earned Revenue            | 163              | -                 | -                | 163               |
| <b>Total Earned Revenue</b>      | <b>1,574</b>     | <b>-</b>          | <b>-</b>         | <b>1,574</b>      |
| <b>Net Costs</b>                 | <b>54,584</b>    | <b>59,100</b>     | <b>-</b>         | <b>113,684</b>    |
| <b>Serving Communities</b>       |                  |                   |                  |                   |
| Intragovernmental Costs          | 8,030            | -                 | -                | 8,030             |
| Public Costs                     | 13,797           | 113,355           | -                | 127,152           |
| <b>Total Costs</b>               | <b>21,827</b>    | <b>113,355</b>    | <b>-</b>         | <b>135,182</b>    |
| Intragovernmental Earned Revenue | 325              | -                 | -                | 325               |
| Public Earned Revenue            | 5                | -                 | -                | 5                 |
| <b>Total Earned Revenue</b>      | <b>330</b>       | <b>-</b>          | <b>-</b>         | <b>330</b>        |
| <b>Net Costs</b>                 | <b>21,497</b>    | <b>113,355</b>    | <b>-</b>         | <b>134,852</b>    |
| <b>UMWA - CBF Transfer</b>       |                  |                   |                  |                   |
| Public Costs                     | -                | -                 | 69,824           | 69,824            |
| <b>Net Costs</b>                 | <b>-</b>         | <b>-</b>          | <b>69,824</b>    | <b>69,824</b>     |
| <b>Total</b>                     |                  |                   |                  |                   |
| Intragovernmental Costs          | 26,076           | -                 | -                | 26,076            |
| Public Costs                     | 67,734           | 231,065           | 69,824           | 368,623           |
| <b>Total Costs</b>               | <b>93,810</b>    | <b>231,065</b>    | <b>69,824</b>    | <b>394,699</b>    |
| Intragovernmental Earned Revenue | 1,736            | -                 | -                | 1,736             |
| Public Earned Revenue            | 173              | -                 | -                | 173               |
| <b>Total Earned Revenue</b>      | <b>1,909</b>     | <b>-</b>          | <b>-</b>         | <b>1,909</b>      |
| <b>Net Costs</b>                 | <b>\$ 91,901</b> | <b>\$ 231,065</b> | <b>\$ 69,824</b> | <b>\$ 392,790</b> |

# NOTES TO THE FINANCIAL STATEMENTS

## Note 12. Continued

### Consolidating Schedule of Net Cost by Responsibility Segment For the Year Ended September 30, 2005

| (dollars in thousands)           | Operating |         | Grants |         | UMWA   | FY 2005           |
|----------------------------------|-----------|---------|--------|---------|--------|-------------------|
| <b>Resource Protection</b>       |           |         |        |         |        |                   |
| Intragovernmental Costs          | \$        | 930     | \$     | -       | \$     | 930               |
| Public Costs                     |           | 3,857   |        | 55,326  | -      | 59,183            |
| Total Costs                      |           | 4,787   |        | 55,326  | -      | 60,113            |
| Less: Public Earned Revenue      |           | 1       |        | -       | -      | 1                 |
| Net Costs                        |           | 4,786   |        | 55,326  | -      | <b>60,112</b>     |
| <b>Resource Use</b>              |           |         |        |         |        |                   |
| Intragovernmental Costs          |           | 17,250  |        | -       | -      | 17,250            |
| Public Costs                     |           | (6,036) |        | 56,435  | -      | 50,399            |
| Total Costs                      |           | 11,214  |        | 56,435  | -      | 67,649            |
| Less:                            |           |         |        |         |        |                   |
| Intragovernmental Earned Revenue |           | 1,463   |        | -       | -      | 1,463             |
| Public Earned Revenue            |           | 59      |        | -       | -      | 59                |
| Total Earned Revenue             |           | 1,522   |        | -       | -      | 1,522             |
| Net Costs                        |           | 9,692   |        | 56,435  | -      | <b>66,127</b>     |
| <b>Serving Communities</b>       |           |         |        |         |        |                   |
| Intragovernmental Costs          |           | 7,755   |        | -       | -      | 7,755             |
| Public Costs                     |           | 3,767   |        | 107,222 | -      | 110,989           |
| Total Costs                      |           | 11,522  |        | 107,222 | -      | 118,744           |
| Less:                            |           |         |        |         |        |                   |
| Intragovernmental Earned Revenue |           | 86      |        | -       | -      | 86                |
| Public Earned Revenue            |           | 1       |        | -       | -      | 1                 |
| Total Earned Revenue             |           | 87      |        | -       | -      | 87                |
| Net Costs                        |           | 11,435  |        | 107,222 | -      | <b>118,657</b>    |
| <b>UMWA - CBF Transfer</b>       |           |         |        |         |        |                   |
| Public Costs                     |           | -       |        | -       | 61,684 | 61,684            |
| Net Costs                        |           | -       |        | -       | 61,684 | <b>61,684</b>     |
| <b>Total</b>                     |           |         |        |         |        |                   |
| Intragovernmental Costs          |           | 25,935  |        | -       | -      | 25,935            |
| Public Costs                     |           | 1,588   |        | 218,983 | 61,684 | 282,255           |
| Total Costs                      |           | 27,523  |        | 218,983 | 61,684 | 308,190           |
| Less:                            |           |         |        |         |        |                   |
| Intragovernmental Earned Revenue |           | 1,549   |        | -       | -      | 1,549             |
| Public Earned Revenue            |           | 61      |        | -       | -      | 61                |
| Total Earned Revenue             |           | 1,610   |        | -       | -      | 1,610             |
| Net Costs                        | \$        | 25,913  | \$     | 218,983 | \$     | 61,684            |
|                                  |           |         |        |         |        | <b>\$ 306,580</b> |

## Note 13. Appropriations Received (Unaudited)

Permanent Indefinite Appropriations. In addition to amounts annually appropriated by Congress, OSM appropriates a portion of the Abandoned Mine Land Fund in an amount equal to the annual transfer to the United Mine Workers Combined Benefit Fund. This appropriated transfer can be classified as a permanent indefinite appropriation, i.e., the budget authority is a permanent authorization in SMCRA and is of an indefinite amount determined on an annual basis to comply with the provisions of the law.

Appropriations Received. The amounts in Appropriations Received on the Combined Statements of Budgetary Resources differ from those reported on the Consolidated Statements of Changes in Net Position because the latter statements exclude appropriations from the AML Fund. Appropriations Received are not Appropriations. Appropriations includes the AML fund which has previously been received.

## Note 14. Apportionment Categories of Obligations Incurred (Unaudited)

OMB usually uses one of two apportionment categories to distribute budgetary resources. Category A apportionments distribute budgetary resources by fiscal quarters. Category B apportionments typically distribute budgetary resources by activities, projects, or objects. All of OSM's direct and reimbursable obligations are incurred against amounts apportioned under Category B, as determined in accordance with OMB Circular A-11. This amount agrees with the aggregate of the related information reported on the year-end SF-133, Reports on Budget Execution.

### Apportionment Categories of Obligations Incurred For the Years Ended September 30, 2006 and 2005

| (dollars in thousands)     | Apportioned |         | FY 2006<br>Total |
|----------------------------|-------------|---------|------------------|
| Obligations Incurred:      |             |         |                  |
| Direct                     | \$          | 389,580 | \$ 389,580       |
| Reimbursable               |             | 2,033   | 2,033            |
| Total Obligations Incurred | \$          | 391,613 | \$ 391,613       |

| (dollars in thousands)     | Apportioned |         | FY 2005<br>Total |
|----------------------------|-------------|---------|------------------|
| Obligations Incurred:      |             |         |                  |
| Direct                     | \$          | 403,171 | \$ 403,171       |
| Reimbursable               |             | 1,902   | 1,902            |
| Total Obligations Incurred | \$          | 405,073 | \$ 405,073       |

# NOTES TO THE FINANCIAL STATEMENTS

## Note 14. Continued

OSM's undelivered orders as of September 30, 2006 and 2005 were \$300 million and \$329 million, respectively.

Differences are primarily the result of certain Treasury requirements related to changes in various liabilities which are reported on the Consolidating Statement of Financing. These requirements are dependent upon whether the change results in an increase or decrease to the liability account. Additionally, some liability accounts not covered by budgetary resources are not included in the Consolidating Statement of Financing.

## Note 15. Offsetting Receipts (Unaudited)

Offsetting receipts are cash collections, resulting from business-type activities that are credited to the offsetting receipt accounts and deducted from gross budget authority and outlays, rather than added to receipts. Per the Treasury Annual Report, the receipt types included for OSM are Intrabudgetary Receipts Deducted by Agencies (OSM's interest earned on investments), and Proprietary Receipts from the Public (OSM's interest and administrative fees related to the AML fees collected from mining companies). The expenditure of these funds is subject to annual appropriation by Congress or as legislated by SMRCA to the United Mine Workers Combined Benefit Fund.

Offsetting Receipts Not Part of the Net Cost of Operations includes regulatory fees, judicial fees, proprietary receipts, fines, penalties, forfeitures, administrative serves fees, and unclaimed refunds in addition to the items included in Offsetting Receipts.

## Note 16. Explanation of Difference between the Statement of Budgetary Resources and the Budget of the United States Government (Unaudited)

The Combined Statements of Budgetary Resources have been prepared to coincide with the amounts shown in the Budget of the United States Government (President's Budget). The actual amounts for FY 2006 in the President's Budget have not yet been published as of the date this report was published. The President's Budget containing the actual FY 2005 amounts was released in February 2006, and the actual FY 2006 President's Budget is anticipated for a February 2007 release. The President's Budget can be located at the OMB website <http://www.whitehouse.gov/omb>.

The President's Budget is rounded to millions of dollars while the Combined Statement of Budgetary Resources is rounded to thousands of dollars. For comparison purposes, we have rounded this schedule to millions of dollars.

## Note 16. Continued

For OSM, the differences between the Combined Statement of Budgetary Resources (SBR) and the President's Budget are caused by the unique reporting requirements and objectives of those two reports, and do not indicate errors. For example, Beginning Unobligated Balances differ because the SBR includes the balances in all funds, whereas the President's Budget does not include expired funds. Amounts in Permanently Not Available in the U.S. Budget exclude canceled funds; the SBR includes these funds. The President's Budget also does not recognize recoveries and obligations of recovered funds for our AML appropriation. These figures are displayed in a separate column. All remaining differences in the Difference column relate to rounding at the millions.

### Reconciliation between the Statement of Budgetary Resources and the Budget of the U.S. Government For the Year Ended September 30, 2005

| (dollars in millions)                            | Total<br>President's<br>Budget | Total<br>Statement<br>of<br>Budgetary<br>Resources | Difference | Expired<br>and<br>Cancelled<br>Funds |
|--|--------------------------------|--|------------|--------------------------------------|
| <b>Budget Authority</b>                          |                                |  |            |                                      |
| Appropriations Received                          | 368                            | 368  | 0          | 0                                    |
| <b>Unobligated Balance</b>                       |                                |  |            |                                      |
| Beginning of Fiscal Year                         | 31                             | 36   | (5)        | (5)                                  |
| Spending Authority from Offsetting Collections   | 4                              | 2  | 2          | 0                                    |
| Recoveries of Prior Year Obligations             | 45                             | 46   | (1)        | 0                                    |
| Temporarily Not Available Pursuant to Public Law | (3)                            | (3)  | 0          | 0                                    |
| Permanently Not Available - Recission            | (2)                            | (3)  | 1          | 0                                    |
| <b>Total Budgetary Resources</b>                 | <b>443</b>                     | <b>446</b>   | <b>(3)</b> | <b>(5)</b>                           |
| <b>Status of Budgetary Resources</b>             |                                |  |            |                                      |
| Obligations Incurred                             | 407                            | 405  | 2          | 0                                    |
| Unobligated Balance                              | 33                             | 41   | (8)        | (5)                                  |
| <b>Total Status of Budgetary Resources</b>       | <b>440</b>                     | <b>446</b>   | <b>(6)</b> | <b>(5)</b>                           |
| <b>Relationship of Obligations to Outlays</b>    |                                |  |            |                                      |
| Obligated Balance, Net, Beginning of Fiscal Year | 362                            | 363  | (1)        | 0                                    |
| Obligated Balance, Transferred, Net              | 0                              | 0  | 0          | 0                                    |
| Obligated Balance, Net, End of Fiscal Year       | (338)                          | (338)  | 0          | 0                                    |
| <b>Outlays:</b>                                  |                                |  |            |                                      |
| Gross Outlays                                    | 385                            | 384  | 0          | 0                                    |
| Less: Offsetting Collections                     | 1                              | (2)  | (1)        | 0                                    |

# NOTES TO THE FINANCIAL STATEMENTS

## Note 17. Allocation Transfer Account, Reconciling Item (Unaudited)

In previous years OSM has transferred Abandoned Mine Land budget authority to the Department of Agriculture's Natural Resource Conservation Service in accordance with SMRCA and Congressional appropriations. These allocation transfers are for the purpose of providing for the control and prevention of erosion and sediment damages from unreclaimed mine lands, and promoting the conservation and development of soil and water resources on those lands. During FY 2006, no expenditures were made by the Department of Agriculture so no reconciling items were present on the Statements of Financing.

Budget authority that is transferred to another agency or bureau will create a reconciling item on the Consolidated Statement of Financing because OSM reports the related budget activity on the Combined Statement of Budgetary Resources while the Natural Resource Conservation Service reports its results of operations on its Statement of Net Cost.

### Allocation Transfer Account, Reconciling Item For the Years Ended September 30, 2006 and 2005

| (dollars in thousands)                            | Nature and Purpose of Transfer     | FY 2006     | FY 2005       |
|---|------------------------------------|-------------|---------------|
| <b>Interior as the Providing Agency (Parent):</b> |                                    |             |               |
| Department of Agriculture                         | To fund Soil Conservation Programs | \$ -        | \$ 100        |
| <b>Net Allocation Transfer Reconciling Items</b>  |                                    | <b>\$ -</b> | <b>\$ 100</b> |

## Note 18. Operating Leases (Unaudited)

OSM's facilities are rented from the General Services Administration (GSA), which charges rent that is intended to approximate commercial rental rates. For Federally-owned property, OSM generally enters into cancelable 10-year occupancy agreements with GSA. OSM is normally required to give 120 to 180 days notice to vacate the property and the amount of these agreements remains fairly constant from year to year. These agreements are included in the estimated future lease payments for FY 2006 through termination of the lease agreements. For publicly-owned property, an occupancy agreement is executed, and again OSM may normally cancel these agreements with 120 days notice. The estimated rent payments to GSA for both Federally-owned and publicly-owned buildings are presented in the table that follows. OSM's rental expense for 2006 and 2005 was \$5,499 and \$2,799 thousand, respectively. The future rent projections are based on an escalation factor of 2.4 percent for 2007 and thereafter, in accordance with GSA budget estimates.

### Future Operating Lease Payments As of September 30, 2006

| (dollars in thousands)                       | Real Property    |             | Personal Property |               | Total            |
|--|------------------|-------------|-------------------|---------------|------------------|
|  | Federal          | Public      | Federal           | Public        |                  |
| FY 2007                                      | \$ 5,634         | \$ -        | \$ 4              | \$ 26         | \$ 5,664         |
| FY 2008                                      | 5,769            | -           | 4                 | 27            | 5,800            |
| FY 2009                                      | 5,762            | -           | -                 | 27            | 5,789            |
| FY 2010                                      | 5,846            | -           | -                 | 27            | 5,873            |
| FY 2011                                      | 5,776            | -           | -                 | 27            | 5,803            |
| Thereafter                                   | 27,598           | -           | -                 | -             | 27,598           |
| <b>Total Future Operating Lease Payments</b> | <b>\$ 56,385</b> | <b>\$ -</b> | <b>\$ 8</b>       | <b>\$ 134</b> | <b>\$ 56,527</b> |

# NOTES TO THE FINANCIAL STATEMENTS

## Note 19. Earmarked Funds

Public Law 95-87 established the Office of Surface Mining (OSM) and authorized the collection of a fee from coal mine operators. Fees of 35 cents per ton of surface mined coal, 15 cents per ton of coal mined underground, and 10 cents per ton of lignite are collected from active mining operations. The fees are deposited in the Abandoned Mine Land (AML) Reclamation Fund, which is used to pay the cost of abandoned mine land reclamation projects. The Surface Mining Law specifies that 50 percent of the reclamation fees collected in each state or tribe with an approved reclamation program are to be allocated to that state or tribe. This 50 percent is designated as the state or tribal share of the fund. The remaining 50 percent (the Federal share) is used by OSM to complete high priority and emergency projects, to fund the Small Operator Assistance Program, to fund additional projects directly through state reclamation programs, and to pay collection, audit, and administration costs.

On September 30, 2004, the authority to collect this standard fee expired. The fee has been extended by various special laws through September 30, 2007. If no extension is granted by the expiration date, section 402(b) of SMCRA requires OSM to establish a new fee at a rate sufficient to continue to provide for the needs of certain beneficiaries of the United Mine Workers Combined Benefit Fund (UMWA-CBF), a non-governmental entity. OSM provides an annual transfer to the UMWA-CBF to help defray the health care costs of mine workers and their beneficiaries for which no current mining company is responsible. SMCRA allows an annual transfer of up to \$70 million to fulfill this requirement. In the event that the AML fee is not extended past September 30, 2007, OSM will issue a Final Rule establishing a fee rate which will provide \$70 million for the UMWA-CBF annually unless Congress passes further extensions or an amendment to the fee.

Expenditures from the Fund may only be made as a consequence of appropriations or other laws. AML reclamation is accomplished primarily by states and tribes and is funded by grants. Grant funding levels are determined by OSM's annual appropriation and consider the individual state or tribe reclamation funding needs as well as their state and Federal shares, emergency and special funding requirements.

Under authority of Public Law 101-509, OSM began investing AML funds in U.S. Treasury Securities. Beginning in 1996, under a requirement of the Energy Policy Act of 1992 (Public Law 102-486), OSM began an annual transfer from the investment interest earned to the United Mine Workers of America Combined Benefit Fund (UMWA CBF). This transfer is used to defray anticipated health care costs for eligible union coalmine workers who retired on or before July 20, 1992 and their dependents.

Payments to the UMWA CBF are made in advance based on the number of beneficiaries and an estimate of their benefit costs. Under current practice, the estimate is then adjusted to actual costs as health benefits are paid in subsequent years.

AML program expenses approximate the net cost for the Serving Communities and Resource Protection GPR program activities with the addition (+/-) of a pro rata share of allocated costs.



# NOTES TO THE FINANCIAL STATEMENTS

Earmarked Funds listed in the Other Earmarked Funds column consist of Civil Penalties and Bond Forfeiture. Civil Penalties consists of receipt and expenditure accounts used to collect penalties levied against operators who violate any permit condition or provision of Title 30 U.S.C. 1268. Funds from these assessments are used to reclaim lands adversely affected by coal mining practices on or after August 3, 1977. Bond Forfeiture consists of coal mining companies that are required to post performance bonds to cover the cost of reclaiming the mine site covered under their mining permit. In states where OSM is the regulatory authority, OSM collects bond proceeds when a company fails to perform adequate reclamation. The forfeited bond proceeds are deposited into the bond forfeiture fund and can be used to reclaim the mine site for which the bonds were posted.

The following table provides condensed information on the AML Fund, Civil Penalties and Bond Forfeiture:

## Earmarked Funds As of and for the Year Ended September 30, 2006

| (dollars in thousands)                    | Abandoned Mine<br>Reclamation<br>Fund | Other<br>Earmarked<br>Funds | FY 2006             |
|---|---------------------------------------|-----------------------------|---------------------|
| <b>ASSETS</b>                             |                                       |                             |                     |
| Fund Balance with Treasury                | \$ 1,005                              | \$ 1,022                    | \$ 2,027            |
| Investments, Net                          | 2,272,961                             | -                           | 2,272,961           |
| Accounts Receivable, Net                  | 1,889                                 | 55                          | 1,944               |
| Other                                     | 570                                   | -                           | 570                 |
| <b>TOTAL ASSETS</b>                       | <b>\$ 2,276,425</b>                   | <b>\$ 1,077</b>             | <b>\$ 2,277,502</b> |
| <b>LIABILITIES</b>                        |                                       |                             |                     |
| Accounts Payable                          | 5,579                                 | -                           | 5,579               |
| Other                                     | 969                                   | -                           | 969                 |
| <b>TOTAL LIABILITIES</b>                  | <b>6,548</b>                          | <b>-</b>                    | <b>6,548</b>        |
| <b>NET POSITION</b>                       |                                       |                             |                     |
| Cumulative Results of Operations          | 2,269,877                             | 1,077                       | 2,270,954           |
| <b>TOTAL NET POSITION</b>                 | <b>2,269,877</b>                      | <b>1,077</b>                | <b>2,270,954</b>    |
| <b>TOTAL LIABILITIES AND NET POSITION</b> | <b>\$ 2,276,425</b>                   | <b>\$ 1,077</b>             | <b>\$ 2,277,502</b> |
| <b>COST/REVENUE</b>                       |                                       |                             |                     |
| Gross Costs                               | 278,226                               | 216                         | 278,442             |
| Earned Revenue                            | (331)                                 | (5)                         | (336)               |
| <b>NET COST OF OPERATIONS</b>             | <b>\$ 277,895</b>                     | <b>\$ 211</b>               | <b>\$ 278,106</b>   |
| <b>NET POSITION</b>                       |                                       |                             |                     |
| Net Position, Beginning Balance           | 2,148,891                             | 1,095                       | 2,149,986           |
| Non-Exchange Revenue                      | 399,274                               | 193                         | 399,467             |
| Other Financing Sources                   |                                       |                             |                     |
| Other                                     | (393)                                 | -                           | (393)               |
| Net Cost of Operations                    | (277,895)                             | (211)                       | (278,106)           |
| Change in Net Position                    | 120,986                               | (18)                        | 120,968             |
| <b>NET POSITION, ENDING BALANCE</b>       | <b>\$ 2,269,877</b>                   | <b>\$ 1,077</b>             | <b>\$ 2,270,954</b> |

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U.S. DEPARTMENT OF THE INTERIOR  
OFFICE OF SURFACE MINING

**Required Supplementary  
Information**

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# REQUIRED SUPPLEMENTAL INFORMATION

## Department of the Interior Office of Surface Mining

### Supplementary Statement of Budgetary Resources by Major Budget Account (Unaudited)

For the Year Ended September 30, 2006

|  | Abandoned<br>Mine Lands | Regulation &<br>Technology | Clearing Accounts<br>& Miscellaneous<br>Receipts | Total<br>Budgetary<br>Accounts |
|--|-------------------------|----------------------------|--|--------------------------------|
| <b>Budgetary Resources:</b>  |                         |                            |  |                                |
| Unobligated Balance, Beginning of Fiscal Year:   | 32,563                  | 8,467                      | -  | 41,030                         |
| Recoveries of prior year unpaid obligations  | 36,938                  | 3,514                      | -  | 40,452                         |
| Budget Authority:  |                         |                            |  |                                |
| Appropriation  | 247,017                 | 110,606                    | -  | 357,623                        |
| Spending Authority from Offsetting Collections:  |                         |                            |  |                                |
| Earned:  |                         |                            |  |                                |
| Collected  | 316                     | 1,550                      | -  | 1,866                          |
| Change in Receivables from Federal Sources   | 14                      | (29)                       | -  | (15)                           |
| Change in Unfilled Customer Orders:  |                         |                            |  |                                |
| Without Advance from Federal Sources   | 201                     | (129)                      | -  | 72                             |
| <b>Total Budget Authority</b>  | <b>247,548</b>          | <b>111,998</b>             | <b>-</b>   | <b>359,546</b>                 |
| Temporarily Not Available Pursuant to Public Law   | (2,767)                 | (1)                        | -  | (2,768)                        |
| Permanently Not Available  | -                       | (2,854)                    | -  | (2,854)                        |
| <b>Total Budgetary Resources</b>   | <b>314,282</b>          | <b>121,124</b>             | <b>-</b>   | <b>435,406</b>                 |
| <b>Status of Budgetary Resources:</b>  |                         |                            |  |                                |
| Obligations Incurred:  |                         |                            |  |                                |
| Direct   | 278,584                 | 110,996                    | -  | 389,580                        |
| Reimbursable   | 527                     | 1,506                      | -  | 2,033                          |
| <b>Total Obligations Incurred</b>  | <b>279,111</b>          | <b>112,502</b>             | <b>-</b>   | <b>391,613</b>                 |
| Unobligated Balance Available:   |                         |                            |  |                                |
| Apportioned  | 34,971                  | 1,553                      | -  | 36,524                         |
| Unobligated Balance Not Available  | 200                     | 7,069                      | -  | 7,269                          |
| <b>Total Status of Budgetary Resources</b>   | <b>314,282</b>          | <b>121,124</b>             | <b>-</b>   | <b>435,406</b>                 |
| <b>Obligated Balance:</b>  |                         |                            |  |                                |
| Obligated Balance, Net:  |                         |                            |  |                                |
| Unpaid Obligations, Brought Forward, Beginning of Fiscal Year                                  | 300,006                 | 38,647                     | -  | 338,653                        |
| Less: Uncollected Customer Payments from Federal Sources, Brought Forward, Beg. of Fiscal Year | (206)                   | (231)                      | -  | (437)                          |
| <b>Total Unpaid Obligated Balances, Net, Beginning of Fiscal Year</b>                          | <b>299,800</b>          | <b>38,416</b>              | <b>-</b>   | <b>338,216</b>                 |
| Obligations Incurred, Net  | 279,112                 | 112,501                    | -  | 391,613                        |
| Less: Gross Outlays  | (268,316)               | (111,636)                  | -  | (379,952)                      |
| Less: Recoveries of Prior Year Unpaid obligations, Actual                                      | (36,938)                | (3,514)                    | -  | (40,452)                       |
| Change in Uncollected Customer Payments from Federal Sources                                   | (215)                   | 158                        | -  | (57)                           |
| <b>Total Unpaid Obligated Balance, Net, End of Year</b>  | <b>273,443</b>          | <b>35,925</b>              | <b>-</b>   | <b>309,368</b>                 |
| <b>Obligated balance, net, end of period</b>   |                         |                            |  |                                |
| <b>- by component:</b>   |                         |                            |  |                                |
| Unpaid Obligations   | 273,866                 | 35,997                     | -  | 309,863                        |
| Less: Uncollected Customer Payments from Federal Sources                                       | (422)                   | (73)                       | -  | (495)                          |
| <b>Total Unpaid Obligated Balance, Net, End of Year</b>  | <b>273,444</b>          | <b>35,924</b>              | <b>-</b>   | <b>309,368</b>                 |
| <b>Net Outlays:</b>  |                         |                            |  |                                |
| Gross Outlays  | 268,315                 | 111,636                    | -  | 379,951                        |
| Less: Offsetting Collections   | (316)                   | (1,550)                    | -  | (1,866)                        |
| Less: Distributed Offsetting Receipts  | (95,929)                | -                          | 206  | (95,723)                       |
| <b>Net Outlays(Receipts)</b>   | <b>172,070</b>          | <b>110,086</b>             | <b>206</b>                                       | <b>282,362</b>                 |

This statement is unaudited. See accompanying independent auditors' report.

# REQUIRED SUPPLEMENTAL INFORMATION

## Department of the Interior Office of Surface Mining

### Supplementary Statement of Budgetary Resources by Major Budget Account (Unaudited)

For the Year Ended September 30, 2005

|  | Abandoned<br>Mine Lands | Regulation &<br>Technology | Total<br>Budgetary<br>Accounts |
|--|-------------------------|----------------------------|--------------------------------|
| <b>Budgetary Resources:</b>  |                         |                            |                                |
| Unobligated Balance, Beginning of Fiscal Year:   | 30,291                  | 5,907                      | 36,198                         |
| Recoveries of Prior Year Unpaid Obligations  | 41,939                  | 3,835                      | 45,774                         |
| Budget Authority:  |                         |                            |                                |
| Appropriation  | 257,396                 | 109,894                    | 367,290                        |
| Spending Authority from Offsetting Collections:  |                         |                            |                                |
| Earned:  |                         |                            |                                |
| Collected  | 94                      | 1,488                      | 1,582                          |
| Change in Receivables from Federal Sources   | (6)                     | (5)                        | (11)                           |
| Change in Unfilled Customer Orders:  |                         |                            |                                |
| Without Advance from Federal Sources   | 188                     | 51                         | 239                            |
| <b>Total Budget Authority</b>  | <b>257,672</b>          | <b>111,428</b>             | <b>369,100</b>                 |
| Temporarily Not Available Pursuant to Public Law   | (2,657)                 | (1)                        | (2,658)                        |
| Permanently Not Available  | -                       | (2,311)                    | (2,311)                        |
| <b>Total Budgetary Resources</b>   | <b>327,245</b>          | <b>118,858</b>             | <b>446,103</b>                 |
| <b>Status of Budgetary Resources:</b>  |                         |                            |                                |
| Obligations Incurred:  |                         |                            |                                |
| Direct   | 294,407                 | 108,764                    | 403,171                        |
| Reimbursable   | 276                     | 1,626                      | 1,902                          |
| <b>Total Obligations Incurred</b>  | <b>294,683</b>          | <b>110,390</b>             | <b>405,073</b>                 |
| Unobligated Balance Available:   |                         |                            |                                |
| Apportioned  | 32,389                  | 1,309                      | 33,698                         |
| Unobligated Balance Not Available  | 173                     | 7,159                      | 7,332                          |
| <b>Total Status of Budgetary Resources</b>   | <b>327,245</b>          | <b>118,858</b>             | <b>446,103</b>                 |
| <b>Obligated Balance:</b>  |                         |                            |                                |
| Obligated Balance, Net:  |                         |                            |                                |
| Unpaid Obligations, Brought Forward, Beginning of Fiscal Year  | 325,235                 | 37,648                     | 362,883                        |
| Less: Uncollected Customer Payments from Federal Sources,<br>Brought Forward, Beginning of Fiscal Year | (25)                    | (186)                      | (211)                          |
| <b>Total Unpaid Obligated Balances, Net, Beginning of Fiscal Year</b>                                  | <b>325,210</b>          | <b>37,462</b>              | <b>362,672</b>                 |
| Obligations Incurred, Net  | 294,682                 | 110,391                    | 405,073                        |
| Less: Gross Outlays  | (277,972)               | (105,557)                  | (383,529)                      |
| Less: Recoveries of Prior Year Unpaid Obligations, Actual  | (41,939)                | (3,835)                    | (45,774)                       |
| Change in uncollected customer payments from Federal Sources   | (181)                   | (45)                       | (226)                          |
| <b>Total Unpaid Obligated Balance, Net, End of Year</b>  | <b>299,800</b>          | <b>38,416</b>              | <b>338,216</b>                 |
| <b>Obligated balance, net, end of period - by component:</b>   |                         |                            |                                |
| Unpaid Obligations   | 300,006                 | 38,647                     | 338,653                        |
| Less: Uncollected Customer Payments from Federal Sources   | (206)                   | (231)                      | (437)                          |
| <b>Total Unpaid Obligated Balance, Net, End of Year</b>  | <b>299,800</b>          | <b>38,416</b>              | <b>338,216</b>                 |
| <b>Net Outlays:</b>  |                         |                            |                                |
| Gross Outlays  | 277,975                 | 105,556                    | 383,531                        |
| Less: Offsetting Collections   | (94)                    | (1,488)                    | (1,582)                        |
| Less: Distributed Offsetting Receipts  | (75,246)                | -                          | (75,246)                       |
| <b>Net Outlays(Receipts)</b>   | <b>202,635</b>          | <b>104,068</b>             | <b>306,703</b>                 |

This statement is unaudited. See accompanying independent auditors' report.



U.S. DEPARTMENT OF THE INTERIOR  
OFFICE OF SURFACE MINING

Independent Auditors' Report

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## United States Department of the Interior

OFFICE OF INSPECTOR GENERAL  
Washington, DC 20240

JAN 22 2007

Memorandum

To: Director, Office of Surface Mining

From: Anne L. Richards *Anne L. Richards*  
Assistant Inspector General for Audits

Subject: Independent Auditors' Report on the Office of Surface Mining Balance Sheets for Fiscal Years 2006 and 2005 (Report No. X-IN-OSM-0021-2006)

### ***INTRODUCTION***

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This memorandum transmits the KPMG LLP (KPMG) auditors' report of the Office of Surface Mining (OSM) balance sheets for fiscal years 2006 and 2005 (Attachment 1). The Chief Financial Officers Act of 1990 (Public Law 101-576), as amended, requires the Inspector General or an independent auditor, as determined by the Inspector General, to audit the Department of the Interior (DOI) financial statements. Under a contract issued by DOI and monitored by the Office of Inspector General (OIG), the independent public accounting firm KPMG performed an audit of the OSM fiscal years 2006 and 2005 balance sheets. The contract required that the audit be performed in accordance with the "Government Auditing Standards" issued by the Comptroller General of the United States and with Office of Management and Budget Bulletin No. 06-03, "Audit Requirements for Federal Financial Statements."

### ***RESULTS OF INDEPENDENT AUDIT***

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In its audit report dated November 6, 2006, KPMG issued an unqualified opinion on the OSM balance sheets. However, KPMG identified one reportable condition in internal controls over financial reporting, which was not considered to be a material weakness. The report contains one recommendation that, if implemented, should resolve the finding.

### ***STATUS OF RECOMMENDATIONS***

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OSM did not formally respond to the draft report. However, in response to the Notice of Potential Finding and Recommendation, OSM agreed with the finding and

# INDEPENDENT AUDITORS' REPORT

recommendation, stating that it was in the process of implementing the recommendation (see Attachment 2, "Status of Audit Report Recommendations").

## ***EVALUATION OF KPMG AUDIT PERFORMANCE***

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To fulfill our monitoring responsibilities, the OIG:

- assessed KPMG's approach and planning of the audit;
- evaluated the qualifications and independence of the auditors;
- monitored the progress of the audit at key points;
- participated in periodic meetings with MMS management to discuss audit progress, findings, and recommendations;
- reviewed and accepted KPMG's audit report; and
- performed other procedures we deemed necessary.

KPMG is responsible for the attached auditors' report and for the conclusions expressed in the report. We do not express an opinion on OSM balance sheets or KPMG conclusions on the effectiveness of internal controls or compliance with laws, regulations, and the Federal Financial Management Improvement Act of 1996.

## ***REPORT DISTRIBUTION***

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The legislation, as amended, creating the OIG (5 U.S.C.A. app. 3) requires semiannual reporting to the Congress on all audit reports issued, actions taken to implement audit recommendations, and recommendations that have not been implemented. Therefore, we will include this report in our next semiannual report. The distribution of the report is not restricted, and copies are available for public inspection.

We appreciate the courtesies and cooperation extended to KPMG and the OIG staff during the audit. If you have any questions regarding the report, please contact me at 202-208-5512.

### Attachments

cc: Assistant Secretary, Land and Minerals Management  
Audit Liaison Officer, Land and Minerals Management  
Chief Financial Officer, Office of Surface Mining  
Audit Liaison Officer, Office of Surface Mining  
Focus Group Leader, Management Control and Audit Follow-up, Office of  
Financial Management  
Focus Leader, Financial Reporting, Office of Financial Management



### Independent Auditors' Report

The Director of the Office of Surface Mining  
and Inspector General U.S. Department of the Interior:

We have audited the accompanying consolidated balance sheets of the Office of Surface Mining (OSM) as of September 30, 2006 and 2005. The objective of our audits was to express an opinion on the fair presentation of these consolidated balance sheets. In connection with our fiscal year 2006 audit, we also considered OSM's internal control over financial reporting and performance measures and tested OSM's compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements that could have a direct and material effect on these consolidated balance sheets.

#### SUMMARY

As stated in our opinion on the consolidated balance sheets, we concluded that OSM's consolidated balance sheets as of September 30, 2006 and 2005 are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles.

The consolidated statements of net cost, consolidated statements of changes in net position, combined statements of budgetary resources, and consolidated statements of financing for the years ended September 30, 2006 and 2005 were not audited by us and, accordingly, we do not express an opinion on them.

As discussed in our opinion, in fiscal year 2006, OSM changed its method of accounting for and reporting of earmarked funds to adopt changes in accounting standards.

Our consideration of internal control over financial reporting and performance measures resulted in the following condition being identified as a reportable condition:

#### A. Controls over Financial Reporting

However, this reportable condition is not believed to be a material weakness.

The following sections discuss our opinion on OSM's consolidated balance sheets; our consideration of OSM's internal control over financial reporting and performance measures; our tests of OSM's compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements, and management's and our responsibilities.

#### OPINION ON THE CONSOLIDATED BALANCE SHEETS

We have audited the accompanying consolidated balance sheets of OSM as of September 30, 2006 and 2005.

# INDEPENDENT AUDITORS' REPORT

In our opinion, the consolidated balance sheets present fairly, in all material respects, the financial position of OSM as of September 30, 2006 and 2005, in conformity with U.S. generally accepted accounting principles.

The accompanying consolidated statements of net cost, consolidated statements of changes in net position, combined statements of budgetary resources, and consolidated statements of financing for the years ended September 30, 2006 and 2005 were not audited by us and, accordingly, we do not express an opinion on them.

As discussed in Note 1 to the consolidated financial statements, OSM changed its method of accounting for and reporting earmarked funds in fiscal year 2006 to adopt the provisions of the Federal Accounting Standards Advisory Board's Statement of Federal Financial Accounting Standards (SFFAS) No. 27, *Identifying and Reporting Earmarked Funds*.

The information in the Management's Discussion and Analysis and Required Supplementary Information sections is not a required part of the consolidated financial statements, but is supplementary information required by U.S. generally accepted accounting principles and Office of Management and Budget (OMB) Circular No. A-136, *Financial Reporting Requirements*. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this information. However, we did not audit this information and, accordingly, we express no opinion on it.

## INTERNAL CONTROL OVER FINANCIAL REPORTING

Our consideration of internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect OSM's ability to record, process, summarize, and report financial data consistent with the assertions by management in the consolidated financial statements.

Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud, in amounts that would be material in relation to the consolidated financial statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal control, misstatements due to error or fraud may nevertheless occur and not be detected.

In our fiscal year 2006 audit, we noted a certain matter described below, involving the internal control over financial reporting and its operation that we consider to be a reportable condition. However, this reportable condition is not believed to be a material weakness. There were no reportable conditions identified in the fiscal year 2005 independent auditors' report.

### A. *Controls over Financial Reporting*

Our review of the draft annual report as of the third quarter of fiscal year 2006, revealed certain inconsistencies, omissions, and errors in the consolidated financial statements and footnote disclosures. For example, the draft operating lease commitment footnote disclosure was reported as \$725.7 million rather than \$50.7 million as of June 30, 2006. In addition, OSM did not include a discussion on the adoption of SFFAS No. 27, *Identifying and Reporting Earmarked Funds*, or a description of each earmarked fund's purpose, how the funds are accounted for and reported, discussion of changes in legislation, discussion of the authority to use earmarked funds, or discussion on sources of revenue for all of OSM's earmarked funds. We also noted instances in which amounts reported were inconsistent between the various consolidated financial statements, between the consolidated financial statements and the footnote disclosures, and between the footnote disclosure

text and related tables. In addition, our review of the draft annual report as of September 30, 2006, revealed some of the same inconsistencies and omissions in the consolidated financial statements as were noted in our review of the draft annual report as of the third quarter.

These deficiencies are a result of a lack of internal control over the preparation and review of consolidated financial statements.

### ***Recommendation***

We recommend that OSM implement procedures and related internal controls to properly prepare and review interim and year-end consolidated financial statements and note disclosures.

### ***Management Response***

Management concurs with our recommendation, but did not prepare an official response to our finding.

## **INTERNAL CONTROLS OVER PERFORMANCE MEASURES**

Under OMB Bulletin No. 06-03, *Audit Requirements for Federal Financial Statements*, the definition of material weaknesses is extended to other controls as follows. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud, in amounts that would be material to a performance measure or aggregation of related performance measures, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal control, misstatements due to error or fraud may nevertheless occur and not be detected.

Our consideration of the design and operation of internal control over the existence and completeness assertions related to performance measures reported in the Management's Discussion and Analysis section would not necessarily disclose all matters involving the design and operation of the internal control over the existence and completeness assertions related to key performance measures that might be reportable conditions.

In our fiscal year 2006 audit, we noted no matters involving the design and operation of the internal control over the existence and completeness assertions related to key performance measures that we considered to be material weaknesses as defined above.

## **COMPLIANCE AND OTHER MATTERS**

Our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements, as described in the Responsibilities section of this report, exclusive of those referred to in the *Federal Financial Management Improvement Act of 1996* (FFMIA), disclosed no instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards* and OMB Bulletin No. 06-03.

The results of our tests of FFMIA disclosed no instances in which OSM's financial management systems did not substantially comply with the three requirements discussed in the Responsibilities section of this report.

\* \* \* \* \*

# INDEPENDENT AUDITORS' REPORT

## RESPONSIBILITIES

**Management's Responsibilities.** The United States Code Title 31 Sections 3515 and 9106 require agencies to report annually to Congress on their financial status and any other information needed to fairly present their financial position and results of operations. To help the U.S. Department of the Interior meet these reporting requirements, OSM prepares and submits consolidated financial statements in accordance with OMB Circular No. A-136.

Management is responsible for the consolidated financial statements, including:

- Preparing the consolidated financial statements in conformity with U.S. generally accepted accounting principles;
- Preparing the Management's Discussion and Analysis (including the performance measures) and Required Supplementary Information;
- Establishing and maintaining effective internal controls over financial reporting; and
- Complying with laws, regulations, contracts, and grant agreements applicable to OSM, including FFMIA.

In fulfilling this responsibility, management is required to make estimates and judgments to assess the expected benefits and related costs of internal control policies.

**Auditors' Responsibilities.** Our responsibility is to express an opinion on the September 30, 2006 and 2005 consolidated balance sheets of OSM based on our audits. The accompanying consolidated statements of net cost, consolidated statements of changes in net position, combined statements of budgetary resources, and consolidated statements of financing for the years ended September 30, 2006 and 2005 were not audited by us and, accordingly, we do not express an opinion on them. We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Bulletin No. 06-03. Those standards and OMB Bulletin No. 06-03 require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated balance sheets are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of OSM's internal control over financial reporting. Accordingly, we express no such opinion.

An audit also includes:

- Examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated balance sheets;
- Assessing the accounting principles used and significant estimates made by management; and
- Evaluating the overall consolidated balance sheet presentation.

We believe that our audits provide a reasonable basis for our opinion.

In planning and performing our fiscal year 2006 audit, we considered OSM's internal control over financial reporting by obtaining an understanding of OSM's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the consolidated balance sheets. We limited our internal control testing to those controls necessary to achieve the objectives described in *Government Auditing Standards* and OMB Bulletin No. 06-03. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*. The objective of our audit was not to provide an opinion on OSM's internal control over financial reporting. Consequently, we do not provide an opinion thereon.

Further required by OMB Bulletin No. 06-03, in our fiscal year 2006 audit, with respect to internal control related to performance measures determined by management to be key and reported in the Management's Discussion and Analysis section, we obtained an understanding of the design of internal controls relating to the existence and completeness assertions and determined whether these internal controls had been placed in operation. We limited our testing to those controls necessary to test and report on the internal control over key performance measures in accordance with OMB Bulletin No. 06-03. However, our procedures were not designed to provide an opinion on internal control over reported performance measures and, accordingly, we do not provide an opinion thereon.

As part of obtaining reasonable assurance about whether OSM's September 30, 2006 consolidated balance sheet is free of material misstatement, we performed tests of OSM's compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of the consolidated balance sheet amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 06-03, including certain provisions referred to in FFMIA. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws, regulations, contracts, and grant agreements applicable to OSM. However, providing an opinion on compliance with laws, regulations, contracts, and grant agreements was not an objective of our audit and, accordingly, we do not express such an opinion.

Under OMB Bulletin No. 06-03 and FFMIA, auditors are required to report whether certain Federal entities' financial management systems substantially comply with (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level. To assist the auditors of the U.S. Department of the Interior meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements.

We noted certain additional matters that we have reported to management of OSM in a separate letter dated November 6, 2006.

## **RESTRICTED USE**

This report is intended solely for the information and use of OSM's and the Department of the Interior's management, the Department of the Interior's Office of Inspector General, OMB, the U.S. Government Accountability Office, and the U.S. Congress and is not intended to be and should not be used by anyone other than these specified parties.

**KPMG LLP**

November 6, 2006

## STATUS OF AUDIT REPORT RECOMMENDATION

**Recommendation**

**Status**

**Action Required**

A

Resolved; not  
implemented

Recommendation will be referred to the Assistant Secretary for Policy, Management and Budget for tracking of implementation.



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