U.S. Department of the Interior

Minerals Management Service

Annual Financial Report
Fiscal Year 2003

Securing Ocean Energy &
Economic Value for America

Visit our web site at www.mms.gov

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Message from the Director

It is my pleasure to submit to you the Fiscal Year 2003 Annual Financial Report of the Minerals Management Service (MMS).

For over 20 years, MMS has been a leader in asset management for the Federal Government. Our mission includes managing the mineral resources on the Outer Continental Shelf (OCS), as well as Federal and Indian mineral revenues, to enhance both public and trust benefits, promote responsible use, and realize fair value. In pursuing this mission, MMS also supports the broader goals of the Department of the Interior, particularly:

- The Department's Resource Use goal for managing resources to enhance public benefit, promote responsible use, and ensure optimal value in energy and non-energy areas.
- The Department's Serving Communities goal for fulfilling Indian trust responsibilities.

MMS contributes to America's energy supply by managing the mineral resources on 1.76 billion acres of the OCS. The approximately 40 million leased OCS acres account for 25 percent of America's domestic natural gas production and 30 percent of America's domestic oil production. MMS ensures optimal value from onshore and offshore, Federal and Indian gas and oil production through valuation processes considering both environmental and economic concerns. MMS distributes mineral revenues to varied sources such as the U.S. Treasury, the States, and trust funds such as Land and Water Conservation. Almost every American benefits from the work of MMS through the gasoline that powers our cars and the natural gas that heats our home to the benefits obtained through the disbursement of collected mineral revenues.

America currently relies on foreign sources for more than half our oil supply. Over the next two decades, our demand for oil is expected to grow by 35 percent and our demand for natural gas is expected to grow by more than 50 percent. Beyond our current energy production and supplies, MMS administers several initiatives designed to increase the domestic production of oil and natural gas, such as the Shallow Water Deep Gas Incentive Program, which provides royalty suspensions to encourage deeper exploration and development using existing shallow water infrastructure.

We at MMS are committed to serving our country in the best, most efficient manner possible. From ensuring value for America's mineral resources to protecting the environment and disbursing revenues, MMS manages a number of responsibilities with efficiency, care and precision. As a small agency, with a vast impact, we never stop looking for the most efficient means to ensure that the Nation receives the best value for its precious resources now and in the future.

R. M. "Johnnie" Burton
Minerals Management Service Director

A diver examines the wealth of sea life living on the legs of a platform in the Gulf of Mexico.

Management's Discussion and Analysis

The Minerals Management Service (MMS) manages the Nation's natural gas, oil and other mineral resources on the Outer Continental Shelf (OCS); and collects, accounts for, and disburses revenues from offshore federal mineral leases and from onshore mineral leases on Federal and Indian lands. [The Outer Continental Shelf is located seaward of State waters and generally begins three geographical miles offshore, except in the case of Texas and the west coast of Florida, where OCS lands begin three marine leagues (approximately 10.3 miles) offshore.]

Following the Independent Commission on Fiscal Accountability's recommendation that proper fiscal accountability and management of the public's mineral resources would be best served by an agency devoted solely to minerals management, MMS was established by the Secretary of the Interior in 1982. Enacted in January 1982, the Federal Oil and Gas Royalty Management Act established a framework to improve management of Federal and Indian mineral royalties.

As the Nation's designated steward of the mineral resources on the OCS, MMS is committed to achieving the proper balance between providing energy for the American people and protecting unique and sensitive coastal and marine environments. The Federal government has been regulating oil and gas activity on the OCS for 50 years, since it gained official jurisdiction with the enactment of legislation in 1953. Since then, over 15 billion barrels of oil and more than 154 trillion cubic feet of natural gas have been produced from the Federal OCS. This production has generated over $150 billion in lease bonuses, rents, and royalty payments. MMS has an excellent environmental and safety record. Due to its regulatory expertise and its successful oversight of environmentally safe and sound operations, MMS is increasingly being called upon to assist with and participate in international forums and projects that further our Nation's foreign policy goals.

The establishment of MMS brought an increased emphasis on proper collection and accounting of mineral lease revenues. As collector of revenues from Federal and Indian lands, MMS utilizes a broad range of financial services and pursues a comprehensive compliance strategy to ensure the accuracy and timeliness of revenues received and disbursed in accordance with Federal laws. The business environment in which MMS administers royalty payments is similar, in many respects, to that in which private and State land minerals owners operate. However, in scale of activity, and variety and complexity of lease terms, it is significantly different. Currently, MMS administers the rental, royalty, and other financial terms for over 26,000 producing and 58,000 non-producing mineral leases.

President's Management Agenda

The Secretary's Plan for Citizen Centered Governance, published in September 2001, outlined the blueprint for implementing the President's Management Agenda (PMA) within the Department of the Interior. In accordance with the Secretary's Plan and the President's management initiatives, MMS is working to improve service delivery and increase the efficiency and effectiveness of our operations by listening closely to and working cooperatively with local citizens, tribal leaders, States, and industry.

Management reform is, and will continue to be, an integral part of MMS operations. Established out of an effort to improve the manner in which proper fiscal accountability and management of the Nation's mineral resources were handled, MMS has always sought to increase the efficiency and effectiveness of its operations. However, there will always remain challenges and opportunities for further growth.

Strategic Management of Human Capital

MMS recently completed a yearlong process of developing a *Workforce Plan*, a road map for integrating human capital initiatives with program goals and objectives. The plan captures the Bureau's analysis of workforce supply, demand, and gaps based on historical trends, future projections and expected work demands.

To determine the challenges facing MMS in the short and long term, the process included face-to-face and teleconference interviews with approximately 120 participants across the four MMS Associate Directorates with participants from offices in Lakewood, Colorado; Herndon, Virginia; and Washington, D.C. In addition to the interviews, MMS gathered and analyzed data on skill and staffing shortages caused by impacts to work in every organizational unit across the bureau and every occupation. The workforce numbers and skills as of May 2003 were compared with 2007 estimates of requirements for the future based on workload drivers and projected impacts to work. The difference between the present workforce and that needed by 2007 formed the basis for identifying the workforce-planning challenges.

This process identified four critical workforce-planning challenges:

1. *The Offshore Minerals Management Program will need to continue its efforts to address recruiting challenges in the areas of engineering and geosciences. More than 43 percent of the geologists, 34 percent of the geophysicists, and 29 percent of the engineers in the Gulf will be eligible for retirement by 2007. Apart from the retirement statistics, workload drivers are expected to require a need to recruit for 32 positions in these disciplines through 2007. Apart from the retirement statistics, workload drivers are expected to require a need to recruit for 32 positions in these disciplines through 2007. These positions are in occupational series that, in the past, have been difficult to fill.*

2. *The Minerals Revenue Management Program, through Fiscal Year 2007, will experience a shift in skill needs from the 500 occupational group, Accounting and Budget, to the 1100 group, Business Specialists, which will affect an estimated 46 employees.*
3. *In general, MMS must focus on the renewal of its workforce and succession planning for supervisory and managerial positions.*
4. *Finally, MMS must improve diversification of the workforce.*

The Workforce Plan also addresses solutions, implementation, and evaluation strategies for immediate workforce requirements and projected workforce requirements through FY 2007. To meet the challenges of the future, MMS will need more engineers and geoscientists, an increased number of RIK business specialists, and succession planning, particularly for supervisory and managerial positions. Because MMS competes with the high paying oil and gas industry for most of its core occupations, creative recruitment strategies must be deployed as well as retention strategies.

Competitive Sourcing

MMS is committed to obtaining services from the private sector when it is cost effective, and will not impact the quality of the products and services provided to constituents. As MMS strives to be the best minerals resource manager in the government, it is also achieving high quality service and cost savings through increased work efficiencies.

During the past year, the Bureau took a number of actions designed to effectively implement its competitive sourcing strategy. In March, the Director discussed the Bureau's competitive sourcing initiatives in an all-employee memorandum. She emphasized her support of the program, and her goal to use innovative methods to allow MMS to meet its goals while having minimal impact on employees.

As part of the President's Management Agenda, OMB directed that by the end of FY 2004 cost comparison studies be conducted on 25 percent of the FY 2000 commercial positions. MMS has completed 79 percent of the total goal. In FY 2002, it studied 42 FTE positions and thus far in FY 2003 has studied 69.5 FTE's. One additional 6 FTE streamlined study is under way and another 2 FTE study is beginning.

Of the 111.5 FTE positions studied, 64 FTE positions were contracted out using direct conversions, and 47.5 FTE positions remained in-house. The contracted positions replaced vacant positions of employees who were reassigned to a new position with different duties.

The positions remaining in-house were the result of streamlined cost comparison studies where the employee(s) won the competitions. No MMS employee has lost a job from competitive sourcing. To date the cost comparison studies have shown that MMS is saving $5 million when retaining work in-house vs. contracting for services; and $2 million through direct conversion.

Improving Financial Performance

MMS has a worthy record of financial performance. Fiscal Year 2002 proved to be a challenging year in managing MMS's financial management activities. Not only did MMS face the arduous task of implementing a reengineered royalty reporting system, it also had to overcome the hurdles presented by a four month court order shut-down of internet access that prevented MMS's customers from filing their royalty and production reports. Despite the obstacles presented, through the efforts and dedication of its staff, MMS was able maintain the integrity of its financial records resulting in an unqualified opinion on its 2002 financial report.

Fiscal Year 2003 has proven to be just as challenging as FY 2002. As a result of the 2002 internet shut-down, MMS had to process the remaining backlog of royalty and production reports. During FY 2003 MMS had to balance the requirements of successfully processing the backlog of royalty and production reports with identifying and making system refinements to more efficiently collect, distribute and record royalty transactions.

In addition to the challenges presented by the processing of royalty transactions, during FY 2003, by memorandum of the Assistant Secretary – Policy, Management and Budget, the financial management and accounting for the for the Interior Franchise Fund (IFF) was transferred from Departmental Offices – National Business Center to MMS. The transfer consolidated IFF under a single management structure thus improving financial accountability. To ensure an accurate accounting of the transfer balances at the agreement level, MMS performed a detail reconciliation of over three thousand customer agreements.

Expanding Electronic Government

Since MMS's formation, it has sought to find easier, faster, and more reliable means of exchanging information with its external and internal constituents. It uses its Internet web page as one of the primary interfaces with all interested parties and the Internet itself as a means of moving information back and forth between MMS and its constituents. MMS also recognizes that electronic government expansion is an integral part of transforming the way it does business.

Within the OMM program, MMS has initiated an E-Government Transformation initiative, referred to as the OCS-Connect project. In FY 2002, a small Program Management Office was established to work with a contractor and determine priorities for the business process re-engineering. In FY 2003, $7.7 million was provided for this initiative, and the President's FY 2004 Budget requested an additional $2.9 million. In FY 2004, OMM will continue to re-engineer selected clusters of business processes to move them from a paper-based data stream to a digital, web-based data stream. OMM will also continue expanding implementation of the Electronic Document Management System (EDMS), which includes integration with the DOI Electronic Records Management System (ERMS).

MMS business partners in the minerals industry now submit and receive access to their royalty and production data, including Royalty-in-Kind (RIK) activity, with MMS via the Internet as part of the MRM program's reengineering project implemented in FY 2002. Other MRM partners who require access restricted to this data, including other Interior Bureaus, States, and Indian Tribes, also have access restricted to data that applies to them via the Internet.

Budget and Performance Integration

MMS is fully committed to improving the link between budget and performance. By using Activity Based Costing/Management (ABC/M), the entire cost for MMS operations, including general and administrative costs, is allocated to DOI mission components and outcome goals. Moreover, it has tied its resource requests to performance levels throughout this document. The MMS is fully committed to improving this linkage.

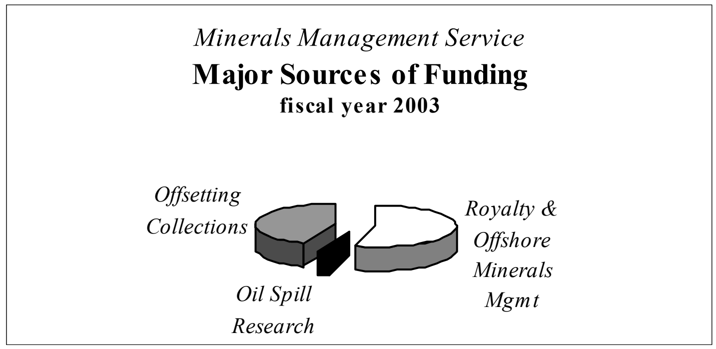
MMS was one of three Department of Interior bureaus tasked with applying ABC/M methods, an automated means of tracking and analyzing both activities and costs, to its operations. MMS implemented its pilot year of ABC at the beginning of FY 2003. Prior to FY 2003, MMS identified costing activities across the bureau, trained staff members in the proper recording of their time to cost activities, and established appropriate output measures. During FY 2003, MMS began capturing data for the ABC/M system and using the ABACIS financial accounting system to collect work activity costs. These activity costs are then exported into the MMS ABC model where the fully burdened cost of the bureau's end products and services are calculated.

Currently, MMS is adjusting the ABC/M system, as necessary, based on the assessment of reports designed to assure that managers are receiving effective and informative data from the system. In preparation for aligning to the DOI ABC system in FY 2004 and in response to clarified MMS management needs, significant changes to the MMS ABC model are planned for FY2004. MMS intends to map the FY2003 ABC data to the newly developed FY2004 bureau end outputs to allow for trend reporting in future years.

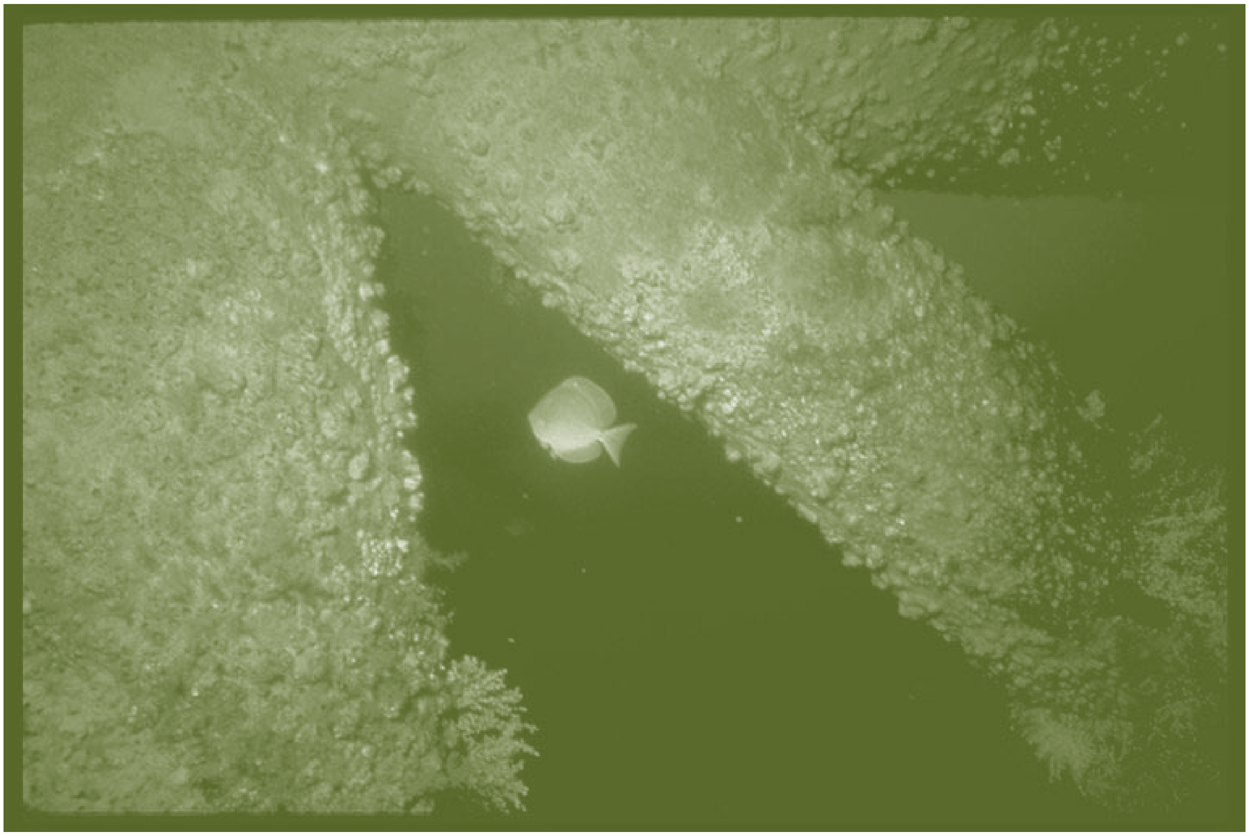
Organization and Funding

The MMS is composed of two specialized operating programs, Offshore Minerals Management (OMM) and Minerals Revenue Management (MRM). The Associate Directorates of Policy and Management Improvement, Administration and Budget, and the Executive Offices of the Director provide support for the director and operating programs.

The MMS offices are located throughout the country, including major offices in the Washington, D.C. area; Lakewood, Colorado; New Orleans, Louisiana; and Anchorage, Alaska. In addition to these major offices, MMS has MRM compliance (audit) and OMM district offices located near major centers of the oil and gas industry.



The MMS's operations are primarily funded from two appropriations: Royalty and Offshore Minerals Management (ROMM), including offsetting collections from OCS activities and Oil Spill Research (OSR). MMS was first authorized to utilize offsetting collections to fund a part of its operations in FY 1994. Since this authorization, MMS has utilized over $670 million in offsetting collections as a source of funding, derived primarily from rents on offshore leases. This has reduced by an equal amount the need for appropriated dollars.



Offshore Minerals Management Program

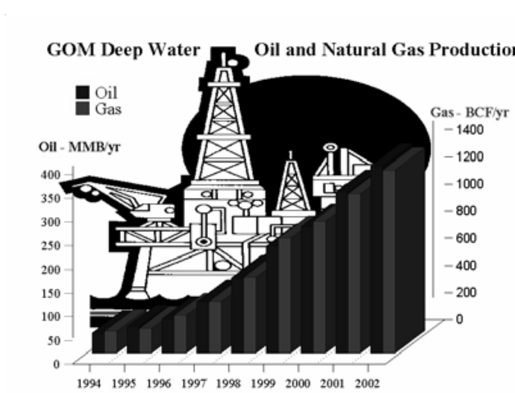
As the manager of the Nation's OCS energy and non-energy mineral resources, MMS's long-term strategy is to assess those resources, to determine if they can be developed in an environmentally sound manner in consultation with affected parties and, if leased, to regulate activities to ensure safety and protect the environment. This long-term strategy directs the way in which MMS faces the challenge of providing energy while protecting the Nation's unique and sensitive natural resources.

The OMM Program significantly contributes to national energy, economic and environmental policy. The OCS Lands Act directs that the program:

- *Help meet the Nation's energy needs;*
- *Provide for environmentally sound and safe exploration and development of OCS mineral and non-mineral resources;*
- *Balance the various environmental and resource issues and concerns of affected parties; and*
- *Assure that the Nation receives fair market value for tracts offered for lease.*

Fiscal Year 2003 OMM Activities

Offshore Oil and Gas Lease Sales — MMS conducted three lease sales in FY 2003. A highly successful oil and gas lease sale was held in the Central Gulf on March 19, 2003. Sale 185 offered 4,459 tracts comprising approximately 23.4 million acres offshore Louisiana, Mississippi and Alabama. The sale attracted $316 million in high bids on 561 tracts from 74 companies. After careful evaluation of bids, MMS rejected 16 high bids totaling $17.9 million as insufficient for fair market value. MMS accepted the high bids on 545 tracts for a net amount of $298 million.



Western Gulf of Mexico Sale 187 was held August 20, 2003. Sale 187 offered 3,996 tracts comprising approximately 21.7 million acres. Sale 187 attracted $148.7 million in high bids on 335 tracts from 63 companies. MMS rejected 5 high bids totaling $2.8 million as insufficient per fair market value. MMS accepted the high bids on 330 tracts for a net amount of $145.9 million.

MMS held Beaufort Sea Sale 186 on September 24, 2003. Three companies bid on 34 tracts generating $8.9 million in high bids. This was the first Federal offshore sale in the Beaufort Sea since 1998. This sale received more bids than any other Beaufort Sea sale since 1991. It was the first of three proposed Beaufort Sea sales in the 2002-2007 OCS Oil and Gas Leasing Program. After MMS' bid evaluation process is completed to ensure fair market value, leases will be awarded.

Deepwater Production — Recent exploration successes in deepwater fields in the Gulf of Mexico (GOM) are of critical importance in providing a vital new domestic source of oil and natural gas. Technological advances are increasing operators' abilities to take advantage of these finds, while reducing the danger and uncertainty in deepwater operations. The Gulf of Mexico's deepwater reservoirs have become America's new frontier for oil and gas exploration. Production potential from proven reserves in deepwater areas is estimated to be roughly 1.8 billion barrels of oil and 5.8 trillion cubic feet of natural gas. Consequently, drilling in the Gulf's OCS has increased greatly over the last 10 years. Today, deepwater drilling from permanent structures and wildcat wells is at an all-time high. In July 2003, 35 deepwater rigs were drilling in water depths greater than 1,000 feet, as compared to only 9 in 1990. The number of wells being drilled in the so-called ultra-deep waters – those in 5,000 feet of water or greater – continues to grow significantly. In FY 2002, 10 different operators drilled a total of 64 wells in ultra-deep water. The top ten ultra-deep water-depths along with the operator for FY 2002 are shown in the table below.

Operator	Water-depth (feet)
Union Oil Co. of California	**9,727**
Kerr-McGee Oil & Gas Corporation	**8,334**
BHP Petroleum (GOM) Inc.	**8,143**
Kerr-McGee Oil & Gas Corporation	**8,015**
Shell Offshore Inc.	**8,013**
Shell Offshore Inc.	**8,009**
Shell Offshore Inc.	**7,995**
Kerr-McGee Oil & Gas Corporation	**7,919**
Marathon Oil Company	**7,729**
Total Final Elf E&P USA, Inc.	**7,067**

Production from deepwater wells is increasing as compared to prior years. In 1985, for example, only 6 percent of the Gulf's oil production came from deepwater wells as compared to approximately 59 percent in FY 2002. Natural gas production from deepwater areas in the Gulf has also increased—from less than 1 percent of total production in 1985 to approximately 27 percent in FY 2002. Sixty-five Gulf of Mexico deepwater projects were in production by the end of 2002. As many as 19 and 16 new production projects were planned for 2003 and 2004, respectively.

Eastern Gulf of Mexico Activities Offshore Alabama (Sale 181 Area) — MMS has received 17 exploration plans for leases that resulted from Eastern Gulf Sale 181. These plans have been sent to affected States for coastal zone management consistency review. Another 3 plans were received on leases located in this area but issued prior to Sale 181. Seven wells have been drilled in this area since January 16, 2003.

Offshore Oil and Gas Activity in Alaska — Beaufort Sea Sale 186 was held in September 2003. The sale was unique in that royalty, minimum bid, and annual rental incentives were offered to encourage exploration and development in this high cost area. Thirty-four tracts received bids generating $8.9 million in high bids. This was the eighth Federal Beaufort Sea offshore lease sale and received the most bids in a Beaufort Sea sale since 1991.

Northstar – First Production Offshore — BP Exploration (Alaska) Inc (BPXA) began production of oil from their Northstar facility in the Alaska Beaufort Sea on October 31, 2001. This is the first oil production from the Federal OCS in Alaska. The Northstar reservoir is managed under a joint Federal/State unit agreement. The Unit is located about 6 miles offshore of Pt. Storkerson and 12 miles northwest of Prudhoe Bay. The unit includes three Federal and five State leases. BPXA is the unit operator with controlling interest in these leases, along with Murphy Oil. The Northstar facility consists of an offshore gravel island located in 39 feet of water within State of Alaska waters, two subsea pipelines in the Beaufort Sea, and onshore above-ground pipelines that connect Northstar to existing facilities. BPXA recently estimated that the Northstar reserves could be as high as 154 million barrels of recoverable oil and natural gas liquids.

Initially, 15.9 percent of Northstar reserves were allocated to Federal leases. Subsequent re-evaluation of the reservoir based on the new wells changed the Federal allocation to 17.84 percent. The October 2003 production averaged in excess of 75,000 barrels per day. The Federal leases are also within the OCS designated 8(g) boundaries that entitle the State of Alaska to receive 27 percent of Federal revenues.

Production Continues in the Pacific — In addition to the continued leasing and production and the deepwater successes in the Gulf of Mexico, MMS continues to oversee safe and environmentally sound production of oil and natural gas offshore California. Twenty-three platforms continue to produce significant quantities of oil and natural gas. Increasingly, extended-reach wells are being employed in the region. One field for which a separate platform was originally planned, Sacate in the Santa Ynez Unit, is now producing from an existing platform using some of the longest extended-reach wells in the Nation. Production by extended-reach wells will increase in the coming years. While there are no current or pending decommissioning proposals in the Pacific Region, early planning has been initiated to carry out future projects offshore California. Early preparation is necessary because several years may be required for permitting, and long lead times are necessary to procure associated equipment and services.

Marine Science — Since 1973, the MMS Environmental Studies Program (ESP) has funded over $750 million in mission-focused scientific research. This research encompasses biological, physical oceanographic, ecological, and socioeconomic issues associated with offshore mineral leasing and development. Extensive program planning and development and rigorous oversight assures that approved projects meet mission relevance, quality of science, and performance criteria. To maximize the efficiency and effectiveness of the research investment, contracts are primarily awarded through a competitive procurement process with peer review. Several internal and independent external program reviews have been critical to program success over the years, and in particular, the continuous oversight provided by the OCS Scientific Committee. During FY 2003, research activities were underway on about 300 different projects, and more than 60 new projects were started.

The ESP actively seeks partnerships with stakeholders who are involved with, or affected by, the oil and gas or marine minerals resource management activities. Not only do partnerships result in important consensus building, but within the current environment of ever-constrained budgets, they also afford an opportunity for leveraging dollars and accomplishing research objectives that might not be attainable otherwise.

MMS has established Coastal Marine Institutes (CMIs) in Alaska, California, and Louisiana. Through these CMIs, MMS can leverage its financial resources with those of the States. This arrangement helps both MMS and the States address mutually agreed upon scientific needs regarding the impacts of OCS activities. All research is funded on a 50/50 matching basis. In FY 2003 the CMI partnerships resulted in research awards including $3,000,000 of non-federal matching funds.

Through its membership in the National Oceanographic Partnership Program, MMS partnered with the National Oceanic and Atmospheric Administration (NOAA) in FY 2003 to procure a deep sea study of sunken ship sites in the Gulf of Mexico, which will provide critical information for protecting historically important artifacts and understanding the potential of deepwater structures as artificial reefs. NOAA's contribution of ship time provided a 1:1 leveraging of MMS dollars for this project. Additional Federal partnerships have been developed this year with the Office of Naval Research and the National Aeronautic and Space Administration to jointly fund common interests in physical oceanography modeling and sea ice dynamics. The marine science program has also actively developed partnerships with industry, known as Joint-industry Partnerships (JIP). In FY 2003, these partnerships have gathered mutually needed scientific information on gas hydrates, deep sea morphology and physical oceanography in the Gulf of Mexico. As a contributing member to a JIP, MMS research dollars can sometimes be leveraged by a factor of 10 or more. MMS has also forged international partnerships. This year, Mexican scientists joined in research of the physical and biological oceanography in deepwater areas of the Gulf of Mexico.

MMS is also one of the Federal government's leading agencies for oil spill research. On average, MMS spends more than $6 million per year on research into oil spill protection, prevention, response technologies, and managing the National Oil Spill Response Test Facility in Leonardo, New Jersey.

Much of the scientific research conducted in FY 2003 continued the emphasis on deepwater development activities in the Gulf of Mexico with studies of:

- *Deepwater Habitats and Benthic Ecology*
- *Exploratory Study of Deepwater Currents*
- *Effects of Oil and Gas Exploration and Development at Deepwater Sites*
- *Sperm Whale Distribution, Abundance, and Behavior Study*
- *Demographic Factors Associated with Offshore Development*

Other major MMS studies addressing critical issues to offshore oil and gas leasing, exploration, and development, as well as non-energy minerals during FY 2003 include:

- *Arctic Nearshore Impact Monitoring*
- *Beaufort and Chukchi Sea and Cook Inlet Ocean Circulation*
- *Marine Mammal (bowhead whale and polar bear) and Seabird Studies in the Beaufort Sea*
- *Environmental Monitoring in the California Intertidal and Offshore areas*
- *Ecological Investigations of Plants and Animals Colonizing Oil and Gas Platforms in California*
- *Environmental Surveys of Potential Borrow Areas and Analyses of Environmental Implications of Sand Removal from Shoal Areas for Coastal and Beach Restoration of the U.S. East Coast and Gulf of Mexico*
- *Importance of offshore platforms to marine life, particularly fish, and prospects for platform decommissioning*

Five-Year Program — Secretary Norton approved MMS's 5-Year Leasing Program for 2002-2007 in July 2002. The Secretary's approval culminated an 18-month process during which MMS and the Department of the Interior consulted with coastal States, the public at large, the environmental community and the natural gas industry.

The program plans 20 lease sales in eight OCS planning areas in the Gulf of Mexico and off Alaska. Four sales have already been held since implementation of the new program. The first sale, Western Gulf of Mexico Sale 184, was held in August 2002. The second sale, Central Gulf of Mexico Sale 185, was held in March 2003. The third sale, Western Gulf of Mexico Sale 187, was held in August 2003. The fourth sale, Beaufort Sea Sale 186, was held on September 24, 2003. A fifth sale, Eastern Gulf of Mexico Sale 189, is scheduled for December 10, 2003. Included in the new 5-Year Program are "special interest sales" in Alaska's Norton and Hope Basins and Chukchi Sea to encourage exploration and development in high-cost frontier areas. The unique sale process asks industry to nominate specific geographic areas of interest within these planning areas. If no interest is expressed, the presale process is halted, and industry is queried the next year throughout the 5-Year Program. This process continues until sufficient interest is expressed to proceed toward a sale, or the program concludes. MMS avoids expending significant presale resources on areas with no industry interest. The new program supports the President's National Energy Policy and will help meet the future energy needs of our country in an environmentally sound manner. The new program estimates to make available from 10 to 21 billion barrels of oil and 40 to 60 trillion cubic feet of natural gas.

The MMS Offshore Sand Cooperatives — Since 1992, MMS has worked cooperatively with States along the east and Gulf coasts of the U.S. to locate sand in Federal waters that could be used to protect the Nation's shores and wetlands. These States are New Jersey, Maryland, Delaware, Virginia, North Carolina, South Carolina, Florida, Alabama, Louisiana, and Texas. To date, over 19 million cubic yards of OCS sand has been placed in 13 shore protection projects, with an average of 2 projects per year. Additionally, MMS is currently in discussion with California, Massachusetts, Maine, and New Hampshire to begin similar cooperative sand programs.

MMS has worked closely with the coastal States to help restore damaged or eroded coastlines and has entered into negotiated agreements (leases) with local, State and Federal agencies for use of OCS sand. Once leased, the sand is then obtained from offshore borrow sites that have been previously identified and placed on the effected beaches. To be sure that removing the sand will not cause environmental damage, MMS typically works with State and Federal agencies to develop an environmental assessment, which contains stipulations to protect against damage to archaeological resources, wildlife, and endangered species and contains a provision to safeguard against the digging of a deep pit on the ocean floor.

Shell's "Ursa" tension leg platform in the Gulf of Mexico.

Minerals Revenue Management Program

Minerals Revenue Management (MRM) Program is responsible for collecting revenues earned from the leasing and production of minerals on Federal and Indian lands. MRM collects and disburses revenues collected on lands administered by the Department of the Interior (MMS Offshore Minerals Management Program, Bureau of Indian Affairs [BIA], and Bureau of Land Management [BLM]), the U.S. Forest Service, the Army Corps of Engineers, and the U.S. military. Numerous statutes govern MMS' distribution of these revenues. In the case of mineral leasing revenues from Indian lands, monies are transferred to the Office of Trust Funds Management (OTFM) for distribution to the appropriate tribe or Individual Indian Mineral Owner.

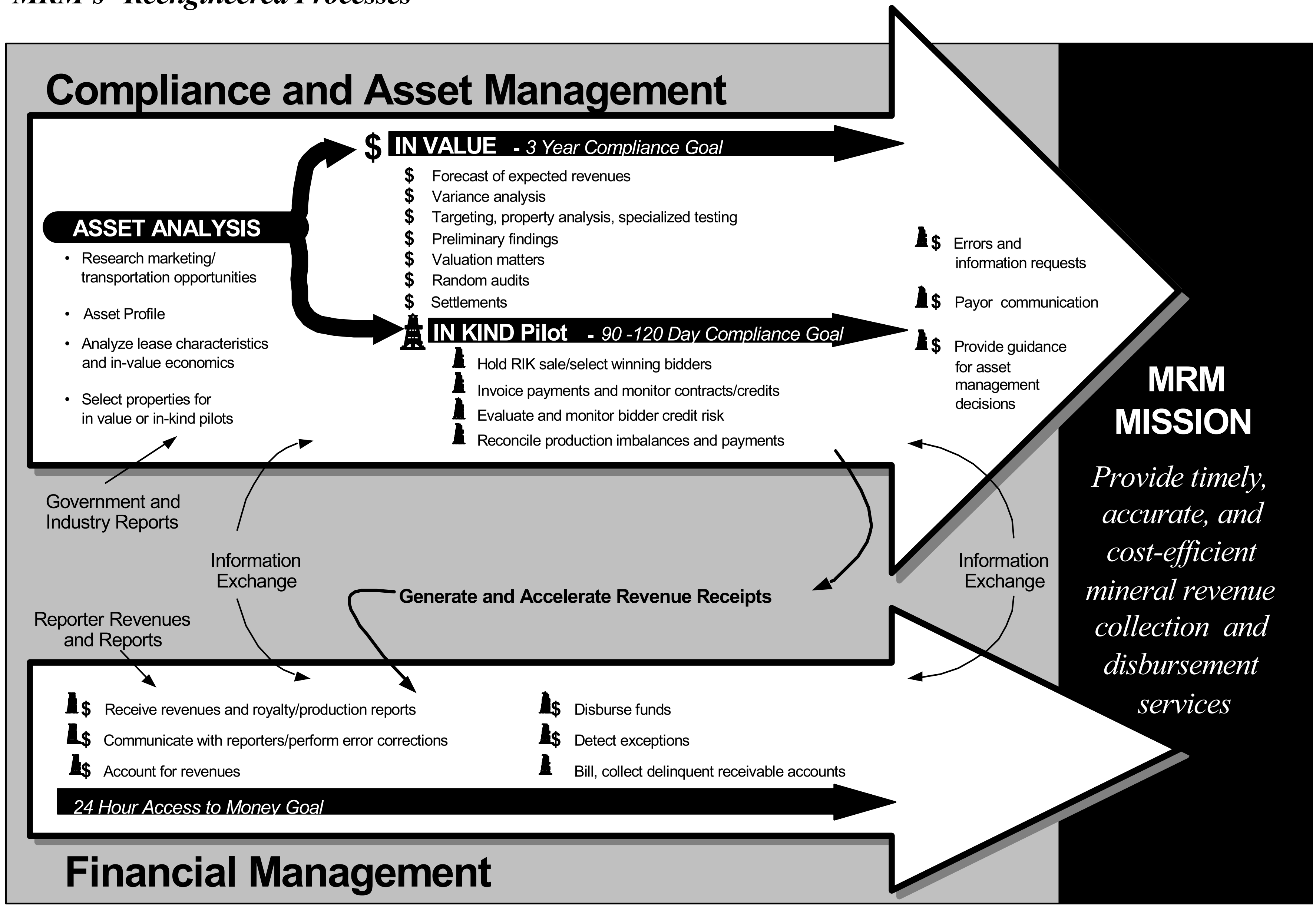
Federal and Indian lands are leased through a competitive bid process for mineral development. Minerals extracted and sold entitle the Federal government and Indian lessors to a royalty (a percentage of the production). MMS's Offshore Program, BIA, and BLM determine lease contract conditions. MRM's role is to:

- *collect, account for and disburse bonuses, rents and royalties;*
- *determine mineral asset value;*
- *assure the proper measurement of volume;*
- *assure the proper royalty rate is applied; and*
- *determine the recipient's share of revenues.*

MRM is a highly integrated, process centered organization that is focused on outcomes. Utilizing newly reengineered tools, MRM's compliance activities include automated and on-site audits of payors' accounting records to determine if the proper royalties have been paid. During the last ten years over $1 billion dollars has been collected through compliance activities alone.

The MRM is aligned to support two end-to-end core business processes – Financial Management and Compliance Asset Management (CAM). The interrelationship of these core business processes is shown below, and further detail is available in our budget submissions.

MRM's Reengineered Processes



In carrying out these two core business processes, MRM provides special focus on its Indian trust responsibilities.

Indian Trust Responsibilities -- The MMS serves American Indian Tribes and Individual American Indian Mineral Owners by ensuring that they receive appropriate royalties from mineral production on their lands. While working to guard American Indian mineral interests, MMS also emphasizes American Indian empowerment through government-to-government relationships. Through cooperative agreements, MMS coordinates with eight tribes that choose to handle their own royalty audit work. When MRM restructured its organization in October 2000, it emphasized a focus on Indian Trust responsibilities by establishing the Indian Compliance and Asset Management (ICAM) office, which is specifically dedicated to serving mineral producing tribes and Individual Indian Mineral Owners (allottees). Based in Denver, ICAM is augmented by teams in New Mexico and Oklahoma. Working with other Federal agencies, ICAM serves as MMS's focal point for all related Indian work including outreach and issue resolution.

In Farmington, New Mexico, MMS participates in the Federal Indian and Minerals Office (FIMO). This office unites employees from BIA, BLM, and MMS, under one director for outreach, inspection, enforcement and mineral revenue compliance services to industry and American Indian allottees and their heirs. With this Department-wide trust focus, FIMO has been instrumental in reengineering its processes and services. Departmental officials are interested in adopting this approach in other geographic areas, and are formalizing the FIMO concept for implementation in the future.

Fiscal Year 2003 MRM Activities

Revenues Disbursed — In FY 2002 alone, MMS distributed over $6 billion in revenues for Federal and Indian properties. During the past decade, mineral revenues from the OCS have accounted for more than 95 percent of the deposits to the LWCF, which provides matching grants to state and local governments for the acquisition and development of public outdoor recreation areas and facilities. In recent years, the LWCF has been used to purchase or acquire through exchange about 4.5 million acres. In May 2003, Secretary Norton announced funding grants of more than $94 million to the 50 states, the territories and the District of Columbia for enhancing parks and other recreational opportunities.

Strategic Petroleum Reserve (SPR) — With approximately 60 percent of the Nation's supply of oil coming from foreign sources, the SPR provides a critical buffer for potential disruptions in oil supplies. Responding to a Presidential directive issued in November 2001, MMS, in partnership with the Department of Energy (DOE) , launched the SPR Fill Initiative. The remaining capacity of three SPR storage facilities in Louisiana will be filled using royalty-in-kind oil. At the current rate of 130,000 barrels per day, the initiative is targeted to be complete by the end of FY 2005 and will involve some 120 million barrels of royalty crude oil. Aggregating, transporting, and delivering that amount of oil to DOE is a formidable challenge for MMS and will provide the country with improved economic security in the event the import stream is interrupted. When full, the SPR will contain approximately 700 million barrels of oil providing a key link in the Nation's security network.

Improved Communication with Indian Tribes — The Director of MMS has visited the major energy-producing tribes for which MMS collects royalties and assigned her Special Assistant as a liaison for the tribes. MMS held 69 outreach meetings in FY 2003. Through these efforts, MRM serviced issues for over 30,000 individual Indian mineral owners related to various types of payment and mineral issues. This reflects MMS's goal to fulfill the Secretary's trust responsibility to the Indian minerals community.

Oil Valuation — As a bureau continuously striving for improvement, MMS believes there is potential to improve the existing Federal oil valuation regulations to ensure that the American public continues to receive a fair return on Federal oil resources. Adding clarification and simplicity to the existing rules will reduce litigation, assure more contemporaneous compliance, reduce administrative costs to lessors and lessees, and make Federal leases more attractive for development. MMS's goal is to ensure that its valuation regulations are not an obstacle to increased exploration and production while at the same time collecting the proper amount due to the public. The issues are determining which published market index prices are appropriate for valuing oil and what transportation deductions should be allowed. Following a series of public workshops MMS compiled and analyzed the information gathered. The MMS published a proposed rule on August 20, 2003.

RIK Pilot Programs — MMS is continually looking for opportunities for improved efficiency in fulfilling its royalty collection responsibilities. MMS is authorized to take the government's royalty share of production from oil and gas leases in-kind rather than in-value. Since 1998, MMS has conducted pilots testing the RIK option. The goal is to reduce friction between the lessee and the Federal lessor about the value (price) used to calculate the royalty share due to the public. MMS is committed to ensuring that the U.S. Treasury receives as much revenue through RIK as it would if the lessee marketed, sold and paid royalties in value. MMS's ongoing RIK pilots include selling crude oil production in Wyoming and natural gas production in the GOM including gas from Outer Continental Shelf Lands Act Section 8(g) leases in Texas. Under current contracts, successful bidders are taking approximately 390 million cubic feet per day of royalty natural gas, and approximately 4,000 barrels of oil per day of RIK oil are sold in Wyoming. The RIK pilots in Wyoming and the Texas 8(g) gas RIK pilot have been reviewed and deemed successful. They demonstrate the conditions under which RIK is feasible without reducing revenue for the U.S. Treasury or any state entitled to a share of those revenues. RIK provides simplicity, accuracy, and certainty for lessees enabling compliance within 120 days as opposed to royalty in value compliance within three years.

RIK Systems Implementation — Based on the success of the RIK pilot projects, MMS decided to adopt RIK as one of two royalty asset management methods to be used in tandem with the traditional cash royalty system. The January 2001 "RIK Road Map to the Future" arrayed a series of management actions to transition RIK from pilot projects to an integrated operational program, and included implementation of management systems, internal controls, organization, and performance measurements. Fiscal Year 2003 witnessed the implementation of all three of the new RIK management information systems, namely:

- **Gas Management System:** A commercial off-the-shelf system from the Caminus Corporation (named Nucleus) was integrated with MRM's financial system and data warehouse through the efforts of MRM's contractor Accenture.
- **Liquids Management System:** The Nucleus system was also selected for the crude oil RIK program and was integrated with existing MRM systems.
- **Risk and Performance Management System:** Accenture designed and implemented this system using baseline capabilities of Nucleus to measure the revenue effectiveness of the RIK program. Commercial consulting recommendations on performance metrics from the Lukens Energy Group were incorporated into the system, and initial measurements of RIK revenue performance are anticipated early in 2004.

These three RIK systems are now providing the necessary information management support tools and internal controls necessary to successfully manage a commercial energy commodity portfolio.

Clymene dolphins frolic in the Gulf of Mexico.

Interior Franchise Fund

In 1996, OMB authorized the Department of the Interior to establish, pursuant to the Government Management Reform Act (GMRA) of 1994, one of six franchise fund pilot programs within the federal government. The franchise fund pilot program's objective is to reduce the cost of government by providing commonly required administrative products and services to other federal agencies on a competitive, fee-for-service basis.

MMS/GovWorks provides acquisition services from inception to closeout (i.e., project planning, solicitations, awards, and contract closeout). GovWorks operates in a business-like manner, consistent with OMB's "Twelve Business Principles." The customer-focused contracting staff can rapidly assist other agencies. GovWorks has made impressive progress toward meeting the franchise fund pilot program's objectives. This year GovWorks issued awards for hundreds of government-wide customers that totaled more than $1 billion.

On October 1, 2002, MMS assumed financial management and reporting responsibilities for IFF. The IFF consists of two activities: GovWorks and US Film and Video Production. Both are part of MMS and are entrepreneurial business practices. They can rapidly serve other agencies using interagency agreements. With almost seven full years of experience, IFF has made impressive progress towards meeting the objectives of the franchise pilot program. The Department continues to work closely with OMB, the government-wide Chief Financial Officers' Council, and the Department's congressional committees to ensure the development of a high quality franchise service program.

GovWorks specializes in IT and telecommunications acquisitions, but can procure virtually anything for the client from environmental studies to business process reengineering to cooperative research agreements. For a host of Federal agencies, GovWorks helps to make their clients' missions happen. The GovWorks' client list includes most DOD and civilian agencies. Significant projects this year include replacing the Office of the President's telephone system, procurement support for the White House Office of National Drug Control Policy, ship maintenance and refurbishment for the Navy, and connecting the Department of Homeland Security's headquarters and field office information systems.

Some of the specific areas for which GovWorks acquires goods and services are:

Advisory and Assistance Studies	*Telecommunications*
Research and Development	*Engineering and Technical Studies*
Environmental Studies	*Consulting Studies*
Personnel	*Architecture and Engineering*
Advisory and Assistance	*Business Process Re-engineering*
Facilities Management Systems	*Integrated Logistics Support*
Logistic Support Analysis	*Sustaining Engineering*
Fleet/Field Support Analysis	*Joint Military Program Support*
Engineering Change Proposals	*E-Health*

Furniture
Master and Enterprise Licensing Solutions
Naval Ship Maintenance and Refurbishment
Information Technology, including Hardware, Software and Services

To meet customer needs, MMS/GovWorks uses many streamlined acquisition vehicles to include:

Commercial Items/Services	*Oral Presentations*
E-commerce	*Task Order Contracts*
Performance Based Service Contracts	*Statement of Objectives*

Due Diligence
Customized Contracts and Financial Assistance Awards
Multiple Award Schedules, including BPAs and Teaming Arrangements

FY 2003 Accomplishments

- *Initial Customer awards increased from 2,280 in FY 2002 to a projected 4,454 in FY 2003, an increase of approximately 96 percent.*
- *There were no recorded instances of dissatisfied customers leaving IFF for another service provider.*
- *Revenues increased from $401.4 million in FY 2002 to $1.1 billion in FY 2003, an increase of approximately 165 percent.*

FY 2004 Planned Actions

- *Improve the business planning process for each IFF business line that includes marketing strategies, pricing analyses, performance measures, and retained earnings analyses.*
- *Continue to evaluate customer satisfaction and the quality of customer services by asking existing customers what and how IFF can do better, with lessons learned being incorporated into future tactical plans.*
- *Continue to explore new products, services, and activities aimed at leveraging cutting-edge technologies and maximizing future opportunities.*
- *Continue the effort to provide top quality services to attract more federal client agencies.*
- *Continue developing expeditious solicitation and award procedures while complying with all Federal, Departmental, and MMS rules and regulations.*
- *Implement an electronic invoicing procedure that supports the President's Management Agenda and expedites invoice payment processing.*
- *Assist the Department in procuring a single, integrated system to replace current stove-piped financial, acquisition, financial assistance, property, and fleet management database systems. GovWorks is procuring the Financial Business Management System for DOI.*

FY 2003 IFF Performance Summary

The performance measures adopted for 2003 were to: (1) maintain cost per dollar awarded (2) increase retained earnings, and (3) increase customer orders. Retained earnings was selected as a measure because it helps in understanding if costs are being recovered, price adjustments are required, or the volume of business is sufficient to cover fixed and semi-variable costs to break even or produce a surplus. Customer orders was selected as a measure because it assists in determining whether IFF's products and services continue to be in demand and are competitively priced. IFF is currently assessing its goals to identify performance and results measures that will allow management to effectively focus its resources. As a result certain 2003 goals may be modified in 2004.

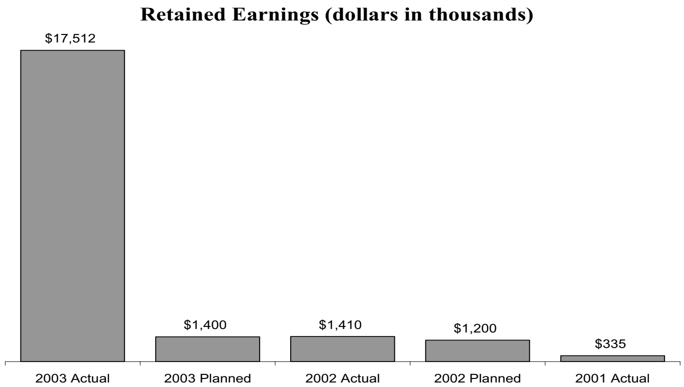
Performance Goal: Maintain a cost of contract dollars awarded that is less than the government-wide benchmark of 2 cents per dollar awarded.

Results: The cost of a dollar awarded has been below the government-wide benchmark for 3-years running. Expenses in 2003 increased to cover the cost of reconciling 2900 agreements transferred from NBC and to cover maintaining a parallel NBC accounting system during a portion of the year. The transition costs should not occur in 2004 and the cost of a contract dollar awarded should drop.

	2001	**2002**	**Plan 2003**	**2003**	**Plan 2004**
Cost per dollar awarded	.008	.006	.004	.001	.004

FY2003 Performance Goal: To increase retained earnings to $1.4 million.

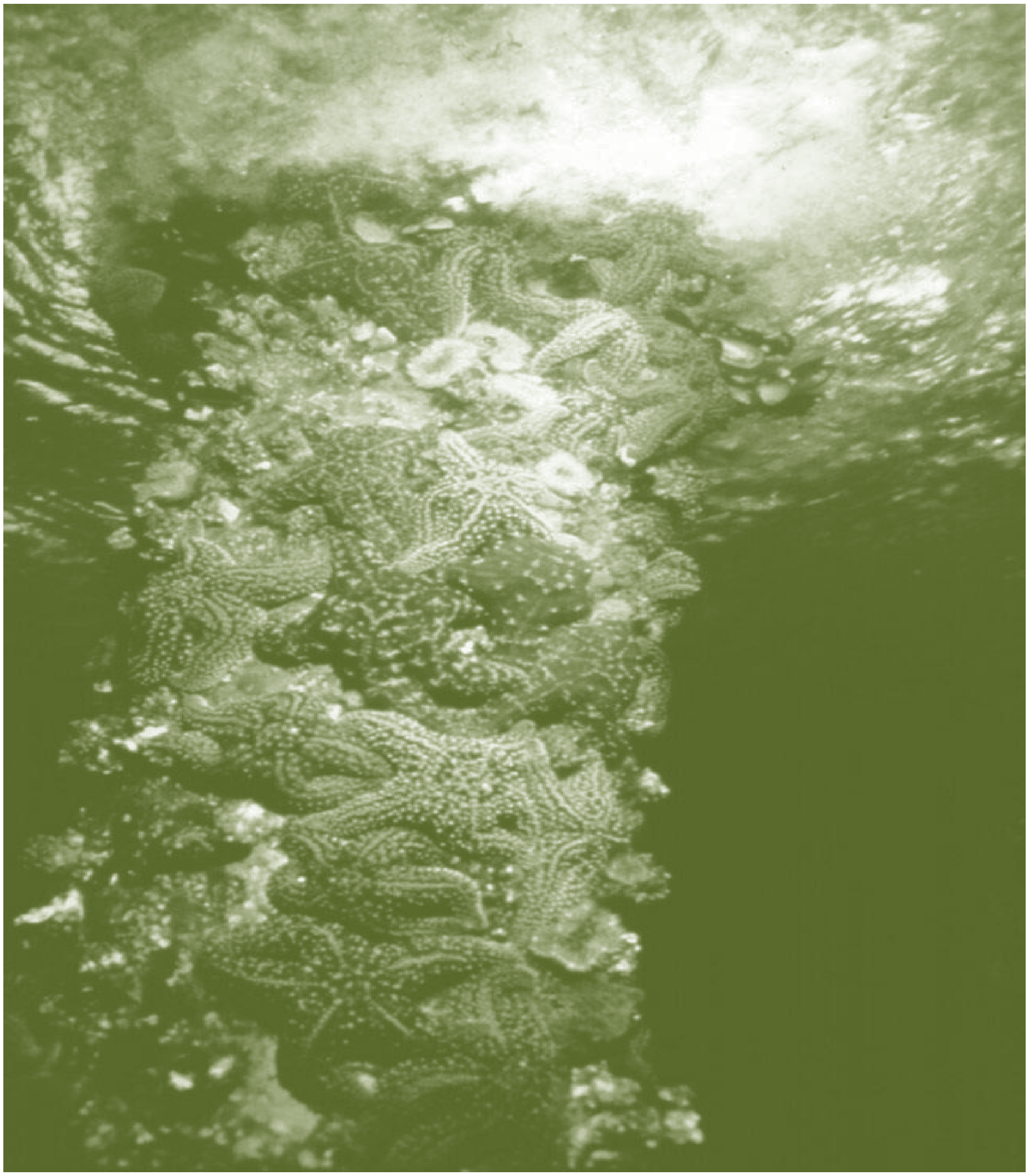
2003 Results: IFF retained earnings increased from $1.4 million in FY2002 to $17.5 million in FY2003.



FY 2003 Performance Goal: To increase customer orders to at least 1,500.

2003 Results: The number of IFF customer orders grew from 2,005 in FY 2002 to 4,403 in FY 2003, an increase of 120%. The number of customer orders has increased each fiscal year since the inception of IFF.

FY2004 Performance Goal: To increase customer orders to at least 4,500.



Starfish meet for lunch on a California platform leg.

FY 2003 Performance Summary

Since its formation in 1982, MMS has been committed to the management of America's mineral resources. Moreover, MMS has served as a leader in asset management for the Federal Government by creating a process that extends from assessing potential mineral resources and protecting the environment to ensuring that America receives the optimum return on its mineral resources.

As stewards of the mineral resources of the OCS, MMS' OMM program provides leadership in the areas of offshore safety, science, and environment. The MRM program ensures the timely and accurate collection, verification, and disbursement of revenues from mineral leases on the OCS, and Federal and Indian lands.

MMS is committed to managing for results and measuring its performance as required by the Government Performance and Results Act. This section presents the FY 2003 goals and performance results.

The Department of the Interior (DOI) has six broad goals that provide a framework for the numerous and diverse responsibilities of DOI's bureaus:[1]

- ***Goal 1****—Protect the environment and preserve our Nation's natural and cultural resources.*
- ***Goal 2****—Provide recreation for America.*
- ***Goal 3****—Manage natural resources for a healthy environment and a strong economy.*
- ***Goal 4****—Provide science for a changing world.*
- ***Goal 5****—Meet our trust responsibilities to Indian Tribes and our commitments to island communities.*
- ***Goal 6****—Manage for excellence and accountability.*

The MMS activities needed to effectively fulfill the MMS mission generally support all of the departmental goals. However, the mandated mission goals and long-term goals contribute most strongly to the departmental goals to manage natural resources for a healthy environment and a strong economy (Goal 3) and to meet our trust responsibilities to Indian Tribes (Goal 5). These are presented below, along with the annual goals and the performance relative to them in FY 2003.

[1] Department of the Interior Strategic Plan, FY 2000-2005.

DOI GOAL 3

Manage Natural Resources for a Healthy Environment and a Strong Economy

The MMS mission goals that support this departmental goal are:

- *Ensure safe OCS mineral development.*
- *Ensure environmentally sound OCS mineral development.*
- *Ensure that the public receives fair market value for OCS mineral development.*
- *Provide revenue recipients with access to their money within 24 hours of the due date.*
- *Assure compliance with applicable laws; lease terms, and regulations for all leases in the shortest possible time, but no later than 3 years from the due date.*

Offshore Minerals Management Program

OMM was created as a result of the Outer Continental Shelf Lands Act of 1953 (OCSLA), which provides for the expeditious and orderly development of minerals on the OCS in an environmentally sound manner. OMM has responsibility for all aspects of offshore minerals development, including: the initial leasing of offshore acreage; approval of exploration and development activities; ensuring compliance with rules; and overseeing platform facilities decommissioning, to include pipelines, wellheads, and seafloor structures and debris removal.

There are two core objectives to MMS offshore program. The first is to achieve safe and incident free operations during exploration and development activity. The second is to protect the environment by ensuring that all activities on the OCS are conducted with appropriate environmental safeguards. The past five decades of experience and events have led us to a regulatory system that has a strong emphasis on environmental protection and safety of offshore workers. This system has helped achieve an outstanding safety and environmental record.

The mission goals are designed to continually improve upon this excellent record. In addition, the evolution of the oil and gas industry in recent years, resulting in new consolidations and mergers, has presented new challenges to improve the accuracy and timeliness of mineral revenue collections and disbursement. The move into deep water and the resulting activity have increased both the level and complexity of monitoring OCS operations. MMS is meeting those challenges by implementing new business processes for managing mineral assets.

Safety — As part of its ongoing safety efforts, OMM began conducting annual operator performance reviews several years ago. This process has been a positive addition to the regulatory program and has provided valuable insight into a company's operating philosophy. In addition, these reviews provide a forum for MMS and the operators to maintain a dialogue about performance in a non-threatening manner, and should serve as an early warning to any operator who is having problems before they get out of control and a serious accident occurs.

MMS developed an operator safety index several years ago that measures the results of these reviews. In FY 2003, OMM decided to use this index as an annual goal because it aligns with an industry standard composite index and will show whether or not OMM is making progress toward achieving its safety mission goal.

Mission Goal	**Ensure safe OCS mineral development.**
Long Term Goal	**Maintain or show a decrease in the annual composite operator safety index.**
FY 2003 Annual Goal	**Maintain an annual composite operator index of 0.2 or less.**
Prior Years' Results	**FY 1999—0.17, FY 2000—0.16, FY 2001—0.17, FY 2002—0.14**
FY 2003 Result	**0.17 (Estimate). This would exceed the target.**

OMM has not yet finished compiling the FY 2003 results for this annual goal because it is calculated on a calendar year basis. However, it is estimated that the result will be 0.17, which will exceed the target. This estimated performance result was developed based upon a statistical average of prior years' data and the fact that there are no known significant issues during the current year. The final FY 2003 performance information will be provided in DOI's FY 2003 Annual Performance and Accountability Supplemental Report published during the 3rd quarter of FY 2004.

OMM is continually looking for ways to focus its resources on the areas of greatest risk and to make its program more efficient by use of information technology. OMM has over 70 inspectors that go offshore every day, weather permitting. In 2002, these inspectors conducted over 20,000 inspections covering a diverse set of operations and facilities. In the future, MMS will conduct audits of safety management systems together with its current inspection program.

Environment — Another critical OMM focus is ensuring a high level of environmental performance during all phases of OCS oil and gas activities. To help ensure sound decisions, OMM has ongoing environmental and technological research programs, continually makes assessments of oil and gas resources, and monitors the environmental impacts from offshore activity. OMM takes an environmentally responsible and judicious approach to offshore oil and gas leasing as required by sections 18 and 19 of the OCSLA. Under section 18 we have formulated a 5-Year OCS Leasing Program that strikes a proper balance between environmental and developmental considerations to achieve the law's goal of meeting national energy needs. The environmental mission goal and the related long-term and annual goals reflect this emphasis on environmentally sound offshore operations.

In recent years, MMS has used an environmental impact indicator as an annual measure to track progress toward achievement of the environmental mission goal. Because a key data component of the environmental impact indicator is no longer being collected by the federal agency that was providing it to MMS, the environmental index measure has been replaced with a new annual goal relating to environmental assessments in FY 2003.

Mission Goal	**Ensure environmentally sound Outer Continental Shelf mineral development.**
Long Term Goal	**By 2005, show a decrease in the environmental impact indicator from the 1999 baseline.**
FY 2003 Annual Goals	**In FY 2003, complete 75 percent of offshore environmental assessments for development plans within 8 months.** **Maintain an oil spill rate of no more than 10 barrels spilled per million barrels produced.**
Prior Years' Results	**Environmental Assessments: N/A This is a new goal in FY 2003.** **Oil Spill—FY 1999—6.9, FY 2000—5.35, FY 2001—1.0, FY 2002—0.58**
FY 2003 Results	**Environmental Assessments: 100 percent (estimated based on year to date results)—This would exceed the target.** **Oil Spill— 5 barrels spilled per million produced (estimate)—This would exceed the target.**

Environmental Assessment annual goal: For FY 2003, 100 percent of environmental assessments for development plans were completed within 8 months.

Oil Spill annual goal: It takes a minimum of 6 months following the end of the fiscal year to complete the oil spill rate. The rate is calculated by dividing total oil spill amount by total offshore oil production, and the final production date will not be available for several months. Also, when an oil spill is large enough to require an investigation, it takes several months for the report to be published with the final oil spill amounts.

The process of reconciling the data reported to MMS for FY 2003 is ongoing, and the information is not complete enough to provide a final result for this measure. However, due to Hurricane Lili in October 2002 and two vessel sinkings in May 2003, FY 2003 appears to be trending similar to FY 2000, the final result for which was 0.000005 bbl spilled per barrel produced. If this estimate holds true, the result would fall within our goal of not exceeding 0.00001 bbl spilled per bbl produced.

MMS anticipates having the final FY 2003 oil spill result by the end of March 2004, and will post it on the MMS website (www.mms.gov).

The FY 2002 oil spill result was not reported last year because of the reasons mentioned above, so it is reported here. The FY 2002 rate was .58 barrel spilled per million barrels produced (347.41 barrels spilled/601,000,000 barrels produced). The low rate (less than one barrel spilled per million barrels produced) was primarily due to having no significant pipeline spills in FY 2002.

Fair Market Value — Another OCSLA mandate is that MMS is to ensure that the Nation receives fair market value for offshore tracts offered for lease. Immediately following an offshore sale, MMS performs careful evaluations of all bids to ensure that the public is receiving fair market value for the offered sale areas. Only after this process is completed are bids actually accepted and companies able to claim their leases. The goals relating to this effort are below.

Mission Goal	**Ensure that the public receives fair market value for Outer Continental Shelf mineral development.**
Long Term Goal	**From 2000-2005, the ratio of high bids accepted for OCS leases to the greater of MMS' estimate of value or the minimum bid is maintained at the 1989-1995 average level of 1.8 (+/- 0.4) to 1.**
FY 2003 Annual Goal	**In FY 2003, we will maintain the current high bids accepted for OCS leases to MMS' estimated value ratio of 1.8 (+/- 0.4) to 1.**
Prior Years' Results	**FY 1999—1.8 to 1, FY 2000—2.02 to 1, FY 2001—2.26 to 1, FY 2002—2.4 to 1**
FY 2003 Result	**1.8 to 1 (Estimate based on partial data). This result is on target.**

MMS cannot provide the final FY 2003 ratio at this time because the evaluations for two sales that were held late in the fiscal year (a sale in the Western Gulf of Mexico in August and an Alaskan Beaufort Sea sale in September) have not been completed. It takes 90 days to complete a sale evaluation after the sale is held. However, OMM has calculated the FMV ratio for Sale 185, which was held in the Gulf of Mexico in March 2003. The ratio for that sale was 1.8 to 1, which is on target.

MMS anticipates finishing the remaining evaluations and calculating the ratio for the year late in the first quarter of FY 2004. It will provide the final FY 2003 performance information in the DOI's FY 2003 Annual Performance and Accountability Supplemental Report published during the 3rd quarter of FY 2004.

Minerals Revenue Management Program

The Federal Government is the largest mineral royalty owner in the United States. In FY 2002 and 2003, MMS collected and disbursed more than $6.6 billion and $8.3 billion respectively, to Federal agencies, U.S. Treasury accounts, States, and the Office of Trust Funds Management on behalf of Indian Tribes and Individual Indian Mineral Owners.

The Federal Oil and Gas Royalty Management Act of 1982 (FOGRMA) established a framework to improve management of Federal and Indian mineral royalties. In response to this mandate, MRM has established a comprehensive consolidated system for collecting, accounting for, verifying, and disbursing mineral revenues to appropriate recipients in a timely manner. Currently, MRM administers the rental, royalty, and other financial terms for over 26,000 producing and 54,000 non-producing mineral leases, both onshore and offshore. In addition to a broad range of financial services, MRM also pursues a comprehensive compliance effort staffed by MRM employees and State and tribal auditors.

Revenue Disbursement — MRM has been working to improve disbursement timeliness, with the eventual goal of providing recipients access to mineral revenues by the end of the business day following the day of receipt. However, the system developers' progress toward developing the system capability to achieve this goal was hampered by a court ordered system shutdown and subsequent recovery efforts. MRM intends to pursue the capability to provide earlier access to funds in the future.

However, MRM continues to ensure that it disburses funds as required by law, by the end of the month following the month of receipt. The following goals track the disbursement performance.

Mission Goal	**Provide revenue recipients with access to their money within 24 hours of the due date.**
Long Term Goal	**By the end of FY 2005, provide recipients access to 90 percent of revenues within one business day of MMS receipt and disburse 98 percent of revenues to recipients by the end of the month following month received.**
FY 2003 Annual Goal	**By the end of FY 2003, disburse 92 percent of revenues to recipients by the end of the month following month received.**
Prior Years' Results	**FY 1999—98.15 percent, FY 2000—98.49 percent, FY 2001—98.4 percent, FY 2002—80 percent**
FY 2003 Result	**92.6 percent. Exceeded the target.**

The goal this year was to significantly increase disbursement timeliness over FY 2002's 80 percent rate. MRM succeeded in this effort by working with companies to increase reporting accuracy and by increasing the accuracy of the financial system's payment matching process.

Compliance & Asset Management — In order to improve its CAM efforts, MRM successfully transitioned from a company-focused compliance approach to a focus on properties and producing areas. The new CAM process enables the agency to better manage resources and ensure that royalties are accurately reported and paid and that the compliance status of leases is known. Specifically, this approach will reduce the business cycle from 6 years to 3 years or less, increase confidence that royalties are paid correctly, increase the capability for timely identification and collection of royalty underpayments, and enable asset management decisions regarding royalties taken in kind or in value.

MRM has established the following goals for its CAM functions.

Mission Goal	**Assure compliance with applicable laws, lease terms, and regulations for all leases in the shortest possible time, but no later than 3 years from the due date.**
Long Term Goal	**By the end of FY 2005, ensure payments are within the expected payment range at the due date for 95 percent of properties.**
FY 2003 Annual Goal	**None. MRM had planned to develop a new compliance measurement methodology to measure progress in meeting this long term goal, but has not been able to do so because of a court-ordered system shutdown and the subsequent recovery efforts. MRM plans to develop the methodology in FY 2003 and establish an annual performance goal for FY 2004.**
Long Term Goal	**By the end of FY 2005, complete compliance work and issue necessary orders within 3 years of the due date for 95 percent of royalties associated with converted properties.**
FY 2003 Annual Goals	**By the end of FY 2003, complete compliance work through the order state for 95 percent of royalties associated with year 2000 converted properties.** **By the end of FY 2003, complete compliance work through the order state for 90 percent of royalties associated with year 2001 converted properties.**
Prior Years' Results	**FY 2001—89 percent of year 1999 royalties, FY 2002—97.2 percent of year 1999 royalties and 50 percent of year 2000 royalties**
FY 2003 Results	**Year 2000: : 99.3 Percent. Exceeded the target.** **Year 2001: : 17.9 percent. Below the target.**

Year 2000: MRM has completed 99.9 percent of all royalties in the 3-year compliance cycle; 46 percent of all 2000 royalties were covered in the 3-year compliance cycle.

Year 2001: The identification of potential variances was delayed due to a backlog of necessary production documents. Production documents must be verified before compliance can be certified. MRM has completed work to eliminate the 2001 production backlog and is now working on the 2002 production backlog. MRM will complete the 2001 compliance workload on time (by 2004) which is within our 3 year GPRA commitment. 60 percent of all 2001 royalties are covered within our 3 year compliance cycle.

Strategic Petroleum Reserve — The following annual goal was adopted for FY 2003 because it tracks progress on a mission requirement that was established by Presidential directive in 2001. On November 13, 2001, President Bush announced that he was directing the Secretary of Energy to fill the remaining capacity of the SPR utilizing Federal RIK oil from the Gulf of Mexico OCS. With almost 60 percent of the Nation's supply of oil coming from foreign sources, the SPR provides a critical buffer for potential disruptions in oil supplies. Approximately 120 million barrels of Gulf of Mexico Federal RIK oil will be used to support the SPR. When full, the SPR will contain approximately 700 million barrels of oil, providing a key link in the Nation's security network.

Although the SPR goal does not directly fit under any of the DOI Goal 3 mission or long term goals, it does support the disbursement and compliance goals. It is included in MRM's SES performance standards along with the rest of the annual goals in this report.

FY 2003 Annual Goal	**Offer up to 130,000 bbls/day of RIK oil for the Strategic Petroleum Reserve.**
Prior Year's Results	**FY 2002—60,100 bbls/day average from April through September 2002.**
FY 2003 Result	**130 bbls/day average from April through September 2003. Met Target.**

MRM met the targets to offer and contract for deliveries of 100,000 barrels of royalty oil per day (bbls/day) during the first two quarters of FY 2003 and 130,000 bbls/day during the final two quarters. However, the actual deliveries to the SPR were less than the volumes contracted for during the 1st, 3rd, and 4th quarters because of temporary production declines due to hurricanes in October 2002 and July 2003, a temporary operational issue on a large producing property (reducing 3rd quarter volumes by approximately 5,000 bbls/day), and production declines on other properties. The volumes actually taken in kind averaged 88,980 bbls/day during the 1st quarter, 99,556 bbls/day during the 2nd quarter, 120,445 bbls/day during the 3rd quarter, and 113,170 bbls/day during the 4th quarter.

DOI GOAL 5
Meet our trust responsibilities to Indian Tribes and our commitments to island communities.

The MMS mission goal that supports this departmental goal is:

- *Fulfill our mineral revenue Indian trust responsibilities.*

The objective of this goal is to provide the highest possible Indian trust protection relative to MRM's role in collecting and disbursing royalties on Indian lands. By focusing efforts on the accuracy and timeliness of collections and disbursements, and industry compliance, MRM ensures that Indian Tribes and Individual Indian Mineral Owners receive all monies due to them.

MRM's goal to fulfill the Secretary's trust responsibility to the Indian minerals community also supports DOI's ongoing effort to improve consultation, communication, and cooperation with Indian constituents. MRM continues to create opportunities for Indian tribes and States to participate in mineral revenue management activities. MMS provides guidance, assistance, and technical support to 8 Tribes and 10 states with delegated audit agreements under Sections 202 and 205 of FOGRMA. These efforts will assist the tribes in assuming royalty functions and further improve the government-to- government relationship with the tribes.

In addition, MMS held 69 outreach meetings in FY 2003, offering sessions in various geographic areas to service over 30,000 Indian individual mineral owners. Through these efforts, MRM resolved various types of payment and minerals issues for Indian constituents.

Mission Goal	**Fulfill our mineral revenue Indian trust responsibilities.**
Long Term Goal	**By the end of FY 2005, ensure 100 percent of Indian gas producing properties are in compliance with index zone/major portion and dual accounting requirements for the period 1984-2004.**
FY 2003 Annual Goals	**By the end of FY 2003, 90 percent of CY 2001 properties complete through the order stage for index zone/major pricing.** **By the end of FY 2003, ensure for the time period 1984-1999 that 95 percent of Indian gas producing properties are in compliance with dual accounting requirements.**
Prior Years' Results	**Index Zone/Major Portion: N/A. This is a new goal in FY 2003.** **Dual Accounting: FY 1999—9 percent, FY 2000—31.2 percent, FY 2001—51.2 percent, FY 2002—86.34 percent**
FY 2003 Results	**Index Zone/Major Portion: 98 percent. Exceeded Target.** **Dual Accounting: 98 percent. Exceeded Target.**
Long Term Goal	**By the end of FY 2005, ensure 100 percent of Indian oil producing properties are in compliance with major portion for the time period 1984-2004.**
FY 2003 Annual Goal	**None. We do not have an FY 2003 annual goal for this long term goal because we cannot make progress on it until after the new Indian oil rule is published.**

Index Zone/Major Portion annual goal: MRM made significant progress during the year and exceeded this goal by moving from a zero percent baseline at the beginning of the year to 98 percent complete by the end of the year for all CY 2001 properties. The remaining properties will be completed during FY 2004; many of these properties are pending completion of audits being performed by tribes.

Dual Accounting annual goal: MRM exceeded the target by ensuring that 98 percent of the properties were in compliance with dual accounting requirements. Of the 558 companies in the initial dual accounting strategy, work is still in progress for only 12 companies with 96 leases. In addition to the initially projected lease coverage, the audits have provided assurance of compliance with dual accounting lease terms for an additional 3,156 lease/payor combinations. Dual accounting compliance for the year 2000 forward is being verified through the 3-year compliance cycle.

The following annual goals were adopted for FY 2003 because they are included in MRM's SES performance standards along with the rest of the annual goals in this report. Although they do not directly fit under any of the DOI Goal 5 mission or long term goals, they do support the MMS and DOI Indian Trust Responsibility goals.

FY 2003 Annual Goals	**Disburse 99 percent of American Indian revenues to OTFM within 24 hours of receipt.** **Tribes manage audit activities for 88 percent of tribal mineral royalties.**
Prior Years' Results	**N/A. These are new annual goals in FY 2003.**
FY 2003 Results	**Revenue Disbursement: 99.3 percent. Met Target.** **Audit Activities: 88 percent. Met Target.**

Revenue Disbursement annual goal: MRM achieved a 99.3 percent OTFM disbursement rate, slightly exceeding the goal. MRM disburses to OTFM into interest-bearing accounts on a daily basis for all funds identified as tribal and allotted lease revenues.

Audit Activities annual goal: Tribes currently are managing 88 percent of their mineral royalty audit activities, thereby meeting the target. Although there was no increase in this percentage during FY 2003, MMS entered into intergovernmental personnel agreements (IPAs) with the Chippewa-Cree Tribe and Hopi. It is anticipated that these IPAs eventually will lead to additional cooperative agreements with the tribes to perform their own audits.

Shell production complex in the Gulf of Mexico.

Discussion and Analysis of the Financial Statements

MMS's goal is to achieve unqualified (clean) audit opinions on all financial statements and to eliminate all reportable conditions related to internal controls and material instances of non-compliance with the Federal Financial Management Improvement Act (FFMIA) requirements. In fiscal year 2002, an unqualified opinion was rendered on MMS financial statements. Additionally, MMS has been able to make improvements in eliminating some of the reportable conditions noted in the FY 2002 independent auditor's report. However, MMS has not been able to eliminate all non-compliance with FFMIA requirements in FY 2003.

Limitations of Financial Statements

Responsibility for the integrity and objectivity of the financial information presented in the financial statements lies with MMS management. The financial statements and supplemental financial schedules included in this report reflect the financial position and results of the operation of the bureau pursuant to the Chief Financial Officers Act of 1990 and the Government Management Reform Act of 1994. While these financial statements have been prepared from the books and records of MMS in accordance with guidance provided by the Office of Management and Budget and the Federal Accounting Standards Advisory Board, the 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 MMS is a bureau of the Department of the Interior, an agency of the executive branch of the United States government, a sovereign entity. Accordingly, unfunded liabilities reported in the statements cannot be liquidated without enactment of an appropriation, and ongoing operations are subject to enactment of appropriations.

General

As discussed above the Interior Franchise Fund (IFF) was transferred from Departmental Office to MMS effective October 1, 2003. The IFF experienced substantial growth in FY 2003 with both expenses and revenues increasing by over $700 million. As a result of the transfer of the IFF to MMS and the growth in the IFF there have been large increases to the following account balances, MMS's Administrative Fund Balance with Treasury, Advances and Deferred Revenue – Intragovernmental, and Administrative Accounts Payable. The transfer also resulted in the substantial decrease in administrative accounts receivable which included in FY 2002 receivables for MMS from the IFF which are now internal to MMS and eliminated.

Expenses

As reflected on the Statement of Net Cost, the fiscal year 2003 gross cost of MMS before earned revenue was approximately $2.22 billion, which is consistent with the costs reported in fiscal year 2002.

In accordance with OMB Bulletin No. 01-09, the Statement of Net Cost presents costs aligned directly to the major goals and outputs described in the bureau's performance plans: (1) Safety — Ensure safe OCS mineral development; (2) Environment — Ensure environmentally sound OCS mineral development; (3) Fair Market Value — Ensure that the public receives fair market value for OCS mineral development; (4) Access to Money — Provide revenue recipients with access to their money within 24 hours of the due date; and (5) Royalty Compliance — Assure compliance with applicable laws, lease terms, and regulations for all leases in the shortest possible time, but no later than 3 years from the due date (Royalty Compliance). The IFF costs are also presented as a separate responsibility segment.

The costs reported in all responsibility segments excluding IFF are lower than in FY 2002 because the FY 2002 amounts include non-recurring charges for a contingent liability of $550 million, and legal settlement of $125 million. These charges are largely responsible for the decrease in net cost of operations from the previous year. Excluding these non-recurring charges the cost for the Safety, Environment, Fair Market Value, and Royalty Compliance programs would not have changed significantly.

Due to substantial growth the costs reported for IFF were significantly higher in 2003. The growth of IFF is primarily attributable to increased orders from the Department of Defense and the Executive Office of the President. The current growth rate is not expected to continue in FY 2004.

Revenues

In general, MMS strategic goals are intended to be funded by general government funds derived from tax receipts and other sources. However, other fees and collections are supporting an increasing number of MMS activities. Approximately $118 million was collected in revenues derived from the public during FY 2003. This represents a decrease of $9 million from FY 2002 revenues of $109 million. These revenues are the royalties, rents, and bonuses MMS is authorized by Congress to use for operations.

Revenues collected from Other Federal Entities consist of reimbursable revenues from activities such as acquisition, personnel, and other technical services. In FY 2003, approximately $1,146 million was collected in revenues from other federal entities. This is an increase of about $728 million from FY 2003. The increase, as discussed above, is a result of increased IFF contracts.

Custodial Accounts

The MMS has custodial revenues of approximately $8.2 billion in Fiscal Year 2003, an increase of approximately 25% from FY 2002, which is a result of an increase in both prices and production. The revenues are from Outer Continental Shelf and onshore oil, gas, and mineral lease sales and royalties, making MMS one of the custodians in the Federal government. These revenues are presented on the MMS's Statement of Custodial Activity since these revenues, under Federal accounting rules, are considered to be revenue to the government as a whole rather than to the MMS or the Department. These revenues are collected by MMS on behalf of the U.S. Treasury, other Federal agencies, States, Indian Tribes and Individual Indian Allottees. Consequently, such revenues are not considered revenues of MMS and are not reported on MMS' Statement of Net Cost or Statement of Changes in Financial Position. The Federal portion of these revenues is ultimately reported as revenues in the financial statements of those Federal agencies who receive distributions from MMS.

Custodial Accounts Receivable from Treasury decreased in FY 2003 because of a decrease in un-transferred custodial revenue. The decrease is a result of eliminating the backlog of unmatched royalty receipts caused by the court order shut-down of the internet in FY2002.

Administrative Accounts Receivable from the public represents amounts due for rents and royalties on Federal lands that will ultimately be paid to the States. The receivable is off-set by a liability to States. The administrative accounts receivable from the public and liabilities to states decreased in FY 2003 as a result of timing of distributions.

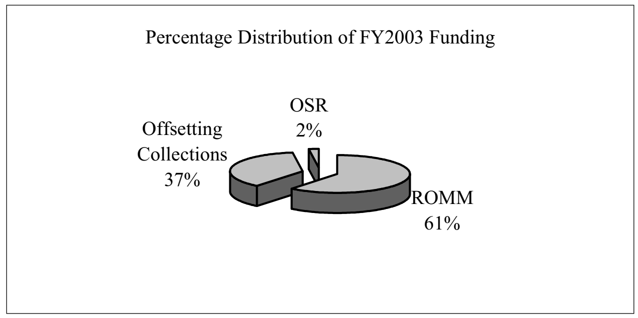
Budgetary Resources

Total budgetary resources increased dramatically from FY 2002 due to the growth and transfer of the IFF to MMS, and increased appropriations for payments to states under the Minerals Leasing Act as the result of increased minerals revenue. The increased payments to States are largely responsible for increases in appropriations received, obligations incurred - direct, and offsetting receipts. The growth in IFF caused increases in obligations incurred – reimbursable, unobligated balances and outlays.

In addition, in FY 2003, a portion of activity related to the IFF continued to be recorded in both 14X1917 - Royalties and Offshore Minerals Management and in 14X4529 - Interior Franchise Fund. For consistency and presentation purposes the "Reimbursable (Franchise Activities)" portion of 14X1917 has been included in the Interior Franchise Fund responsibility segment on the Consolidating Balance Sheets, and Statements of Net Costs, and the Combining Statements of Budgetary Resources. Because the Statement of Budgetary Resources is presented on combined basis and intra-bureau activity is not eliminated obligations incurred and offsetting collections show these amounts from both accounts. In FY 2004, all of the IFF activity will be recorded directly in the IFF.

MMS receives approximately 61 percent, or $2,353 million, of its total budgetary resources of $3,871 million through offsetting collections. Other major sources of budgetary resources include net appropriations and unobligated balances transferred in from the IFF, totaling $1,125 million and $378 million respectively. Of the total budgetary resources, $3,139 million were obligated in FY 2003.

MMS receives funding for mission critical operations from three sources: the Royalty and Offshore Minerals Management (ROMM) appropriation, Oil Spill Research (OSR), and offsetting collections (primarily from rental receipts from offshore leases). For FY 2003, the MMS had total annual appropriated resources of $270.5 million, of which $100.2 million was from offsetting collections.



Liabilities and Net Position

Federal agencies, by law, cannot make payments unless Congress has appropriated funds. MMS's unfunded liabilities excluding the accrued liability to the states, deferred credits for lease bonus money on oil and gas leases that have not yet been finalized, and custodial liabilities for royalty's payable is approximately $572 million. The $572 million consists of accrued contingent liabilities as described below, and annual leave and unfunded workers compensation claims under the Federal Employees Compensation Act which are considered an expense and liability in the current year, but which will be paid out of funds made available to the agency in future years.

The Net Position of the bureau consists of (1) Unexpended Appropriations, (2) Cumulative Results of Operations, and (3) Restricted Equity for the Environmental Improvement Restoration Fund (EIRF). MMS's Net Position as of September 30, 2003 is $539 million, of which $7 million is Unexpended Appropriations, a deficit of $445 million is Cumulative Results of Operations and $977 million is Restricted Equity for the EIRF.

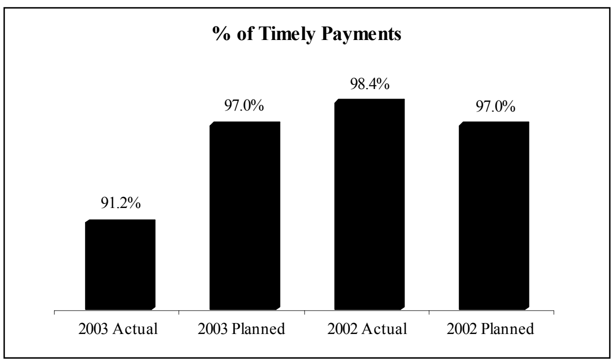
The Unexpended Appropriations represents spending authority appropriated by Congress that has not yet been used. Cumulative Results of Operations is the net results of the bureau's operations over time, and is a deficit at September 30, 2003 because a contingent liability has been accrued in the accompanying financial statements related to a pending lawsuit. It is legal counsel's opinion that any ultimate liability associated with this case will be funded by the Department of Justice's Judgment Fund. At which time, MMS will recognize such revenues and the deficit will be eliminated. The Restricted Equity for the EIRF results from a June 29, 2000 U.S. Supreme Court decree settling a long-standing dispute between the state of Alaska and the Federal government over the State/Federal boundary of areas leased for oil and gas in the Beaufort Sea.

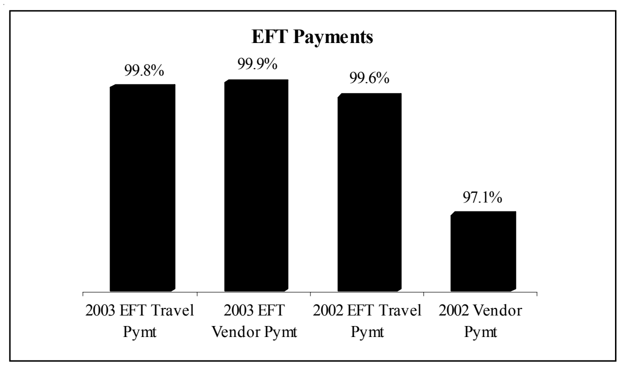
Financial Performance and Compliance

The MMS monitors financial management performance through periodic, collection and reporting of data for the Prompt Payment, Electronic Funds Transfers, and the Debt Collection Act. These reports are prepared and submitted to the Department of the Interior's Office of Financial Management for review by departmental senior managers.

Performance Measure: To have the percentage of payments without interest penalties meet or exceed the government-wide goal of 97 percent.

2003 Results: MMS exceeded the government-wide goal for the quarter ending September 30, 2003 by paying invoices 98 percent of the time on time. New operational procedures were implemented by the MMS during the fiscal year fourth quarter that allowed the MMS to adapt to the rapid growth of the Interior Franchise Fund and enabled the MMS to exceed the government-wide goal for the final quarter of the fiscal year.





Performance Measure: To use Electronic Funds Transfer (EFT) to the maximum extent possible, except for payments covered by waiver.

2003 Results: MMS achieved its goal by continuing to require new vendors and employees to enroll for EFT payments. This resulted in a 2.78% increase in Vendor EFT payments during the fiscal year.

Performance Measure: To identify and refer 93% of delinquent debt to Treasury when 180 days past due.

2003 Results: MMS was successful in identifying and referring 79% of delinquent debt to Treasury when 180 days past due. The existing tracking system is being enhanced and undergoing development to refine and improve this result. The MMS plans to identify and refer 93% of delinquent debt to Treasury when 180 days past due, by the end of the March, 2004.

Federal Financial Management Improvement Act (FFMIA)

As of September 30, MMS financial management systems complied substantially with accounting standards applicable to Federal entities.

MMS did not comply substantially with Federal Financial Management Systems Requirements, and the U.S. Standard General Ledger (USSGL) at the Transaction Level. MMS has implemented steps to address and correct the non-compliance with Systems Requirements during FY 2004. On October 1, 2003, MMS implemented new posting models and trading partner identification processes that we believe will place the MRM accounting system in substantial compliance with the USSGL in FY 2004.

Federal Managers' Financial Integrity Act (FMFIA)

The MMS centrally manages the Federal Managers Financial Integrity Act program, with oversight responsibilities assigned to the bureau CFO and Deputy CFO. Each of the four MMS directors maintains responsibility for effective controls to provide reasonable assurance that Government resources are protected against fraud, waste, abuse, mismanagement, or misappropriation.

A jack warily eyes a diver's offering.

Principal Financial Statements

Department of the Interior
Minerals Management Service
Consolidated Balance Sheet
As of September 30, 2003 and 2002

(dollars in thousands)

	2003	2002
ASSETS		
Intragovernmental Assets:		
Administrative Fund Balance	**$ 1,259,161**	$ 94,119
Custodial Fund Balance	**437**	-
Restricted Fund Balance	**1**	1
Fund Balance with Treasury (Note 2)	**1,259,599**	94,120
Restricted Treasury Securities	**977,521**	967,273
Custodial Treasury Securities	**25,073**	24,617
Investments, Net (Note 3)	**1,002,594**	991,890
Custodial Accounts Receivable from Treasury	**194,939**	379,879
Administrative Accounts Receivable	**21,842**	97,085
Accounts Receivable, Net (Note 4)	**216,781**	476,964
Other:		
Advances and Prepayments	**5**	-
Total Intragovernmental Assets	**2,478,979**	1,562,974
Custodial Accounts Receivable	**789,658**	770,949
Administrative Accounts Receivable	**234,507**	374,945
Accounts Receivable, Net (Note 4)	**1,024,165**	1,145,894
Property & Equipment, Net of Accumulated Depreciation (Note 5)	**36,360**	33,307
Other:		
Travel Advances	**8**	29
Total Public Assets	**1,060,533**	1,179,230
TOTAL ASSETS (Note 6)	**$ 3,539,512**	$ 2,742,204

Department of the Interior
Minerals Management Service
Consolidated Balance Sheet
As of September 30, 2003 and 2002

(dollars in thousands)

	2003	2002
LIABILITIES		
Intragovernmental Liabilities:		
Administrative Accounts Payable	**$ 4,739**	$ 4,077
Other:		
Custodial Liability	**948,605**	1,132,957
Advances and Deferred Revenue	**872,973**	1,245
Accrued Payroll and Benefits	**2,504**	3,466
Total Intragovernmental Liabilities	**1,828,821**	1,141,745
Public Liabilities:		
Administrative Accounts Payable	**301,805**	114,122
Federal Employees Compensation Act Liability (Note 7)	**9,376**	9,560
Accounts Payable	**311,181**	123,682
Other:		
Contingent Liabilities (Note 8)	**550,000**	550,000
Liabilities to States	**234,416**	374,919
Custodial Liability	**35,992**	17,870
Deferred Credits	**25,738**	24,845
Accrued Payroll and Benefits	**13,791**	18,092
Advances and Deferred Revenue	**68**	63
Capital Lease Liability (Note 9)	**51**	21
Total Public Liabilities	**1,171,237**	1,109,492
TOTAL LIABILITIES (Note 10)	**3,000,058**	2,251,237
Commitments and Contingencies (Note 8 and 9)		
Net Position		
Unexpended Appropriations	**6,969**	6,316
Cumulative Results of Operations:		
Administrative Cumulative Results of Operations	**(445,037)**	(482,623)
EIRF Cumulative Results of Operations	**977,522**	967,274
Total Cumulative Results of Operations	**532,485**	484,651
Total Net Position	**539,454**	490,967
TOTAL LIABILITIES AND NET POSITION	**$ 3,539,512**	$ 2,742,204

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

Department of the Interior
Minerals Management Service
Consolidated Statement of Net Cost
For the years ended September 30, 2003 and 2002
(dollars in thousands)

	2003	2002
Safety		
Cost -Services provided to the Public	$ 64,577	$ 237,466
Revenue Earned from the Public	26,168	26,973
Net Cost (Revenue) of Operations	38,409	210,493
Environment		
Cost -Services provided to the Public	59,876	224,321
Revenue Earned from the Public	24,860	25,624
Net Cost (Revenue) of Operations	35,016	198,697
Fair Market Value		
Cost -Services provided to the Public	32,949	127,002
Revenue Earned from the Public	14,191	14,627
Net Cost (Revenue) of Operations	18,758	112,375
Access to Money		
Cost -Services provided to the Public	859,713	952,272
Revenue Earned from the Public	21,655	16,035
Net Cost (Revenue) of Operations	838,058	936,237
Royalty Compliance		
Cost -Services provided to the Public	74,606	217,548
Revenue Earned from the Public	30,876	25,524
Net Cost (Revenue) of Operations	43,730	192,024
Interior Franchise Fund		
Cost - Services provided to Federal Agencies	1,120,933	401,412
Revenue Earned from Federal Agencies	1,138,445	401,412
Net Cost (Revenue) of Operations	(17,512)	-
Other		
Cost -Services provided to the Public	99	601
Revenue Earned from the Public	99	601
Net Cost of Services to the Public	-	-
Cost - Services provided to Federal Agencies	7,431	16,313
Revenue Earned from Federal Agencies	7,431	16,313
Net Cost of Services provided to Federal Agencies	-	-
Net Cost (Revenue) of Operations	-	-
Total		
Cost -Services provided to the Public	1,091,820	1,759,210
Revenue Earned from the Public (Note 12)	117,849	109,384
Net Cost of Services to the Public	973,971	1,649,826
Cost - Services provided to Federal Agencies	1,128,364	417,725
Revenue Earned from Federal Agencies (Note 12)	1,145,876	417,725
Net Cost of Services provided to Federal Agencies	(17,512)	-
Net Cost (Revenue) of Operations (Note 11)	$ 956,459	$ 1,649,826

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

Department of the Interior
Minerals Management Service
Consolidated Statement of Changes in Net Position
For the years ended September 30, 2003 and 2002

(dollars in thousands)

	2003	2002
UNEXPENDED APPROPRIATIONS		
Beginning Balances	**$ 6,316**	$ 8,434
Budgetary Financing Sources		
Appropriations Received, General Funds	**165,321**	150,667
Appropriations-Used	**(162,550)**	(152,542)
Other Adjustments	**(2,118)**	(243)
Total Budgetary Financing Sources	**653**	**(2,118)**
Ending Balance - Unexpended Appropriations	**$ 6,969**	**$ 6,316**
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	**$ 484,651**	$ 1,008,649
Transfer In of the Interior Franchise Fund Operations (Note 19)	**1,410**	-
Beginning Balances, as adjusted	**486,061**	1,008,649
Budgetary Financing Sources		
Appropriations-Used	**162,550**	152,542
MRM Exchange Revenue (Note 13)	**812,765**	823,841
Transfers In/Out without Reimbursement	**6,065**	6,105
Non-Exchange Revenue:		
Other Non-Exchange Revenue	**10,248**	18,424
Other Financing Sources		
Imputed Financing from Financing absorbed from others	**11,525**	125,305
Transfers In/Out without Reimbursement	**(270)**	(389)
Total Financing Sources	**1,002,883**	**1,125,828**
Net Cost of Operations	**(956,459)**	**(1,649,826)**
Ending Balance - Cumulative Results of Operations	**$ 532,485**	**$ 484,651**

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

Department of the Interior
Minerals Management Service
Statement of Custodial Activity
For the years ended September 30, 2003 and 2002

(dollars in thousands)

		2003		2002
Revenues on Behalf of the Federal Government				
Mineral Lease Revenue				
Rents and Royalties	**$**	**6,716,830**	$	5,445,180
Offshore Lease Sales		**485,841**		884,859
Strategic Petroleum Reserve (Note 14)		**1,044,350**		262,752
Total Revenue	**$**	**8,247,021**	$	6,592,791
Disposition of Revenue				
Distribution to Department of the Interior				
National Park Service Conservation Funds	**$**	**1,049,000**	$	1,047,980
Bureau of Reclamation		**753,374**		544,826
Minerals Management Service (Note 15)		**1,070,294**		794,779
Bureau of Land Management		**72,843**		8,270
Fish and Wildlife Service		**2,909**		891
Distribution to Other Federal Agencies				
Department of the Treasury		**4,208,092**		4,138,702
Department of Energy (Note 14)		**1,044,350**		262,752
Department of Agriculture		**22,920**		16,091
Distribution to Indian Tribes and Agencies		**79,544**		61,338
Distribution to States and Others		**65,488**		30,443
Change in Untransferred Revenue		**(121,793)**		(313,281)
Total Disposition of Revenue	**$**	**8,247,021**	$	6,592,791

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

Department of the Interior
Minerals Management Service
Combined Statement of Budgetary Resources
For the years ended September 30, 2003 and 2002

(dollars in thousands)

		2003		2002
Budgetary Resources:				
Budget Authority:				
Appropriations Received	**$**	**1,124,694**	$	844,006
Unobligated Balance:				
Beginning of Period		**9,838**		14,525
Transfer In of the Interior Franchise Fund Operations, Beginning of Period (Note 19)		**378,443**		-
Spending Authority From Offsetting Collections:				
Earned				
Collected		**2,163,170**		466,742
Receivable from Federal Sources		**(119,020)**		61,898
Change in Unfilled Customer Orders				
Advance Received		**499,075**		(720)
Without Advance from Federal Sources		**(189,857)**		89,263
Recoveries of Prior Year Obligations		**7,130**		10,586
Permanently not Available		**(2,158)**		(243)
Total Budgetary Resources	**$**	**3,871,315**	$	1,486,057
Status of Budgetary Resources:				
Obligations Incurred:				
Direct (Category B)	**$**	**1,124,291**	$	846,578
Reimbursable (Category B)		**2,015,239**		629,641
Total Obligations Incurred (Note 16)		**3,139,530**		1,476,219
Unobligated Balances:				
Apportioned		**730,542**		7,657
Unobligated Balance not Available		**1,243**		2,181
Total Status of Budgetary Resources	**$**	**3,871,315**	$	1,486,057
Relationship of Obligations to Outlays:				
Obligations Incurred	**$**	**3,139,530**	$	1,476,219
Obligated Balance, Net, Beginning of Period		**84,270**		73,376
Transfer In of the IFF Operations, Obligated Balance, Net Beginning of Period (Note 19)		**48,799**		-
Obligated Balance, Net, End of Period:				
Accounts Receivable		**23,653**		97,075
Unfilled Customer Orders from Federal Sources		**244,594**		209,447
Undelivered Orders		**(484,808)**		(263,764)
Accounts Payable		**(310,803)**		(127,028)
Less: Spending Authority Adjustments		**301,747**		(161,747)
Outlays:				
Disbursements		**3,046,982**		1,303,578
Collections		**(2,662,245)**		(466,021)
Net Outlays before Offsetting Receipts		**384,737**		837,557
Less: Offsetting Receipts		**(1,191,019)**		(867,646)
Net Outlays	**$**	**(806,282)**	$	(30,089)

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

Department of the Interior
Minerals Management Service
Consolidated Statement of Financing
For the years ended September 30, 2003 and 2002
(dollars in thousands)

		2003		2002
Resources Used to Finance Activities:				
Budgetary Resources Obligated:				
Obligations Incurred	**$ 3,139,530**		$ 1,476,219	
Less: Spending Authority From Offsetting Collections/Adjustments	**(2,360,498)**		(627,769)	
Obligations Net of Offsetting Collections and Adjustments	**779,032**		848,450	
Less: Offsetting Receipts	**(1,191,019)**		(867,646)	
Net Obligations	**(411,987)**		(19,196)	
Other Resources:				
Transfers In/Out Without Reimbursement	**(270)**		(389)	
Imputed Financing From Costs Absorbed by Others	**11,525**		125,305	
Net Other Resources Used to Finance Activities	**11,255**		124,916	
Total Resources Used to Finance Activities		**$ (400,732)**		$ 105,720
Resources Used to Finance Items Not Part of the Net Cost of Operations:				
Change in Budgetary Resources Obligated for Goods, Services, and Benefits Ordered but Not Yet Provided	**308,818**		(8,313)	
Resources That Fund Expenses Recognized in Prior Periods	**(140,570)**		136,592	
Budgetary Offsetting Collections and Receipts That Do Not Affect Net Cost of Operations:				
Offsetting Receipts Not Part of the Net Cost of Operations	**1,191,019**		867,646	
Resources That Finance the Acquisition of Assets	**(7,775)**		(8,974)	
Total Resources Used to Finance Items Not Part of the Net Cost of Operations		**1,351,492**		986,951
Total Resources Used to Finance the Net Cost of Operations		**950,760**		1,092,671
Components of Net Cost of Operations That Will Not Require or Generate Resources in the Current Period:				
Components Requiring or Generating Resources in Future Periods:				
Increase (Decrease) in Annual Leave Liability (Note 21)	**(247)**		117	
Change in Unfunded Liabilities and Other (Note 21)	**(355)**		552,394	
Total Components of Net Cost of Operations That Will Require or Generate Resources in Future Periods	**(602)**		552,511	
Components Not Requiring or Generating Resources:				
Depreciation and Amortization	**4,722**		4,644	
Bad Debt Expense	**1,579**		-	
Total Components of Net Cost of Operations That Will Not Require or Generate Resources	**6,301**		4,644	
Total Components of Net Cost of Operations That Will Not Require or Generate Resources in the Current Period		**5,699**		557,155
		$ 956,459		$ 1,649,826

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

Sunset on Spar platform and construction barge in the Gulf of Mexico.

Notes to Financial Statements September 30, 2003 and 2002

Note 1.1 Significant Accounting Policies

A. Basis of Presentation

These financial statements have been prepared to report the financial position, net cost of operations, changes in net position, budgetary resources, reconciliation of net cost to budgetary obligations, and custodial activities of the Minerals Management Service (MMS), as required by the Chief Financial Officers Act of 1990.

The financial statements have been prepared from the accounting records of MMS in accordance with accounting principles generally accepted in the United States of America (GAAP) using guidance issued by the Federal Accounting Standards Advisory Board (FASAB), and the Office of Management and Budget (OMB). Significant MMS accounting policies are summarized in this note.

The financial statements should be read with the realization that they are for a component of the United States Government, a sovereign entity. One implication of this is that liabilities cannot be liquidated without legislation that provides resources and legal authority to do so.

Certain MMS financial activities interact with and depend on the financial activities of the centralized management function of the Federal Government. These activities are performed for the benefit of the whole Federal Government, and include public debt and employee retirement, life insurance, and health benefit programs. Employee retirement, life insurance and health benefit costs, along with an assigned (imputed) financing source for these costs, are included in the MMS financial statements. Public debt activities that are performed for the benefit of the Federal Government as a whole are not included in these financial statements.

B. Reporting Entity

The Minerals Management Service was created on January 19, 1982, by Secretarial Order No. 3071, under authority of Section 2 of Reorganization Plan No. 3 of 1950 (64 Stat. 1262). On May 10, 1982, by Secretarial Order No. 3071, Amendment No. 1, all Outer Continental Shelf (OCS) leasing responsibilities of the Department of the Interior were consolidated within MMS under Section 2 of Reorganization Plan No. 3 of 1950. Amendment No. 2, dated May 26, 1982, set forth the basic organizational structure for MMS and provided for the transfer of administrative functions. Secretarial Order No. 3087, dated December 3, 1982, and Amendment No. 1, dated February 7, 1983, provided for the transfer of royalty and mineral revenue management functions, including collection and distribution performed by the Bureau of Land Management, to MMS.

The accompanying financial statements include all components of Minerals Management Service, including, Royalty and Offshore Mineral Management, Mineral Leasing, Oil Spill Research, and Interior Franchise Fund.

MMS has principal responsibility for the offshore leasing program, leasing management, and resource evaluation and classification functions, the environmental review of leasing activities, regulation of operations and lease management, inspection and enforcement programs, and leasing and related public liaison and planning functions on OCS lands. In addition, MMS is responsible for the prevention of fraud and theft and the prompt, full, and complete collection of monies and certain other forms of royalty due the Federal Government, States, and Indian lessors under contractual agreements with lessees.

Minerals Revenue Management (MRM) Program, MMS, performs primarily custodial activities that include the collection, distribution, and accounting for revenues and asset transfers as regulated by law. Some operational accounting activities also performed by MRM Program personnel include but are not limited to providing data for reporting requirements, investing revenues for both federal and non-federal funds, expending appropriations, establishing accounting procedures, and reconciling balances with other entities and Treasury.

The Department of the Interior transferred part of the Interior Franchise Fund (IFF) from Interior's Departmental Offices to MMS commencing October 1, 2002. The IFF was established in May 1996 as a result of the Government Management Reform Act (GMRA) of 1994. It operates as a revolving fund providing common administrative support service on a competitive fee-for-service basis for government agencies. A revolving fund is a budgetary structure set by statute that authorizes Executive Branch agencies to collect user fees or revenue to finance operational activities. The IFF is a component of MMS.

The IFF's authorizing legislation has a sunset date and expires October 1st of each year. Section 628 of Title VI within the General Provisions of the President's 2004 budget, extended the sunset date in the Franchise Fund Pilot Program authorizing legislation to October 1, 2004. However, this sunset date creates an uncertainty about the IFF's ability to continue as a going concern because the operation of the IFF is dependent on the renewal of its authorizing legislation.

Management's plan to deal with this uncertainty is to seek additional wording in the FY 2005 appropriation language that establishes franchising as a permanent program or provides franchise-like authority permanently. Should this plan be unsuccessful, MMS will eliminate or downsize some business lines, adjust its pricing conventions to eliminate retained earnings, and continue to cross service its remaining Federal clientele under the authority of the Economy Act.

In accordance with OMB Bulletin No. 01-09, Form and Content of Agency Financial Statements, comparative statements are presented.

C. Transactions within MMS

Transactions and balances among the MMS components have been eliminated from the Consolidated Balance Sheet, the Consolidated Statement of Net Cost, and the Consolidated Statement of Changes in Net Position.

As provided for by OMB Bulletin No. 01-09, Form and Content of Agency Financial Statements, the Statement of Budgetary Resources is presented on a combined basis. Therefore, intra-MMS transactions and balances have not been eliminated from this statement.

In accordance with OMB Bulletin No. 01-09, intra-MMS transactions and balances have been eliminated from all the amounts on the Consolidated Statement of Financing, except for obligations incurred and spending authority from offsetting collections and adjustments, which are presented on a combined basis.

In order to present all custodial activity, the distributions to MMS have not been eliminated on the Statement of Custodial Activity. However, the amounts are reported separately on the statement.

D. Basis of Accounting

MMS maintains its accounting records on both an accrual accounting basis and a budgetary accounting basis. Under the accrual method, revenues are recognized when earned and expenses are recognized when incurred, without regard to the receipt or payment of cash.

Under budgetary accounting, MMS records budgetary authority when it's legally received and records obligations of authority when legally incurred. Budgetary accounting facilitates compliance with constraints and controls over the use of Federal Funds.

E. Fund Balance With Treasury

MMS' receipts and disbursements are processed through the Federal Reserve System and the U.S. Treasury. The "Fund Balance with Treasury" balance as shown on the Consolidated Balance Sheet includes the unexpended balances of appropriations from which MMS is authorized to incur expenses and pay liabilities. The unobligated appropriation fund balances in expired accounts are unavailable for new obligations.

F. Accounts Receivable

Accounts receivable consist of amounts owed to MMS by other federal agencies and the public. No allowance is established for receivables due from federal agencies, as they are considered fully collectible.

G. Property and Equipment

Property and equipment are valued at historical costs. Property and equipment are capitalized if the initial acquisition cost is $15,000 or more and the estimated useful life is two years or greater (excluding internal use software). Internal use software with a purchase price or development cost of more than $100,000 is capitalized. Depreciation is recorded using the straight-line method based on useful lives ranging from 3 to 6 years for equipment and 10 years for internal use software.

In FY 2003, MMS moved the Royalty in Kind System (RIK) into production and began amortization of this internal use software.

H. Liabilities

Operating liabilities of MMS represent amounts likely to be paid by MMS as a result of transactions or events that have already occurred. However, no liabilities relating to MMS operations can be paid absent an appropriation. Liabilities for which an appropriation has not been enacted are classified as liabilities not covered by budgetary resources, without any certainty that an appropriation will be enacted.

I. Federal Employees Compensation Act

The Department of Labor (DOL) administers the Federal Employees Compensation Act (FECA), which provides workers' compensation benefits to Federal employees. There are two types of liabilities related to workers' compensation.

The first type is unfunded accrued FECA liability, which represents MMS Workers Compensation claims paid by the DOL for Workers' Compensation that have not yet been reimbursed by MMS. There is generally a two to three year time period between payment by DOL and reimbursement by MMS.

The second type is the unfunded actuarial FECA liability, which represents the estimated liability of future workers' compensation. This liability includes death, disability, medical, and miscellaneous costs.

DOL determines the actuarial FECA liability annually, as of September 30, using a method that considers historical benefit payment patterns, wage inflation factors, medical inflation factors, and other variables. DOL discounts the projected annual benefit payments to present value using the Office of Management and Budget's economic assumptions for 10-year Treasury notes and bonds.

To provide for the effects of inflation on the actuarial FECA liability, DOL applies wage inflation factors (i.e., cost of living adjustments) and medical inflation factors (i.e., consumer price index medical adjustments) to the calculation of projected future benefit payments. These factors are also used to adjust historical benefit payments to current-year constant dollars. DOL applies a discounting formula to recognize the timing of benefit payments as 13 payments per year instead of one lump sum payment per year.

DOL evaluates the estimated projections to ensure that the estimated future benefit payments are appropriate. The analysis includes three tests: (1) a comparison of the current-year projections to the prior year projections; (2) a comparison of the prior-year projected payments to the current-year actual payments, excluding any new case payments that had arisen during the current year; and (3) a comparison of the current-year actual payment data to the prior-year actual payment data. Based on the outcome of this analysis, adjustments may be made to the estimated future benefit payments.

J. Federal Employees Group Life Insurance (FEGLI) Program

Most MMS employees are entitled to participate in the FEGLI Program. Participating employees can obtain "basic life" term life insurance, with the employee paying two-thirds of the cost and MMS paying one-third. Additional coverage is optional, to be paid fully by the employee. The basic life coverage may be continued into retirement if certain requirements are met.

The Office of Personnel Management (OPM) administers this program and is responsible for the reporting of liabilities. For each fiscal year, OPM calculates the U.S. Government's service cost for the post-retirement portion of the basic life coverage. Because MMS's contributions to the basic life coverage are fully allocated by OPM to the pre-retirement portion of coverage, MMS has recognized the entire service cost of the post-retirement portion of basic life coverage as an imputed cost and imputed financing source.

K. Advances and Deferred Revenue

Federal advances and deferred revenue represent liabilities to perform services or deliver goods to customers that have remitted payment in advance of receiving the goods and services. These amounts will be earned upon furnishing goods and services to customers typically within the next 12 months.

Public advances and deferred revenue primarily consists of bond forfeiture collections. MMS is authorized to use bond collections of an Outer Continental Shelf lessee who did not fulfill the requirements of the lease. These forfeited bond collections are to be used to cover the cost of improvement, protection, or rehabilitation work arising from the forfeiture. Bond fortfeitures are recorded as deferred revenue and the revenue is recognized when the expense is incurred.

L. Accrued Unfunded Annual Leave

Amounts associated with the payment of annual leave are accrued while employees are earning leave. This accrual is reduced as leave is taken. Each year the balance in the accrued annual leave account is adjusted to reflect current pay rates. To the extent current or prior year appropriations are not available to finance annual leave, future financing sources will be used.

Sick leave and other types of leave are expensed as taken because they are non-vesting in nature.

M. Contingent Liabilities

Contingent liabilities are recorded in the financial statements when an event potentially leading to the recognition of a liability is probable, and the scope of the potential liability may be estimated.

Contingent liabilities are disclosed in the footnotes to the financial statements when the conditions for financial statement recognition are not met and when the outcome of a liability is more than remote.

N. Retirement Plans

MMS employees participate in one of two retirement systems, the Civil Service Retirement System (CSRS) or the Federal Employees' Retirement System (FERS). Employees hired prior to January 1, 1984 could elect to join FERS or continue to participate in CSRS. Employees hired after December 31, 1983 are automatically covered by FERS and Social Security.

CSRS employees may contribute up to seven percent of basic pay and receive no matching contributions from MMS. For FERS employees, MMS automatically contributes one percent of pay and matches any employee contribution up to an additional four percent of pay. FERS employees may contribute up to 12 percent of gross earnings. For employees in FERS, MMS also contributes the employer's matching share for Social Security.

The OPM is responsible for reporting assets, accumulated plan benefits and unfunded liabilities, if any, applicable to CSRS participants and FERS employees government-wide, including MMS employees. MMS has recognized an imputed cost and imputed financing source for the difference between the estimated service cost and the contributions made by the MMS and covered CSRS employees.

O. Exchange Revenues

The prices charged by Minerals Management Service are set by law or regulation. MMS bases the prices for products/services offered through the Interior Franchise Fund on the cost of products/services plus a fee of up to four percent of the cost of products/services. The Interior Franchise Fund is authorized to charge a fee up to four percent in accordance with the Government Management Reform Act (GMRA). Prices set for products and services offered through reimbursable agreements under the Economy Act are intended to recover the full costs incurred by these activities.

MMS reports, as exchange revenues, the amount of royalties, rents and bonuses that congress authorizes MMS to use for operations, as these revenues off-set the costs incurred to generate the revenues.

P. Other Financing Sources and Revenues

The primary financing sources for Minerals Management Service operations come from its annual Congressional appropriation and its authority to retain certain receipts resulting from its activities. MMS is authorized to retain a portion of the rental income collected as a part of the custodial activity provided by the Minerals Revenue Management Program to fund its operating costs. These funds are used for operating and capital expenses of MMS. Additional amounts are obtained through reimbursements for services performed for other Federal agencies under the GMRA or Economy Act.

In addition, MMS receives appropriations for specific purposes such as computer acquisitions; to carry out title I, section 1016, title IV, section 4202 and 4303, title VII, and title VIII, section 8201 of the Oil Pollution Act of 1990; to carry out provisions of the Minerals Leasing Act; to provide National Forest Fund payments to States, and to provide payments to States from lands acquired for flood control, navigation, and allied purposes.

Appropriations: Appropriations are recognized as financing sources when goods and services are received or benefits are provided. This is true whether the goods, services, and benefits are payable or paid as of fiscal year end and whether the appropriations are used for items that are expensed or capitalized.

Imputed Financing Sources: In certain instances, operating costs of MMS are paid out of funds appropriated to other federal agencies. For example, the Office of Personnel Management, by law, pays certain costs of retirement programs and the Judgment Fund maintained by Treasury pays certain legal judgments against MMS. When costs that are identifiable to MMS and directly attributable to MMS operations are paid by other agencies, MMS recognizes these amounts as operating expenses of MMS. In addition, MMS recognizes an imputed financing source on the Consolidated Statement of Changes in Net Position to indicate the funding of Bureau operations by other federal agencies.

Q. Net Position

Net position consists of unexpended appropriations, cumulative results of operations, and restricted equity. Unexpended appropriations include available and unavailable unobligated balances as well as undelivered orders. Cumulative results of operations include the difference between revenues and expenses, the net amount of transfers of assets in and out without reimbursement, and donations (all of these include balances since the inception of the fund). The Environmental Improvement and Restoration Fund is classified as restricted equity on the Balance Sheet. As of September 30, 2003 and 2002, there are no estimated obligations related to canceled appropriations.

R. Income Taxes

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

S. Use of Estimates

The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates.

T. Comparative Data

MMS has reclassified data on the fiscal year 2002 financial statements to conform with fiscal year 2003 presentation requirements.

Note 1.2 Significant Accounting Policies Relating to the Minerals Revenue Management (MRM) Program

A. MRM Financing Sources and Revenues

MRM collects and accrues for bonuses, rents, royalties and other receipts from Federal Government and Indian leases and distributes all proceeds to the Treasury, other Federal agencies, states, Indian tribes, and Indian allottees, in accordance with legislated allocation formulas. MMS reports these revenues on the Statement of Custodial Activity.

In addition, MMS reports certain state amounts as revenues on the Statement of Changes in Net Position because the revenues are derived from the sale of federally owned mineral rights for which MMS incurred minimal costs in earning the revenue. When distributed to the states, MMS reports the distributions as costs in the Access to Money program on the Statement of Net Cost, because the distributions reduce the net position of the Federal Government as a whole and MMS received budgetary authority to make the distributions.

Royalty-in-Kind (RIK) Program

MMS, under the provisions of the Mineral Lands Leasing Act of 1920 and the Outer Continental Shelf Lands Act (OCSLA) of 1953, may take part or all of its oil and gas royalties in-kind (a volume of the commodity) as opposed to in value (cash). MMS may either transfer the volume of oil or gas commodity taken in kind to Federal agencies for internal use or sell the commodity on the open market at fair market value and transfer the cash received. MMS reflects royalty-in-kind as mineral lease revenue on the Statement of Custodial Activity.

MRM assists the administration's initiative to fill the Strategic Petroleum Reserve. MMS transfers to the Department of Energy royalty oil taken in kind from Federal leases in the Gulf of Mexico. During fiscal years 2003 and 2002, MMS transferred approximately 38.2 and 11.2 million barrels, respectively, to the Department of Energy for use in adding to the reserve. MMS determines the value of the commodity transferred using the fair market value on the date of the transfer. MMS reports these transfers as mineral lease revenue and distribution to the Department of Energy on the Statement of Custodial Activity.

Environmental Improvement and Restoration Fund (EIRF)

The Environmental Improvement and Restoration Fund (EIRF) was established pursuant to Title 4 of the Department of the Interior and Related Agencies Appropriations Act for FY 1998. Half of the principal and interest from the distribution of the Alaska Escrow Fund was deposited into EIRF during FY 2000. During FY 2003 and 2002, MRM deposited to the EIRF interest earned from investments of the EIRF principal. Congress has permanently appropriated 20% of the prior fiscal year interest earned by the EIRF to the Department of Commerce. The remaining 80% of interest earned remains in the fund and may be appropriated by Congress to certain other agencies, as provided by law. No assets of the fund are available to the Department of the Interior unless appropriated by Congress.

B. Distributions of Revenues

Federal Revenues: Distributions are based on the Mineral Lands Leasing Act of 1920, 30 USC 191 as amended, the Federal Oil and Gas Royalty Management Act of 1982 (PL 97-451, 96 Stat. 2447, 30 USC 1701), the 1986 OCS Lands Act amendments of 1985 (PL 99-272), and subsequent legislation and lease terms.

Federal revenues distributed to MMS are subsequently appropriated and/or made available for program expenses and disbursements approved by Congress. Monies collected in MMS administrative appropriated funds are recorded as exchange revenues and subsequently used for operational purposes.

Non-Federal Revenues: Distributions are based on the Mineral Lands Leasing Act of 1920, as amended, subsequent legislation and lease terms.

Revenues generated from mineral production on Indian Lands go directly to Interior's Office of Trust Fund Management for subsequent distribution to tribes and allottees, meeting a wide variety of needs as outlined in the Indian Mineral Development Act of 1982 and other applicable laws and guidance. Indian nonstandard leases are negotiated directly between individual Indian tribes and industry.

C. Fund Balance With Treasury

MRM receipts and disbursements are processed through the Federal Reserve System and the U.S. Treasury. Receipts are processed through electronic transfers, fedwires, Treasury's Government On-Line Accounting Link System, and checks. The "Fund Balance with Treasury" as shown on the Consolidated Balance Sheet for custodial activity includes deposit and clearing account balances that are not available for obligation.

At the end of each fiscal year, MMS transfers the undistributed custodial clearing account fund balance to the General Fund of the Treasury and reports this as an accounts receivable. At the beginning of the following year, the balances are received from Treasury and distributed to the beneficiaries.

D. Accounts Receivable

The financial statements reflect an accounts receivable accrual. Custodial receivables due from the public are reported net of allowance amount. The custodial receivables represent amounts due for royalty revenue, deferred bonuses and accumulated interest.

Oil and gas companies provide MMS sureties to secure the majority of the receivables for audit bills, but not for most RIK receivables. The current surety value, excluding RIK, is $293 million and $279 million for receivables as of September 30, 2003 and 2002, respectively.

The royalty accrual for custodial receivables and distributions payable represents September activity due in October. The balance is estimated based on an analysis of the last twelve months of royalty activity, and current events, such as significant settlements due in September.

An allowance for estimated uncollectible custodial receivables is recognized to reduce the gross amount of receivables to its realizable value. The allowance is estimated based on historical experience of collections in relation to revenues. The allowance is calculated as the historical collection percentage multiplied by the year end accounts receivable balance.

E. Investments of Custodial Assets

Investments represent non-marketable market based Treasury securities issued by the Bureau of the Public Debt. These securities are not traded on any securities exchange, but mirror the prices of similar Treasury Securities trading in the Government securities market. Investments are expected to be held to maturity.

Investments are reported at cost, net of amortized premiums or discounts. Premiums and discounts are amortized using the straight-line method as these are short-term securities (i.e. bills) and the difference between the straight-line and effective interest method is inconsequential. Interest on investments is accrued as it is earned.

The market value of investments is calculated using the market price of securities as shown on Treasury's FedInvest Price File on September 30. Market values for overnight investments are the same as, or equivalent to par value.

MMS has limited investment authority based on two categories: (1) restricted and (2) custodial.

Restricted Investments

The Environmental Improvement and Restoration Fund (EIRF) is available for investment under the DOI and Related Agencies Appropriations Act, 1998. Congress has permanently appropriated 20% of the prior fiscal year interest earned by the EIRF to the Department of Commerce. The remaining 80% of interest earned remains in the fund and may be appropriated by Congress to certain other agencies, as provided by law. This investment was initially funded in FY 2000 by the settlement of the boundary dispute with the State of Alaska.

Custodial Investments

MMS is also required by regulation to invest the 1/5 OCS bid amounts from the apparent high bidders for all OCS lease sales. Should any of the apparent high bids later be rejected, the 1/5 bid and actual interest earned are returned to the bidder. The interest earned on accepted bids reverts to the Treasury when the bids are accepted.

F. Liabilities

MRM liabilities include custodial liabilities, deposit liabilities, and other accrued liabilities. Custodial liabilities represent amounts owed to royalty recipients (the public or Federal agencies) and offset custodial assets. Deposit liabilities include receipts for bonuses that are pending award or refund and non-Federal revenues collected on behalf of the states. Other Accrued Liabilities include payments due to the states for Federal revenues that will be funded from future revenues appropriated for this purpose.

Liabilities for which an appropriation has not been enacted are classified as liabilities not covered by budgetary resources.

G. Other Accrued Liabilities

MMS makes payments to states according to the Mineral Lands Leasing Act of 1920, 30 USC 191 as amended, the Federal Oil and Gas Royalty Management Act of 1982 (PL 97-451, 96 Stat. 2447, 30 USC 1701), and PL 99-272 from the 1986 OCS Lands Act amendments of 1985. The liabilities to states for accrued minerals revenue are shown as unfunded because budgetary resources, which are authorized by the Act as permanent indefinite appropriations, are based on actual collections (appropriated revenues). The accrued unfunded liabilities associated with expenses for the payments to the States are reported on the Consolidated Balance Sheet.

Note 2. Fund Balance with Treasury

A summary of the Fund Balance with Treasury by fund type is listed in the first table below. The general funds consist of the appropriated funds for the operation of MMS, such as salaries and expenses, and computer acquisition. The trust funds consist of oil spill liability funds. The revolving funds represent collections from Interior Franchise Fund customers and increased in fiscal year 2003 as a result of Interior transferring the Interior Franchise Fund to MMS on October 1, 2002. The special fund represents EIRF. Refer to Footnote 1.2A for information on the EIRF. The other funds are custodial funds and proceeds from the sale of vehicles. The custodial funds represent royalty collections received by MMS, they are held as custodial, until disbursed to recipients. The proceeds received from the sale of vehicles can be retained for two years to purchase new vehicles. The second table shows the same information by status instead of fund type.

Fund Balance with Treasury by Fund Type
As of September 30,
(dollars in thousands)

	2003	2002
General Funds	$91,275	$87,859
Trust Funds	5,961	6,260
Revolving Funds	1,161,913	-
Special Fund (EIRF)	1	1
Other Funds	449	-
Total Fund Balance with Treasury	**$1,259,599**	**$94,120**

The table below displays the status of Fund Balance with Treasury only. The Statement of Budgetary Resources includes Fund Balance with Treasury as well as additional obligated and unobligated balances of investments and allocation transfers. Thus, the obligated and unobligated balances in the Status of Fund Balance with Treasury table will not agree with the Statement of Budgetary Resources. The unobligated and obligated balances increased in fiscal year 2003 as a result of the Interior transferring the Interior Franchise Fund to MMS on October 1, 2002.

Status of Fund Balance by Fund Type
As of September 30,
(dollars in thousands)

	2003	2002
Unobligated Balance		
Available – Budget Authority	$730,542	$ 7,657
Unavailable	1,693	2,194
Obligated Balance not yet Disbursed	527,364	84,269
Total	**$1,259,599**	**$94,120**

Note 3. Investments, Net

Investments consist of non-marketable, market-based Treasury securities that are not traded on any securities exchange but mirror the prices of marketable securities with similar terms. MMS has limited investment authority based on two categories: restricted and custodial. The restricted (EIRF) investments are further discussed in Footnote 1.2A and the custodial investments are further discussed in Footnote 1.2E.

As of September 30, 2003
(dollars in thousands)

Description	Cost	Amortized (Premium)/ Discount	Investments, Net	Market Value Disclosure
Non-Marketable market-based Treasury Securities				
Restricted	$977,236	$285	$977,521	$977,595
Custodial	25,070	3	25,073	25,074
Total Treasury Securities	**$1,002,306**	**$288**	**$1,002,594**	**$1,002,669**

As of September 30, 2002
(dollars in thousands)

Description	Cost	Amortized (Premium)/ Discount	Investments, Net	Market Value Disclosure
Non-Marketable market-based Treasury Securities				
Restricted	$965,867	$1,406	$967,273	$967,758
Custodial	24,613	4	24,617	24,619
Total Treasury Securities	**$990,480**	**$1,410**	**$991,890**	**$992,377**

Note 4. Accounts and Interest Receivable, Net

Accounts receivable relating to general operations of the bureau consist primarily of amounts due to MMS from other agencies in connection with various interagency agreements, and refunds due from MMS vendors and/or employees. Interest receivables are included as part of the custodial receivables in the amount of $165 million and $152 million as of September 30, 2003 and 2002, respectively. Refer to Footnote 1.2C for information on custodial receivables from Federal agencies.

Accounts and Interest Receivable, Net
As of September 30,
(dollars in thousands)

	2003	2002
Accounts Receivable from Federal Agencies		
Billed - Current	$4	$11
Unbilled Accounts Receivable	218,354	476,953
Total Accounts Receivable - Federal	**$218,358**	**$476,964**
Allowance for Doubtful Accounts	(1,577)	-
Total Accounts Receivable – Federal Net of Allowance	**$216,781**	**$476,964**
Change in Allowance for Bad Debts – Federal		
Additions	$1,577	-
Allowance for Bad Debts - Federal	**$1,577**	**-**

	2003	2002
Accounts Receivable from the Public		
Current	$56,377	$160,927
1 – 180 Days Past Due	79,669	254
181 – 365 Days Past Due	60,225	2,979
Over 1 Year Past Due	239,216	310,880
Total Billed Accounts Receivable – Public	$435,487	475,040
Unbilled Accounts Receivable	882,145	971,802
Total Accounts Receivable – Public	$1,317,632	1,446,842
Allowance for Doubtful Accounts	(293,467)	(300,948)
Total Accounts Receivable – Public Net of Allowance	**$1,024,165**	**$1,145,894**
Change in Allowance for Bad Debts - Public		
Allowance for Doubtful Accounts, Beginning	$300,948	270,281
Additions	-	30,667
Deletions	(7,481)	-
Allowance for Bad Debts - Public	**$293,467**	**$300,948**

Note 5. Property and Equipment

MMS property and equipment categories, with corresponding accumulated depreciation, are shown in the table below. Depreciation expense amounted to approximately $4.7 million in fiscal year 2003 and $4.6 million in fiscal year 2002.

Property and Equipment
As of September 30, 2003
(dollars in thousands)

Description	Gross	Accumulated Depreciation	Net Book Value
Equipment and Vehicles	$17,368	($12,770)	$4,598
Internal Use Software, In Use	36,519	(4,757)	31,762
Total Property and Equipment	**$53,887**	**($17,527)**	**$36,360**

Property and Equipment
As of September 30, 2002
(dollars in thousands)

Description	Gross	Accumulated Depreciation	Net Book Value
Equipment and Vehicles	$20,643	($15,283)	$5,360
Internal Use Software in Service:			
In Use	23,067	(2,115)	20,952
In Development	6,995	-	6,995
Total Property and Equipment	**$50,705**	**($17,398)**	**$33,307**

Note 6. Assets Analysis

Assets of MMS include entity unrestricted, entity restricted and non-entity assets. Entity assets are those currently available for use by MMS. Restricted entity assets consist of the Environmental Improvement and Restoration Fund (EIRF). Restricted entity assets cannot be used until appropriated by Congress, except for twenty percent of the interest earned on the EIRF investments that are transferred once a year to the Department of the Commerce. Non-entity assets are currently held by MMS but will be forwarded to Treasury, other agencies, or states at a future date. These assets are not available for use by MMS.

Assets Analysis

Description	Entity Unrestricted	Entity Restricted	Total Entity	Non-Entity	2003
Intragovernmental Assets:					
Fund Balance with Treasury	$1,259,161	$1	$1,259,162	$437	$1,259,599
Investments, Net - Treasury Securities	-	977,521	977,521	25,073	1,002,594
Accounts and Interest Receivable, Net	21,842	-	21,842	194,939	216,781
Advances and Prepayments	5	-	5	-	5
Total Intragovermental Assets	**$1,281,008**	**$977,522**	**$2,258,530**	**$220,449**	**$2,478,979**
Accounts and Interest Receivable, Net	90	-	90	1,024,075	1,024,165
Property & Equipment, Net	36,360	-	36,360	-	36,360
Travel Advances & Prepayments	8	-	8	-	8
Total Public Assets	**$36,458**	**$-**	**$36,458**	**$1,024,075**	**$1,060,533**
Total Assets	**$1,317,466**	**$977,522**	**$2,294,988**	**$1,244,524**	**$3,539,512**

Assets Analysis

As of September 30, 2002
(dollars in thousands)

Description	Entity Unrestricted	Entity Restricted	Total Entity	Non-Entity	2002
Intragovernmental Assets:					
Fund Balance with Treasury	$94,119	$ 1	$94,120	$ -	$94,120
Investments, Net - Treasury Securities	-	967,273	967,273	24,617	991,890
Accounts and Interest Receivable, Net	97,085	-	97,085	379,879	476,964
Total Intragovermental Assets	**191,204**	**967,274**	**1,158,478**	**404,496**	**1,562,974**
Accounts and Interest Receivable, Net	26	-	26	1,145,868	1,145,894
Property & Equipment, Net	33,307	-	33,307	-	33,307
Travel Advances & Prepayments	29	-	29	-	29
Total Public Assets	**33,362**	**-**	**33,362**	**1,145,868**	**1,179,230**
Total Assets	**$224,566**	**$967,274**	**$1,191,840**	**$1,550,364**	**$2,742,204**

Note 7. Federal Employee Compensation Act Liability Due to the Public

MMS has recorded an estimated, unfunded actuarial liability for the expected future cost for death, disability, and medical claims under the Federal Employees Compensation Act (FECA) of approximately $9.4 million and $9.6 million as of September 30, 2003 and 2002, respectively. This estimated liability is calculated by the Department of Labor using a method that considers historical benefit payment patterns, wage inflation factors, medical inflation factors, and other variables. These actuarially computed projected annual benefit payments are discounted to present value using the Office of Management and Budget's economic assumptions for ten year Treasury notes and bonds.

The Department of Labor calculated the estimated future benefit payments based on several assumptions. The interest rate assumptions utilized to discount the estimated future benefit payments to present value are 3.84 percent in year one, and 4.35 percent in year two and thereafter. The wage inflation factors (Cost of Living Adjustments) and medical inflation factors (Consumer Price Index Medical Adjustments) used in the calculation are as follows:

FECA Wage Inflation Factors

	2003		2002	
Fiscal Year	Cost of Living Adjustment	Consumer Price Index Medical Adjustment	Cost of Living Adjustment	Consumer Price Index Medical Adjustment
1992	5.00%	7.96%	5.00%	7.96%
1993	2.83%	6.61%	2.83%	6.61%
1994	2.77%	5.27%	2.77%	5.27%
1995	2.57%	4.72%	2.57%	4.72%
1996	2.63%	3.99%	2.63%	3.99%
1997	2.77%	3.11%	2.77%	3.11%
1998	2.70%	2.77%	2.70%	2.77%
1999	1.53%	3.50%	1.53%	3.50%
2000	1.97%	3.70%	1.97%	3.70%
2001	2.93%	4.42%	2.93%	4.42%
2002	3.33%	4.44%	3.33%	4.44%
2003	1.80%	4.31%	1.80%	4.31%
2004	2.30%	3.21%	2.67%	4.01%
2005	2.00%	3.54%	2.40%	4.01%
2006	1.83%	3.64%	2.40%	4.01%
2007	1.97%	3.80%	2.40%	4.01%
2008 and thereafter	2.17%	3.92%	2.40%	4.01%

Note 8. Contingent Liabilities

The MMS is party to various administrative proceedings, legal actions, environmental suits, and claims that may eventually result in the payment of substantial monetary claims to third parties. MMS accrued $550 million as of September 30, 2003 and 2002 respectively, for claims, deemed probable of loss and where the amount of potential liability can be estimated. The potential liability claims deemed to be probable of loss have been estimated between $200 million and $1,200 million and $400 million and $2,000 million as of September 30, 2003 and 2002, respectively. It is management's opinion that any amounts due will be paid from the Department of the Justice Judgment Fund. Management believes that the ultimate resolution of other proceedings, actions and claims will not materially affect the financial position or net cost of operations of MMS.

Note 9. Leases

Capital Leases:

MMS has four capital leases with Oce USA, Inc., Xerox, and Cannon for copiers, which transfer ownership of the property to MMS at the end of the lease term. The gross cost and net book value of these leases is $121 thousand and $67 thousand as of September 30, 2003 and $76 thousand and $40 thousand as of September 30, 2002, respectively. The table below shows the future payments expected for these lease agreements.

Future Payments Due
As of September 30, 2003
(dollars in thousands)

Capital Leases:	
Fiscal Year	**Copiers**
2004	$34
2005	14
2006	11
2007	6
2008	3
Total Future Lease Payments	**68**
Less: Imputed Interest	(17)
Net Capital Lease Liability	**$51**
Lease Liability Covered by Budgetary Resources	**$51**

Operating Leases:

MMS has several General Services Administration (GSA) lease agreements for office space. The terms of the lease agreements vary according to whether the underlying assets are owned by GSA (or another Federal agency) or rented by GSA from the private sector. Future lease payments are subject to appropriations becoming available.

For GSA-owned property, MMS generally does not execute an agreement with GSA nor is there a formal lease expiration date. Although MMS may normally vacate these properties after giving 120 to 180 days notice of intent to vacate, in actuality, MMS normally occupies these properties for an extended period of time, with little variation from year to year.

In the table below, MMS discloses future lease commitments in years 2004 through 2008 for GSA-owned property and future lease commitments for privately owned property based on the lease terms. The future lease payments for all leases are based on 2003 actual expenses plus an escalation in accordance with GSA budget estimates, normally 3 percent but rangingup to 14 percent for selected locations for 2004, with an escalation of 3 percent per year for all periods after 2004.

MMS also has some small equipment leases for copiers that are not disclosed in the schedule below as the amounts are insignificant.

Future Payments Due
As of September 30, 2003
(dollars in thousands)

Operating Leases:	
Fiscal Year	**GSA Space Leases**
2004	$10,115
2005	7,778
2006	7,675
2007	7,743
2008	7,768
After 5 Years	13,840
Total Future Lease Payments	**$54,919**

Note 10. Liabilities

Liabilities shown below include all liabilities, both funded and unfunded, that are due to the public and other Federal entities. Funded liabilities are liabilities covered by budgetary resources; likewise, unfunded liabilities are liabilities not covered by budgetary resources.

LIABILITIES
As of September 30, 2003
(dollars in thousands)

	Covered by Budgetary Resources		Not Covered by Budgetary Resources		
	Current	**Non-Current**	**Current**	**Non-Current**	**2003**
Intragovernmental Liabilities:					
Accounts Payable	$4,739	$-	$-	$-	$4,739
Other:					
Custodial Liability	-	-	948,605	-	948,605
Advances and Deferred Revenue	872,973	-	-	-	872,973
Accrued Payroll and Benefits	630	-	573	1,301	2,504
Total Intragovernmental Liabilities	878,342	-	949,178	1,301	1,828,821
Public Liabilities:					
Accounts Payable	301,805	-	-	-	301,805
Federal Employees Compensation Act Liabilities	-	-	-	9,376	9,376
Other:					
Contingent Liabilities	-	-	550,000	-	550,000
Liabilities to States	-	-	234,416	-	234,416
Custodial Liability	-	-	35,992	-	35,992
Deferred Credits	216	-	25,522	-	25,738
Accrued Payroll and Benefits	3,395	-	-	10,396	13,791
Advances and Deferred Benefits	68	-	-	-	68
Capital Lease Liability	-	-	51	-	51
Total Public Liabilities	305,484	-	845,981	19,772	1,171,237
Total Liabilities	**$1,183,826**	**$-**	**$1,795,159**	**$21,073**	**$3,000,058**

LIABILITIES
As of September 30, 2002
(dollars in thousands)

	Covered by Budgetary Resources		Not Covered by Budgetary Resources		
	Current	Non-Current	Current	Non-Current	2002
Intragovernmental Liabilities:					
Accounts Payable	$4,077	$-	$-	$-	$4,077
Other:					
Custodial Liability	-	-	1,132,957	-	1,132,957
Advances and Deferred Revenue	1,245	-	-	-	1,245
Accrued Payroll and Benefits	1,391	-	654	1,421	3,466
Total Intragovernmental Liabilities	**6,713**	**-**	**1,133,611**	**1,421**	**1,141,745**
Public Liabilities:					
Accounts Payable	114,122	-	-	-	114,122
Federal Employees Compensation Act Liabilities	-	-	-	9,560	9,560
Other:					
Contingent Liabilities	-	-		550,000	550,000
Liabilities to States	-	-	374,919	-	374,919
Custodial Liability	-	-	17,870	-	17,870
Deferred Credits	216	-	24,629	-	24,845
Accrued Payroll and Benefits	7,449	-	-	10,643	18,092
Advances and Deferred Revenue	63	-	-	-	63
Capital Lease Liability	-	-	21	-	21
Total Public Liabilities	**121,850**	**-**	**417,439**	**570,203**	**1,109,492**
Total Liabilities	**$128,563**	**$-**	**$1,551,050**	**$571,624**	**$2,251,237**

Note 11. Net Cost by Responsibility Segment

Schedule of Net Cost by Program and Responsibility Segment
For the year ended September 30, 2003
(dollars in thousands)

	Offshore Minerals Management	Mineral Revenue Management	Interior Franchise Fund	Other	Elimination of Intra Bureau Activity	2003
Safety						
Cost – Services provided to the Public	$64,577	$-	$-	$-	$-	$64,577
Revenue Earned from the Public	26,168	-	-	-	-	26,168
Net Cost (Revenue) of Operations	38,409	-	-	-	-	38,409
Environment						
Cost – Services provided to the Public	59,876	-	-	-	-	59,876
Revenue Earned from the Public	24,860	-	-	-	-	24,860
Net Cost (Revenue) of Operations	35,016	-	-	-	-	35,016
Fair Market Value						
Cost – Services provided to the Public	32,949	-	-	-	-	32,949
Revenue Earned from the Public	14,191	-	-	-	-	14,191
Net Cost (Revenue) of Operations	18,758	-	-	-	-	18,758
Access to Money						
Cost – Services provided to the Public	-	859,713	-	-	-	859,713
Revenue Earned from the Public	-	21,655	-	-	-	21,655
Net Cost (Revenue) of Operations	-	838,058	-	-	-	838,058
Royalty Compliance						
Cost – Services provided to the Public	-	74,606	-	-	-	74,606
Revenue Earned from the Public	-	30,876	-	-	-	30,876
Net Cost (Revenue) of Operations	-	43,730	-	-	-	43,730
Interior Franchise Fund						
Cost – Services provided to Federal Agencies	-	-	1,901,591	-	(780,658)	1,120,933
Revenue Earned from Federal Agencies	-	-	1,919,103	-	(780,658)	1,138,445
Net Cost (Revenue) of Operations	-	-	(17,512)	-	-	(17,512)
Other						
Cost – Services provided to the Public	-	-	-	99	-	99
Revenue Earned from the Public	-	-	-	99	-	99
Net Cost of Services to the Public	-	-	-	-	-	-
Cost – Services provided to Federal Agencies	-	-	-	7,431	-	7,431
Revenue Earned from Federal Agencies	-	-	-	7,431	-	7,431
Net Cost of Services provided to Federal Agencies	-	-	-	-	-	-
Net Cost (Revenue) of Operations	-	-	-	-	-	-
Total						
Cost – Services provided to the Public	157,402	934,319	-	99	-	1,091,820
Revenue Earned from the Public	65,219	52,531	-	99	-	117,849
Net Cost of Services to the Public	92,183	881,788	-	-	-	973,971
Cost – Services provided to Federal Agencies	-	-	1,901,591	7,431	(780,658)	1,128,364
Revenue Earned from Federal Agencies	-	-	1,919,103	7,431	(780,658)	1,145,876
Net Cost of Services provided to Federal Agencies	-	-	(17,512)	-	-	(17,512)
Net Cost (Revenue) of Operations	$92,183	$881,788	(17,512)	-	-	$956,459

Note 11. Net Cost by Responsibility Segment (Continued)

Schedule of Net Cost by Program and Responsibility Segment
For the year ended September 30, 2002
(dollars in thousands)

	Offshore Minerals Management	Mineral Revenue Management	Interior Franchise Fund	Other	Elimination of Intra Bureau Activity	2002
Safety						
Cost – Services provided to the Public	$237,466	$-	$-	$-	$-	$237,466
Revenue Earned from the Public	26,973	-	-	-	-	26,973
Net Cost (Revenue) of Operations	210,493	-	-	-	-	210,493
Environment						
Cost – Services provided to the Public	224,321	-	-	-	-	224,321
Revenue Earned from the Public	25,624	-	-	-	-	25,624
Net Cost (Revenue) of Operations	198,697	-	-	-	-	198,697
Fair Market Value						
Cost – Services provided to the Public	127,002	-	-	-	-	127,002
Revenue Earned from the Public	14,627	-	-	-	-	14,627
Net Cost (Revenue) of Operations	112,375	-	-	-	-	112,375
Access to Money						
Cost – Services provided to the Public	-	952,272	-	-	-	952,272
Revenue Earned from the Public	-	16,035	-	-	-	16,035
Net Cost (Revenue) of Operations	-	936,237	-	-	-	936,237
Royalty Compliance						
Cost – Services provided to the Public	-	217,548	-	-	-	217,548
Revenue Earned from the Public	-	25,524	-	-	-	25,524
Net Cost (Revenue) of Operations	-	192,024	-	-	-	192,024
Interior Franchise Fund						
Cost – Services provided to Federal Agencies	-	-	403,159	-	(1,747)	401,412
Revenue Earned from Federal Agencies	-	-	403,159	-	(1,747)	401,412
Net Cost (Revenue) of Operations	-	-	-	-	-	-
Other						
Cost – Services provided to the Public	-	-	-	601	-	601
Revenue Earned from the Public	-	-	-	601	-	601
Net Cost of Services to the Public	-	-	-	-	-	-
Cost – Services provided to Federal Agencies	-	-	-	16,386	(73)	16,313
Revenue Earned from Federal Agencies	-	-	-	16,386	(73)	16,313
Net Cost of Services provided to Federal Agencies	-	-	-	-	-	-
Net Cost (Revenue) of Operations	-	-	-	-	-	-
Total						
Cost – Services provided to the Public	588,789	1,169,820	-	601	-	1,759,210
Revenue Earned from the Public	67,224	41,559	-	601	-	109,384
Net Cost of Services to the Public	521,565	1,128,261	-	-	-	1,649,826
Cost – Services provided to Federal Agencies	-	-	403,159	16,386	(1,820)	417,725
Revenue Earned from Federal Agencies	-	-	403,159	16,386	(1,820)	417,725
Net Cost of Services provided to Federal Agencies	-	-	-	-	-	-
Net Cost (Revenue) of Operations	$521,565	$1,128,261	$-	$-	$-	$1,649,826

During fiscal year 2002, MMS allocated the imputed judgment fund and contingent costs, totaling $550 million, across all Government Performance and Results Act (GPRA) segments excluding Interior Franchise Fund and Other. MMS did not incur similar costs in fiscal year 2003. These costs have been allocated across MMS's GPRA segments for fiscal year 2002 as follows:

GPRA Segment	Allocated %
Safety	26.0%
Environment	24.7%
Fair Market Value	14.1%
Access to Money	13.0%
Royalty Compliance	22.2%

Note 12. Earned Revenue

The Sales of Goods and Services in the table below represent reimbursable revenues from customers recognized for services provided. Other revenues represent MRM federal revenues distributed to MMS for operational purposes.

Description	2003	2002
Sales of Goods and Services:		
To the Public	$99	$ 601
To Other Federal Agencies – IFF	1,138,445	401,412
To Other Federal Agencies - Other	7,431	16,313
Other Revenues:		
Other Revenues from the Public	724	1,238
As appropriated by Congress	117,026	107,545
Total Earned Revenue	**$1,263,725**	**$527,109**

Note 13. MRM Exchange Revenues

The royalty exchange revenues distributed to Federal agencies are reported by the receiving entity on the Statement of Changes in Net Position as an exchange revenue in accordance with the federal accounting standards. In fiscal year 2003 and 2002, MMS received $813 million and $824 million of revenues, respectively, of permanent indefinite appropriations that MMS subsequently provided to the states.

Note 14. Strategic Petroleum Reserve

During FY 2003 and FY 2002, MMS transferred to the Department of Energy (DOE) approximately 38.2 million and 11.2 million barrels of oil, respectively, drawn from Federal leases within the Gulf of Mexico. The purpose of these transfers was to refill selected Strategic Petroleum Reserve (SPR) locations in accordance with no-cost transfer arrangement of Royalty-in-Kind crude oil to DOE. The transferred oil is reflected as mineral lease revenue and a distribution of revenue on the Statement of Custodial Activity.

The value of the oil transferred in FY 2003 and FY 2002 was $1,044 million and $263 million, respectively. The value of the oil is based on actual volumes reported on pipeline statements applied to commodity prices at on-shore market centers less actual monthly value differences between offshore and onshore market centers that were bid by the successful bidders on the RIK volumes. The volume of oil transferred in September is estimated based on nominations from the suppliers as the actuals were not available. In addition, the value of the September oil is estimated based on August pricing.

Note 15. Custodial Distributions to MMS

MRM distributes custodial funds to MMS, which includes payments to States, RIK transportation costs, and revenues to fund operations. The amount distributed as Revenues to Fund Operations is legislated by Congress as part of MMS' annual appropriation.

Fiscal Years 2003 and 2002

(dollars in thousands)

Distribution to MMS	2003	2002
Payments to States	$953,268	$687,234
RIK and SPR Transportation	17,250	5,250
Revenues to Fund Operations	99,776	102,295
Total Distribution	**$1,070,294**	**$794,779**

Note 16. Apportionment Categories of Obligations Incurred

The amounts of direct and reimbursable obligations incurred at MMS, are apportioned under Category B. The obligation amounts match the Statement of Budgetary Resources, but do not match MMS's FACTSII Report (SF-133) in FY 2002 by $1 million. This difference is attributable to the fact that MMS reports a portion of 14X5003 on FACTSII (SF-133) for Bureau of Land Management (BLM). BLM reports their portion of 14X5003 on their Statement of Budgetary Resources.

The following table reflects direct and reimbursable obligations.

Fiscal Years 2003 and 2002
(dollars in thousands)

Description	2003	2002
Direct Obligations	$1,124,291	$846,578
Reimbursable Obligations	2,015,239	629,641
Total Obligations	**$3,139,530**	**$1,476,219**

Note 17. Permanent Indefinite Appropriations

MMS has three permanent, indefinite appropriations that relate to the State Program:

1. The Mineral Leasing Act (MLA), 30 U.S.C. 181 et seq., provides that all States be paid 50 percent of the revenues resulting from the leasing of mineral resources on Federal public domain lands within their borders (except Alaska which receives 90%).

2. Forest Fund payments to a state are determined by the total revenues collected from mineral leasing and production within its boundaries except for the Forest Fund payments. Law requires a state's payment be based on national forest acreage and where a national forest is situated in several states, an individual state's payment is proportionate to its area within that particular national forest.

3. Flood control payments to states are shared according to the Flood Control Act of 1936 (22U.S.C.701 et seq.) which provides that 75 percent of revenue collected be shared with the state in which it was collected. These funds are to be expended as the state legislature may prescribe for the benefit of the public schools and roads in the county which the revenue was collected or for defraying of the expenses of county government. These types of expenses include public obligations of levee and drainage districts for flood control and draining improvements.

Note 18. Differences Between the Statement of Budgetary Resources and the Budget of the United States Government

The differences between the FY 2002 Statement of Budgetary Resources (SBR), the SF-133, and Budget of the United States Government are greatly attributed to the unique reporting requirements for each report. The differences are summarized as follows:

a. Appropriation 14X5003 is a shared appropriation between MMS and Bureau of Land Management (BLM). For reporting purposes, MMS reports the BLM annual amount for appropriation 14X5003 on the MMS SF-133 and Budget of the United States Government, but does not report the BLM amount on the MMS SBR. However, it is reported on BLM's SBR. In FY 2002, the BLM amount that was included in the MMS SF-133 and Budget of the US Government was approximately $1 million. This difference occurs in the following lines, new obligations, budgetary resources available for obligation, appropriations, and outlays.

b. Unobligated balances, start of year and end of year, reflect a difference between the SBR, SF-133 and the Budget of the United States Government because the SBR and SF-133 include expired appropriations but the Budget of the United States Government does not.

c. For the resources available from recoveries of prior year obligations, the Budget of the United States Government does not include the Oil Spill Trust fund and annual year appropriations, where as the SBR and SF-133 do include them.

d. The budgetary resources available for obligation contains a difference due to the fact that the SBR, SF-133 include appropriations 14X5003, 14X5243 and 14X5248, yet in the Budget of the United States Government the net of budgetary resources available for these funds is 0.

e. The total outlays lines and the offsets, non-federal sources have a difference between the SBR, SF-133 and the Budget of the United States Government due to the deletion of line 7400 in the final MAX report.

f. The differences in the following categories, budgetary resources available for obligation, unobligated balance end of year, uncollected customer payments from federal sources, and obligated balance end of year, within appropriations 14X4529 (IFF) are due to adjustments made in the SBR and SF-133, but not in the Budget for the United States Government.

g. Additionally, small differences have resulted between the SBR, SF-133 and the Budget of the United States Government from rounding. The SBR is presented in "thousands of dollars", the Budget of the US Government is presented in "millions of dollars", and the SF-133 is not rounded.

Since the Budget of the United States Government for FY 2004 will not be available until after January 1, 2004, any differences between the Statement of Budgetary Resources and the Budget of the United States Government for FY 2003 cannot be identified.

Note 19. Transfer in of Interior Franchise Fund Operations

As a result of the significant growth of the Interior Franchise Fund and increase in operating costs, the Department of the Interior management determined that it could improve the efficiency of the Interior Franchise Fund by transferring the Interior Franchise Fund to MMS. Effective October 1, 2002, Interior's Departmental Offices transferred the Interior Franchise Fund to MMS. MMS will provide the products and services for the existing customer agreements and future customer agreements related to Government Works and U.S. Films and Video Productions.

MMS received and has reflected the transfer in of the Interior Franchise Fund operations. These transfers are shown on the fiscal year 2003 Statement of Changes in Net Position and Statement of Budgetary Resources. The following table reflects amounts MMS received from Departmental Offices.

Description	Amounts (dollars in thousands)
Assets	$468,870
Liabilities	467,460
Net Position	1,410
Unobligated Budgetary Resources	378,443
Obligated Budgetary Resources	48,799

Note 20. Dedicated Collections

The Environmental Improvement Restoration Fund (EIRF) was initially funded with a distribution of half the Alaska Escrow Fund. MMS invests the EIRF in Treasury securities. The purpose of EIRF is to invest money and earn interest until there is further Congressional action. Congress has permanently appropriated and MRM transfers 20% of the prior fiscal year interest earned by the EIRF to the Department of Commerce each year for their marine research activities. The amounts transferred to the Department of Commerce were $3 million and $5 million in FY 2003 and FY 2002, respectively. The remaining 80% will remain in the fund to earn interest and may be appropriated by Congress to certain other agencies, as provided by law. No assets of the fund are available to the Department of the Interior unless appropriated by Congress.

(dollars in thousands)	2003	2002
ASSETS		
Fund Balance with Treasury	$1	$1
Investments	977,521	967,273
TOTAL ASSETS	$977,522	$967,274
Total Net Position	$977,522	$967,274
TOTAL LIABILITIES AND NET POSITION	$977,522	$967,274
CHANGE IN NET POSITION		
Net Position, Beginning of Fiscal Year	$967,274	$948,850
Change in Net Position:		
Investment Interest and Other	10,248	18,424
Net Position, End of Fiscal Year	$977,522	$967,274

Note 21. Explanation of the Relationship Between Liabilities Not Covered by Budgetary Resources on the Balance Sheet and the Change in Components Requiring or Generating Resources in Future Periods

Increases and decreases in unfunded liabilities that are not covered by budgetary resources, excluding custodial liabilities, liabilities to states, and deferred credits, (see Note 10) are displayed in this section of the statement.

Liability	2003	2002	Decrease (dollars in thousands)
Annual Leave Liability	$10,396	$10,643	($247)
Unfunded Liabilities and Other	561,301	561,656	(355)
Total	**$571,697**	**$572,299**	**($602)**

Liability	2002	2001	Increase (dollars in thousands)
Annual Leave Liability	$10,643	$10,526	$117
Unfunded Liabilities and Other	561,656	9,262	552,394
Total	**$572,299**	**$19,788**	**$552,511**

A sea anemone waits patiently for a passing fish to have for dinner.

Required Supplementary Information

(Unaudited, see accompanying auditors' report)

Department of the Interior
Minerals Management Service
Combining Statement of Budgetary Resources
For the year ended September 30, 2003
(dollars in thousands)

	Royalty and Offshore Mineral Management	Mineral Leasing	Oil Spill Research	Interior Franchise Fund	Other	2003
Budgetary Resources:						
Budget Authority:						
Appropriations Received	$ 165,321	$ 947,006	$ 6,105	$ -	$ 6,262	**$ 1,124,694**
Unobligated Balance:						
Beginning of Period	9,816	-	9	13	-	**9,838**
Transfer In of the Interior Franchise Fund Operations, Beginning of Period	-	-	-	378,443	-	**378,443**
Spending Authority From Offsetting Collections:						
Earned						
Collected	125,170	-	178	2,037,822	-	**2,163,170**
Receivable from Federal Sources	(319)	-	(19)	(118,682)	-	**(119,020)**
Change in Unfilled Customer Orders						
Advance Received	(575)	-	(30)	499,680	-	**499,075**
Without Advance from Federal Sources	(3,139)	-	71	(186,789)	-	**(189,857)**
Recoveries of Prior Year Obligations	7,124	-	6	-	-	**7,130**
Permanently not Available	(2,118)	-	(40)	-	-	**(2,158)**
Total Budgetary Resources	$ 301,280	$ 947,006	$ 6,280	$ 2,610,487	$ 6,262	**$ 3,871,315**
Status of Budgetary Resources:						
Obligations Incurred:						
Direct (Category B)	$ 165,065	$ 947,006	$ 5,958	$ -	$ 6,262	**$ 1,124,291**
Reimbursable (Category B)	125,096	-	200	1,889,943	-	**2,015,239**
Total Obligations Incurred	290,161	947,006	6,158	1,889,943	6,262	**3,139,530**
Unobligated Balance:						
Apportioned	9,876	-	122	720,544	-	**730,542**
Unobligated Balance not Available	1,243	-	-	-	-	**1,243**
Total Status of Budgetary Resources	$ 301,280	$ 947,006	$ 6,280	$ 2,610,487	$ 6,262	**$ 3,871,315**
Relationship of Obligations to Outlays:						
Obligations Incurred	$ 290,161	$ 947,006	$ 6,158	$ 1,889,943	$ 6,262	**$ 3,139,530**
Obligated Balance, Net, Beginning of Period	77,844	-	6,251	175	-	**84,270**
Transfer In of the IFF Operations, Obligated Balance, Net Beginning of Period	-	-	-	48,799	-	**48,799**
Obligated Balance, Net, End of Period:						
Accounts Receivable	222	-	11	23,420	-	**23,653**
Unfilled Customer Orders from Federal Sources	1,215	-	71	243,308	-	**244,594**
Undelivered Orders	(63,385)	-	(5,065)	(416,358)	-	**(484,808)**
Accounts Payable	(17,570)	-	(855)	(292,378)	-	**(310,803)**
Less: Spending Authority Adjustments	(3,666)	-	(58)	305,471	-	**301,747**
Outlays						
Disbursements	284,821	947,006	6,513	1,802,380	6,262	**3,046,982**
Collections	(124,595)	-	(148)	(2,537,502)	-	**(2,662,245)**
Net Outlays before Offsetting Receipts	160,226	947,006	6,365	(735,122)	6,262	**384,737**
Less: Offsetting Receipts	-	(947,006)	-	-	(244,013)	**(1,191,019)**
Net Outlays	$ 160,226	$ -	$ 6,365	$ (735,122)	$ (237,751)	**$ (806,282)**

Department of the Interior
Minerals Management Service
Combining Statement of Budgetary Resources
For the year ended September 30, 2002
(dollars in thousands)

	Royalty and Offshore Mineral Management	Mineral Leasing	Oil Spill Research	Interior Franchise Fund	Other	2002
Budgetary Resources:						
Budget Authority:						
Appropriations Received	$ 150,668	$ 683,510	$ 6,105	$ -	$ 3,723	**$ 844,006**
Unobligated Balance:						
Beginning of Period	13,385	-	1,083	57	-	**14,525**
Spending Authority From Offsetting Collections:						
Earned						
Collected	125,254	-	519	340,969	-	**466,742**
Receivable from Federal Sources	(415)	-	30	62,283	-	**61,898**
Change in Unfilled Customer Orders						
Advance Received	(732)	-	(53)	65	-	**(720)**
Without Advance from Federal Sources	13	-	(17)	89,267	-	**89,263**
Recoveries of Prior Year Obligations	4,707	-	23	5,856	-	**10,586**
Permanently not Available	(243)	-	-	-	-	**(243)**
Total Budgetary Resources	$ 292,637	$ 683,510	$ 7,690	$ 498,497	$ 3,723	**$ 1,486,057**
Status of Budgetary Resources:						
Obligations Incurred:						
Direct (Category B)	$ 152,159	$ 683,510	$ 7,186	$ -	$ 3,723	**$ 846,578**
Reimbursable (Category B)	130,662	-	495	498,484	-	**629,641**
Total Obligations Incurred	282,821	683,510	7,681	498,484	3,723	**1,476,219**
Unobligated Balance:						
Apportioned	7,635	-	9	13	-	**7,657**
Unobligated Balance not Available	2,181	-	-	-	-	**2,181**
Total Status of Budgetary Resources	$ 292,637	$ 683,510	$ 7,690	$ 498,497	$ 3,723	**$ 1,486,057**
Relationship of Obligations to Outlays:						
Obligations Incurred	$ 282,821	$ 683,510	$ 7,681	$ 498,484	$ 3,723	**$ 1,476,219**
Obligated Balance, Net, Beginning of Period	69,941	-	4,109	(674)	-	**73,376**
Obligated Balance, Net, End of Period:						
Accounts Receivable	541	-	30	96,504	-	**97,075**
Unfilled Customer Orders from Federal Sources	4,355	-	-	205,092	-	**209,447**
Undelivered Orders	(53,586)	-	(4,956)	(205,222)	-	**(263,764)**
Accounts Payable	(29,155)	-	(1,325)	(96,548)	-	**(127,028)**
Less: Spending Authority Adjustments	(4,305)	-	(36)	(157,406)	-	**(161,747)**
Outlays						
Disbursements	270,612	683,510	5,503	340,230	3,723	**1,303,578**
Collections	(124,521)	-	(465)	(341,035)	-	**(466,021)**
Net Outlays before Offsetting Receipts	146,091	683,510	5,038	(805)	3,723	**837,557**
Less: Offsetting Receipts	-	(683,510)	-	-	(184,136)	**(867,646)**
Net Outlays	$ 146,091	$ -	$ 5,038	$ (805)	$ (180,413)	**$ (30,089)**

Interior Franchise Fund:

The Interior Franchise Fund (IFF) comprises two business entities – GovWorks and US Films. GovWorks (MMS Herndon, VA) provides full life cycle procurement services to DoD and the Civilian Agencies through a staff of Federal contracting officers and support staff. DoD and the military service branches account for $792.6 million (57.9%) while the Civilian Agencies represent $576.2 million (42.1%). The client base includes the Executive Office of the President totaling $298.8 million (22%), Department of Defense at $320.5 million (23%), and the US Army at $235.4 million (17%).

US Films (MMS Denver, CO) offers video production, copywriting, creative development, and production management. Still photos, digital video, and graphics coupled with occasional editing and audio engineering complete the product offering. US Films also bundles video production and printing through a government owned contractor operation, producing integrated training packages for a broad range of clients – but primarily Civilian agencies. Total revenue for FY 2003 was $1,472 thousand. Major clients for FY 2003 include the FDA at $350 thousand (18%), TSA at $100 thousand, and DOI's Office of Law Enforcement at $75 thousand.

Interior Franchise Fund	**2003** (dollars in thousands)
Fund Balance with Treasury	$1,162,551
Accounts and Interest Receivable, Net	21,849
Total Assets	$1,184,400
Accounts Payable	292,065
Accrued Payroll and Benefits	316
Advances and Deferred Revenue	872,480
Net Position	19,539
Total Liabilities and Net Position	$1,184,400

Summary of Interior Franchise Fund Business Lines
For the year ending September 30, 2003

	Full Cost of Goods and Services Provided	**Related Exchange Revenue**	**Excess of Exchange Revenues Over Full Cost**
U.S. Films and Video Productions	$1,472	($1,472)	$-
GovWorks Acquisition Services	1,119,461	(1,136,973)	(17,512)
Total	$1,120,933	($1,138,445)	($17,512)

A star fish extends an invitation for dinner to an unsuspecting clam.

Required Supplementary Stewardship Information

(Unaudited, see accompanying auditors' report)

Museum Collections:

The Mineral Management Service maintains a collection of 54 objects in its administrative offices at five bureau locations (table below). There are no accessions or deaccessions during the year. The current museum collection consists of 4 Art, 3 Ethnography, 5 History, 12 Documents, and 30 Geology items. The collection is fully documented and is in good condition.

FY 2003 Status of Cataloging and Condition of Cataloged Museum Collections								
Estimated Total Collection Size FY 2002	Additions Since Last Report	Withdrawals Since Last Report	Estimated Total Collection Size FY 2003	Total Number of Museum Items Cataloged	Number of Catalogued Items with Item-Level Condition Data	Number of Catalogued Items in Good, Fair, & Poor Condition		
						Good	Fair	Poor
54	-	-	54	54	54	X		

MMS Identification and Cataloging of Collection					
	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003
Total Museum Collection Size (estimates)	54	54	54	54	54
Number of items cataloged	54	54	54	54	54

Investment in Research and Development:

Environmental studies and operational requirements for the leasing and development of natural gas and oil are mandated by the OCS Lands Act (OCSLA). Research in support of these mandates has been pursued to allow prediction of potential impacts, aid in development of mitigating measures, and to ensure safe, pollution-free operations. In addition to research as required by the OCSLA, the Oil Pollution Act (OPA) of 1990 sets down specific areas of research for agencies, including MMS. The goal of this Act is to improve not only the technologies for preventing oil pollution, but also the response to accidental spills. Inherent in this effort is improvement of our understanding of the fate, transport, and effects of oil when spilled. The MMS research program, which implements the OCSLA and OPA requirements, is pursued with universities, private companies, and Government laboratories, US and foreign.

Investment in Research and Development (in millions)					
	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003
	MMS/OMM	MMS/OMM	MMS/OMM	MMS/OMM	MMS/OMM
Applied	$30.1	$30.7	$31.0	$28.5	$29.4
Total R&D Investment	$30.1	$30.7	$31.0	$28.5	$29.4

California elephant seals exchange terms of endearment.

Other Supplementary Information

(See accompanying auditors' report)

Department of the Interior
Minerals Management Service
Consolidating Balance Sheet
As of September 30, 2003
(dollars in thousands)

	Minerals Revenue Management	Offshore Minerals Management	Interior Franchise Fund	Custodial	Environmental	Other	Elimination of Intra Bureau Activity	2003
ASSETS								
Intragovernmental Assets:								
Administrative Fund Balance	$ 36,478	$ 59,537	$ 1,162,551	$ -	$ -	$ 595	$ -	**$ 1,259,161**
Custodial Fund Balance	-	-	-	437	-	-	-	**437**
Restricted Fund Balance	-	-	-	-	1	-	-	**1**
Fund Balance with Treasury	36,478	59,537	1,162,551	437	1	595	-	**1,259,599**
Restricted Treasury Securities	-	-	-	-	977,521	-	-	**977,521**
Custodial Treasury Securities	-	-	-	25,073	-	-	-	**25,073**
Investments, Net	-	-	-	25,073	977,521	-	-	**1,002,594**
Custodial Accounts Receivable from Treasury	-	-	-	194,939	-	-	-	**194,939**
Administrative Accounts Receivable	-	-	21,846	-	-	234	(238)	**21,842**
Accounts Receivable, Net	-	-	21,846	194,939	-	234	(238)	**216,781**
Other:								
Advances and Prepayments	2	3	-	-	-	-	-	**5**
Total Intragovernmental Assets	36,480	59,540	1,184,397	220,449	977,522	829	(238)	**2,478,979**
Custodial Accounts Receivable	-	-	-	789,658	-	-	-	**789,658**
Administrative Accounts Receivable	234,453	51	3	-	-	-	-	**234,507**
Accounts Receivable, Net	234,453	51	3	789,658	-	-	-	**1,024,165**
Property & Equipment, Net of Accumulated Depreciation	33,381	2,979	-	-	-	-	-	**36,360**
Other:								
Travel Advances	3	5	-	-	-	-	-	**8**
Total Public Assets	267,837	3,035	3	789,658	-	-	-	**1,060,533**
TOTAL ASSETS	$ 304,317	$ 62,575	$ 1,184,400	$ 1,010,107	$ 977,522	$ 829	$ (238)	**$ 3,539,512**

Department of the Interior
Minerals Management Service
Consolidating Balance Sheet
As of September 30, 2003
(dollars in thousands)

	Minerals Revenue Management	Offshore Minerals Management	Interior Franchise Fund	Custodial	Environmental	Other	Elimination of Intra Bureau Activity	2003
LIABILITIES								
Intragovernmental Liabilities:								
Administrative Accounts Payable	$ 858	$ 1,536	$ 2,581	$ -	$ -	$ 2	$ (238)	**$ 4,739**
Other:								
Custodial Liability	-	-	-	948,605	-	-	-	**948,605**
Advances and Deferred Revenue	-	-	872,480	-	-	493	-	**872,973**
Accrued Payroll and Benefits	911	1,556	31		-	6	-	**2,504**
Total Intragovernmental Liabilities	1,769	3,092	875,092	948,605	-	501	(238)	**1,828,821**
Public Liabilities:								
Administrative Accounts Payable	5,777	6,319	289,484	-	-	225	-	**301,805**
Federal Employess Compensation Act Liability	3,300	6,076	-	-	-	-	-	**9,376**
Accounts Payable	9,077	12,395	289,484	-	-	225	-	**311,181**
Other:								
Contingent Liabilities	193,600	356,400	-	-	-	-	-	**550,000**
Liabilities to States	234,416	-	-	-	-	-	-	**234,416**
Custodial Liability				35,992				**35,992**
Deferred Credits	4	224	-	25,510	-	-	-	**25,738**
Accrued Payroll and Benefits	4,963	8,508	285	-	-	35	-	**13,791**
Advances and Deferred Revenue	-	-	-	-	-	68	-	**68**
Captial Lease Liability	18	33	-	-	-	-	-	**51**
Total Public Liabilities	442,078	377,560	289,769	61,502	-	328	-	**1,171,237**
TOTAL LIABILITIES	443,847	380,652	1,164,861	1,010,107	-	829	(238)	**3,000,058**
Commitments and Contingencies								
Net Position								
Unexpended Appropriations	3,142	3,827	-	-	-	-	-	**6,969**
Cumulative Results of Operations:								
Administrative Cumulative Results of Operations	(142,672)	(321,904)	19,539	-	-	-	-	**(455,037)**
EIRF Cumulative Results of Operations	-	-	-	-	977,522	-	-	**977,522**
Total Cumulative Results of Operations	(142,672)	(321,904)	19,539	-	977,522	-	-	**532,485**
Total Net Position	(139,530)	(318,077)	19,539	-	977,522	-	-	**539,454**
TOTAL LIABILITIES AND NET POSITION	$ 304,317	$ 62,575	$ 1,184,400	$ 1,010,107	$ 977,522	$ 829	$ (238)	**$ 3,539,512**

Department of the Interior
Minerals Management Service
Consolidating Balance Sheet
As of September 30, 2002
(dollars in thousands)

	Minerals Revenue Management	Offshore Minerals Management	Interior Franchise Fund	Custodial	Environmental	Other	2002
ASSETS							
Intragovernmental Assets:							
Administrative Fund Balance	$ 34,058	$ 58,305	$ 187	$ -	$ -	$ 1,569	**$ 94,119**
Restricted Fund Balance	-	-	-	-	1	-	**1**
Fund Balance with Treasury	34,058	58,305	187	-	1	1,569	**94,120**
Restricted Treasury Securities	-	-	-	-	967,273	-	**967,273**
Custodial Treasury Securities	-	-	-	24,617	-	-	**24,617**
Investments, Net	-	-	-	24,617	967,273	-	**991,890**
Custodial Accounts Receivable from Treasury	-	-	-	379,879	-	-	**379,879**
Administrative Accounts Receivable	-	-	96,514	-	-	571	**97,085**
Accounts Receivable, Net	-	-	96,514	379,879	-	571	**476,964**
Total Intragovernmental Assets	34,058	58,305	96,701	404,496	967,274	2,140	**1,562,974**
Custodial Accounts Receivable	-	-	-	770,949	-	-	**770,949**
Administrative Accounts Receivable	374,928	16	1	-	-	-	**374,945**
Accounts Receivable, Net	374,928	16	1	770,949	-	-	**1,145,894**
Property & Equipment, Net of Accumulated Depreciation	29,834	3,473	-	-	-	-	**33,307**
Other:							
Travel Advances	11	18	-	-	-	-	**29**
Total Public Assets	404,773	3,507	1	770,949	-	-	**1,179,230**
TOTAL ASSETS	$ 438,831	$ 61,812	$ 96,702	$ 1,175,445	$ 967,274	$ 2,140	**$ 2,742,204**

Department of the Interior
Minerals Management Service
Consolidating Balance Sheet
As of September 30, 2002
(dollars in thousands)

	Minerals Revenue Management	Offshore Minerals Management	Interior Franchise Fund	Custodial	Environmental	Other	2002
LIABILITIES							
Intragovernmental Liabilities:							
Administrative Accounts Payable	$ 1,268	$ 2,192	$ 612	$ -	$ -	$ 5	**$ 4,077**
Other:							
Custodial Liability	-	-	-	1,132,957	-	-	**1,132,957**
Accrued Payroll and Benefits	1,300	2,135	30	-	-	1	**3,466**
Advances and Deferred Revenue	-	-	143	-	-	1,102	**1,245**
Total Intragovernmental Liabilities	2,568	4,327	785	1,132,957	-	1,108	**1,141,745**
Public Liabilities:							
Administrative Accounts Payable	7,058	10,429	95,667	-	-	968	**114,122**
Federal Employees Compensation Act Liability	3,365	6,195	-	-	-	-	**9,560**
Accounts Payable	10,423	16,624	95,667	-	-	968	**123,682**
Other:							
Contingent Liabilities	193,600	356,400	-	-	-	-	**550,000**
Liabilities to States	374,919	-	-	-	-	-	**374,919**
Custodial Liability	-	-	-	17,870	-	-	**17,870**
Deferred Credits	4	223	-	24,618	-	-	**24,845**
Accrued Payroll and Benefits	6,762	11,079	250	-	-	1	**18,092**
Advances and Deferred Revenue	-	-	-	-	-	63	**63**
Capital Lease Liability	7	14	-	-	-	-	**21**
Total Public Liabilities	585,715	384,340	95,917	42,488	-	1,032	**1,109,492**
TOTAL LIABILITIES	588,283	388,667	96,702	1,175,445	-	2,140	**2,251,237**
Commitments and Contingencies							
Net Position							
Unexpended Appropriations	2,758	3,558	-	-	-	-	**6,316**
Cumulative Results of Operations:							
Administrative Cumulative Results of Operations	(152,210)	(330,413)	-	-	-	-	**(482,623)**
EIRF Cumulative Results of Operations	-	-	-	-	967,274	-	**967,274**
Total Cumulative Results of Operations	(152,210)	(330,413)	-	-	967,274	-	**484,651**
Total Net Position	(149,452)	(326,855)	-	-	967,274	-	**490,967**
TOTAL LIABILITIES AND NET POSITION	$ 438,831	$ 61,812	$ 96,702	$ 1,175,445	$ 967,274	$ 2,140	**$ 2,742,204**

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Independent Auditors' Report

United States Department of the Interior
Office of Inspector General
Washington, D.C. 20240

December 9, 2003

Memorandum

To: Director, Minerals Management Service

From: Roger La Rouche
Assistant Inspector General for Audits

Subject: Independent Auditors' Report on the Minerals Management Service's Financial Statements for Fiscal Years 2003 and 2002 (Report No. E-IN-MMS-0066-2003)

We contracted with KPMG LLP, an independent certified public accounting firm, to audit the Minerals Management Service's (MMS) financial statements as of September 30, 2003, and for the year then ended. The contract required that KPMG conduct its audit in accordance with the *Government Auditing Standards* issued by the Comptroller General of the United States of America, Office of Management and Budget Bulletin 01-02, *Audit Requirements for Federal Financial Statements*, and the General Accounting Office/President's Council on Integrity and Efficiency, *Financial Audit Manual.*

In the attached draft report, KPMG issued an unqualified opinion on MMS's financial statements. KPMG identified four reportable conditions related to internal controls and financial operations: (A) application and general controls over financial management systems, (B) transactions and balances with trading partners, (C) accounts receivable, and (D) customer orders. KPMG does not consider any of the reportable conditions to be material weaknesses. With regard to compliance with laws and regulations, KPMG found MMS to be noncompliant with portions of the Federal Financial Management Improvement Act of 1996 (FFMIA). Specifically, KPMG reported that MMS's financial management systems did not substantially comply with the federal financial management systems requirements and the United States Standard General Ledger at the transaction level.

KPMG is responsible for the auditors' report and for the conclusions expressed in the report. We do not express an opinion on the Minerals Management Service's financial statements, conclusions about the effectiveness of internal controls, conclusions on whether the Minerals Management Service's financial management systems substantially complied with FFMIA, or conclusions on compliance with laws and regulations.

In the November 25, 2003 response (Attachment 2), MMS concurred with the report's findings and recommendations and indicated corrective actions would be taken. Based on MMS's response, we consider all the recommendations resolved but not implemented. The recommendations will be referred to the Assistant Secretary for Policy, Management and Budget for tracking of implementation.

The legislation, as amended, creating the Office of Inspector General, (5 U.S.C.A. App. 3) requires semiannual reporting to Congress on all audit reports issued, actions taken to implement audit recommendations, and recommendations that have not been implemented. Therefore, this report will be included in our next semiannual report.

We appreciate the cooperation and assistance of MMS personnel during the audit. If you have any questions, please contact me at (202) 208-5512.

Attachments (2)

2001 M Street NW
Washington, DC 20036

Independent Auditors' Report

Director of the Minerals Management Service and Inspector General
U.S. Department of the Interior:

We have audited the accompanying consolidated balance sheets of the Minerals Management Service (MMS) as of September 30, 2003 and 2002, and the related consolidated statements of net costs, consolidated statements of changes in net position, combined statements of budgetary resources, consolidated statements of financing, and statements of custodial activity for the years then ended (herein after referred to as 'financial statements'). The objective of our audits was to express an opinion on the fair presentation of these financial statements. In connection with our audits, we also considered MMS's internal control over financial reporting and tested MMS's compliance with certain provisions of applicable laws and regulations that could have a direct and material effect on its financial statements.

SUMMARY

As stated in our opinion on the financial statements, we concluded that MMS's financial statements as of and for the years ended September 30, 2003 and 2002 are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America.

MMS prepared the accompanying financial statements assuming that the Interior Franchise Fund will continue as a going concern. As discussed in Note 1 to the financial statements, the expiration of the Interior Franchise Fund's authorizing legislation on October 1, 2004 creates an uncertainty about the Interior Franchise Fund's ability to continue as a going concern. Management's plans in regard to this matter are also described in Note 1. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Our consideration of internal control over financial reporting identified the following reportable conditions.

A. Application and General Controls over Financial Management Systems

B. Transactions and Balances with Trading Partners

C. Accounts Receivable

D. Customer Orders

However, we do not consider these reportable conditions to be material weaknesses.

The results of our tests of compliance with certain provisions of laws and regulations disclosed the following instances of noncompliance that are required to be reported herein under *Government Auditing Standards,* issued by the Comptroller General of the United States, or Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements:*

E. *Federal Financial Management Improvement Act of 1996* (FFMIA)

The following sections discuss our opinion on MMS's financial statements, our consideration of MMS's internal control over financial reporting, our tests of MMS's compliance with certain provisions of applicable laws and regulations, and management's and our responsibilities.

OPINION ON THE FINANCIAL STATEMENTS

We have audited the accompanying consolidated balance sheets of the Minerals Management Service as of September 30, 2003 and 2002, and the related consolidated statements of net costs, consolidated statements of changes in net position, combined statements of budgetary resources, consolidated statements of financing, and statements of custodial activity, for the years then ended.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of MMS as of September 30, 2003 and 2002, and its net costs, changes in net position, budgetary resources, reconciliation of net costs to budgetary obligations, and custodial activity for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

MMS prepared the accompanying financial statements assuming that the Interior Franchise Fund will continue as a going concern. As discussed in Note 1 to the financial statements, the expiration of the Interior Franchise Fund's authorizing legislation on October 1, 2004 creates an uncertainty about the Interior Franchise Fund's ability to continue as a going concern. Management plans regarding this matter are also described in Note 1. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

The information in the Management's Discussion and Analysis, Required Supplementary Stewardship Information, and Required Supplementary Information sections is not a required part of the financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America or OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements*. 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.

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The consolidating information in the Other Supplementary Information section is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position of MMS's components individually. The consolidating information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

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 MMS's ability to record, process, summarize, and report financial data consistent with the assertions by management in the 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, in amounts that would be material in relation to the 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.

In our fiscal year 2003 audit, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. However, we do not consider any of these reportable conditions to be material weaknesses.

A. Application and General Controls over Financial Management Systems

MMS does not have adequate information technology security and general controls to protect its financial information systems as required by OMB Circular A-130, *Management of Federal Information Resources*. These conditions could affect MMS's ability to prevent and detect unauthorized changes to financial information, control electronic access to sensitive information, and protect its information resources. Although MMS has improved its application and general controls, MMS needs to continue improving its security and general controls, as discussed below.

1. *Entity-wide Security Program and Planning* – An effective security program includes security plans, system risk assessments and accreditations, background investigations, and incident response plans. MMS has a security monitoring and reporting program, however, the program does not include all Minerals Royalty Management information systems, platforms and components. In addition, MMS has not formally documented its physical security program for its operations facility. Furthermore, MMS has a certification and accreditation program, however, MMS has not fully completed the certification and accreditation process for all application and general support systems.

2. *Access Controls* – Access controls should provide reasonable assurance that computer resources such as data files, application programs, and computer-related facilities and equipment are protected against unauthorized modification, disclosure, and loss. We identified access vulnerabilities relating to certain systems. In addition, MMS does not require periodic reviews of access controls over network and application access and does not consistently perform periodic reviews of user access. Furthermore, MMS is not fully utilizing security reports to detect manual overrides for automated royalty transactions.

3. *Software Development and Change Controls* – Establishing controls over the modification of application software programs helps ensure that only authorized programs and modifications are implemented. MMS has not established policies and procedures for testing certain application changes prior to the implementation of the changes.

4. *Service Continuity* – Losing the capability to process, retrieve, and protect information maintained electronically could significantly affect MMS's ability to accomplish its mission. MMS has a Continuity of Operations Plan; however, the plan does not include an inventory of hardware and software, prioritization for the recovery of applications and hardware in the event of a disaster, or insurance coverage. In addition, MMS has not documented its policies and procedures for backing up certain files.

Recommendation

We recommend that MMS develop and implement a formal action plan to improve the general and application controls over its financial management systems. This plan should address each of the areas discussed above, as well as other areas that might impact the information technology control environment, to ensure adequate security and protection of MMS's information systems.

B. **Transactions and Balances with Trading Partners**

MMS does not fully reconcile its intra-departmental transactions and balances, in accordance with the OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements,* and Treasury's *Federal Intragovernmental Transactions Accounting and Policies Guide* in a timely manner. MMS and the other Interior components did not start the reconciliation process until the third quarter of the fiscal year. In addition, MMS is dependent upon other Interior components to provide information and these components do not consistently respond to MMS. As a result, MMS expended a significant amount of time after month end reconciling and adjusting transactions and balances.

Recommendation

We understand that the Department of the Interior is developing an automated process to facilitate the reconciliation of intra-Departmental transactions. We recommend that MMS work with the Department to complete and implement the automated process to facilitate the reconciliation of intra-departmental transactions and balances. Until the automated process is implemented, we recommend that MMS work with other Interior components to identify and reconcile the intra-departmental transactions and balances. The reconciliation process should be completed at least quarterly and include procedures to resolve any differences identified in a timely manner.

C. Accounts Receivable

MMS does not consistently analyze and adjust accounts receivable balances related to royalties, bonuses, rents and other transactions. MMS needs to improve controls over accounts receivable as follows:

1. *Royalties* – Although MMS has reserved all accounts receivable balances over one year old and a portion of receivables over six months old, MMS has aged royalty and negative royalty receivables, open invoices, and credits dating back to 1986.

2. *Rents and Bonuses* – MMS's royalty system does not enable MMS to efficiently match bonus and rent receivables with the payments MMS has received. As a result of our observations, MMS analyzed and adjusted the unmatched receivables and payments.

Recommendations

We recommend that MMS perform the following to improve controls over accounts receivable:

1. *Royalties* – We recommend that MMS analyze and resolve the aged and unusual accounts receivable balances. This includes monitoring delinquent accounts, resolving credit balances, and writing off older balances when appropriate.

2. *Rents and Bonuses* – We recommend that MMS improve the configuration of the royalty system to minimize unmatched rent and bonus receivables with the related payments. In addition, MMS should configure the royalty system to provide MMS with a monthly report of any unmatched items. MMS should investigate and resolve the unmatched item report on a monthly basis.

D. Customer Orders

MMS does not effectively reconcile customer orders from the subsidiary ledger to the general ledger. In addition, MMS does not consistently record modifications to customer orders. As a result of our observations, MMS analyzed and adjusted the customer orders.

Recommendation

We recommend that MMS reconcile the customer orders from the subsidiary ledger to the general ledger on a monthly basis. In addition, we recommend that MMS require supervisors to review and approve customer orders sent from the subsidiary ledger to the general ledger suspense records before posting the customer orders to the general ledger.

A summary of the status of prior year reportable conditions is included as Exhibit I. We also noted other matters involving internal control over financial reporting and its operation that we have reported to the management of MMS in a separate letter dated November 14, 2003.

COMPLIANCE WITH LAWS AND REGULATIONS

The results of our tests of compliance with certain provisions of laws and regulations described in the Responsibilities section of this report, exclusive of those referred to in FFMIA, disclosed no instances of noncompliance that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 01-02.

The results of our tests of FFMIA disclosed instances, described below, where MMS's financial management systems did not substantially comply with Federal financial management systems requirements and the United States Standard General Ledger at the transaction level. The results of our tests of FFMIA disclosed no instances in which MMS's financial management systems did not substantially comply with the Federal accounting standards.

E. *Federal Financial Management Improvement Act of 1996* (FFMIA)

1. *Federal Financial Management System Requirements* – As discussed in the section of our report entitled "Internal Control over Financial Reporting," MMS needs to improve its EDP security and general control environment. MMS needs to improve its entity-wide security program, strengthen access controls, improve software change and development controls, and enhance its service continuity policies. As a result, MMS does not substantially comply with the security and general control requirements of OMB Circular A-130, *Management of Federal Information Resources*.

2. *U.S. Standard General Ledger at the Transaction Level* – In accordance with OMB Circular A-127, *Financial Management Systems*, MMS is required to record financial events consistent with the applicable account descriptions and attributes reflected in the United States Standard General

Ledger (SGL) at the transaction level. However, we noted that MMS does not substantially comply with the SGL at the transaction level as the royalty accounting system does not have all the appropriate posting models and does not allow MMS to track trading partners. In addition, certain posting models are not consistent with Treasury's guidance. As a result, MMS expended a significant amount of time and resources analyzing and manually adjusting its trial balances to ensure the amounts were fairly stated.

Recommendations

We recommend that during fiscal year 2004, MMS perform the following:

1. *Federal Financial Management Systems Requirements* – Improve the application and general controls over its financial management systems in accordance with requirements set forth in OMB Circular A-130.

2. *U.S. Standard General Ledger at the Transaction Level* – Modify its royalty accounting system to ensure that royalty activity is recorded consistently with requirements set forth in OMB Circular A-127.

RESPONSIBILITIES

Management's Responsibilities

The *Government Management Reform Act of 1994* (GMRA) requires each federal agency to report annually to Congress on its financial status and any other information needed to fairly present its financial position and results of operations. To assist the Department of the Interior in meeting the GMRA reporting requirements, MMS prepares annual financial statements.

Management is responsible for:

- Preparing the financial statements in conformity with accounting principles generally accepted in the United States of America

- Establishing and maintaining internal controls over financial reporting, and preparation of the Management's Discussion and Analysis (including the performance measures), required supplementary information, and required supplementary stewardship information

- Complying with laws and regulations, including FFMIA

In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies. Because of inherent limitations in internal control, misstatements, due to error or fraud may nevertheless occur and not be detected.

Auditors' Responsibilities

Our responsibility is to express an opinion on the fiscal year 2003 and 2002 financial statements of MMS based on our audits. 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*, and OMB Bulletin No. 01-02. Those standards and OMB Bulletin No. 01-02 require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit includes:

- Examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements

- Assessing the accounting principles used and significant estimates made by management
- Evaluating the overall financial statement presentation

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

In planning and performing our fiscal year 2003 audit, we considered MMS's internal control over financial reporting by obtaining an understanding of MMS'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 financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 01-02 and *Government Auditing Standards*. 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 assurance on internal control over financial reporting. Consequently, we do not provide an opinion thereon.

As required by OMB Bulletin No. 01-02, we considered MMS's internal control over required supplementary stewardship information by obtaining an understanding of MMS's internal control, determining whether these internal controls had been placed in operation, assessing control risk, and performing tests of controls. Our procedures were not designed to provide assurance on internal control over required supplementary stewardship information and, accordingly, we do not provide an opinion thereon.

As further required by OMB Bulletin No. 01-02, with respect to internal control related to performance measures determined by management to be key and reported in the Management's Discussion and Analysis, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions. Our procedures were not designed to provide assurance on internal control over performance measures and, accordingly, we do not provide an opinion thereon.

As part of obtaining reasonable assurance about whether MMS's fiscal year 2003 financial statements are free of material misstatement, we performed tests of MMS's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 01-02, 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 and regulations applicable to MMS. Providing an opinion on compliance with laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion.

Under OMB Bulletin No. 01-02 and FFMIA, we are required to report whether MMS's 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 meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements.

DISTRIBUTION

This report is intended for the information and use of MMS's management, Department of the Interior's management, the Department of the Interior's Office of the Inspector General, OMB, the General Accounting 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 14, 2003

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Exhibit 1

MINERALS MANAGEMENT SERVICE

Summary of the Status of Prior Year Findings

September 30, 2003

Ref	Condition Area	FY2003 Status
A	Improve controls over Information Technology data security	This condition has not been corrected and is repeated in fiscal year 2003. See finding A.
B	Improve controls over investment reconciliations	This condition has been corrected.
C	Improve controls over the reporting of the Strategic Petroleum Reserve	This condition has been corrected.
D	Federal Financial Management Systems Requirements	This condition has not been corrected and is repeated in fiscal year 2003. See finding E.
E	U.S. Standard General Ledger at the Transaction Level	This condition has not been corrected and is repeated in fiscal year 2003. See finding E.

Attachment 2

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
Washington, DC 20240

NOV 25 2003

Memorandum

To: Assistant Inspector General for Audits

From: R. M. "Johnnie" Burton
Director

Johnnie Burton

Walter D. Cruickshank Walter D. Cruickshank
Deputy Director and Chief Financial Officer

Subject: Draft Independent Auditors' Report on the Minerals Management Service's Financial Statements for Fiscal Years 2003 and 2002 (Assignment Number: E-IN-MMS-0102-2002)

Thank you for the opportunity to respond to the draft independent auditors' (KPMG) report on MMS's financial statements for Fiscal Years 2003 and 2002. We concur with the independent auditors' findings of four reportable conditions, none of which are considered material weaknesses, related to internal controls and financial operations. Attached are our specific comments on the identified recommendation.

Please contact Denise Johnson at 202-208-3976 if you have any further questions.

Attachment

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Audit Agency: Office of Inspector General (OIG)

General Comments

MMS concurs with the independent auditors' findings involving internal control over financial reporting and its operations and provides the following specific comments:

INTERNAL CONTROL OVER FINANCIAL REPORTING

A. Application and General Controls over Financial Management Systems

MMS does not have adequate information technology security and general controls to protect its financial information systems as required by OMB Circular A-130, *Management of Federal Information Resources*. These conditions could affect MMS's ability to prevent and detect unauthorized changes to financial information, control electronic access to sensitive information, and protect its information resources. Although MMS has improved its application and general controls, MMS needs to continue improving its security and general controls, as discussed below.

1. Entity-wide Security Program and Planning – An effective security program includes security plans, system risk assessments and accreditations, background investigations, and incident response plans. MMS has a security monitoring and reporting program, however, the program does not include all Minerals Royalty Management information systems, platforms and components. In addition, MMS has not formally documented its physical security program for its operations facility. Furthermore, MMS has a certification and accreditation program, however, MMS has not fully completed the certification and accreditation process for all application and general support systems.

2. Access Controls – Access controls should provide reasonable assurance that computer resources such as data files, application programs, and computer-related facilities and equipment are protected against unauthorized modification, disclosure, and loss. We identified access vulnerabilities relating to certain systems. In addition, MMS does not require periodic reviews of access controls over network and application access and does not consistently perform periodic reviews of user access. Furthermore, MMS is not fully utilizing security reports to detect manual overrides for automated royalty transactions.

3. Software Development and Change Controls – Establishing controls over the modification of application software programs helps ensure that only authorized programs and modifications are implemented. MMS has not established policies and procedures for testing certain application changes prior to the implementation of the changes.

4. Service Continuity – Losing the capability to process, retrieve, and protect information maintained electronically could significantly affect MMS's ability to accomplish its mission. MMS has a Continuity of Operations Plan; however, the plan does not include an inventory of hardware and software, prioritization for the recovery of applications and hardware in the event of a disaster, or insurance coverage. In addition, MMS has not documented its policies and procedures for backing up certain files.

Recommendation

We recommend that MMS develop and implement a formal action plan to improve the general and application controls over its financial management systems. This plan should address each of the areas discussed above, as well as other areas that might impact the information technology control environment, to ensure adequate security and protection of MMS's information systems.

MMS Response

MMS concurs that it should continue in improving its security and general controls. A number of the issues documented in the finding have been corrected, or are scheduled as discussed below, to be corrected in the near future.

1. Entitywide Security Program and Planning: We feel that we have addressed the findings in relation to the security monitoring and reporting program. The issues cited are primarily related to the network infrastructure to which the MRMFS is attached. Currently MMS is utilizing Microsoft Operations Manager (MOM) to monitor the security event logs and analyze them for issues. The MOM servers have the full capability to monitor NT 4.0 servers with the proper application pack plug-ins. The plug-ins have been procured and loaded. Licenses for the NT 4.0 servers have previously been procured, and the agents have been installed. In addition, access to these systems is monitored and controlled by IDS, router tables, and access permissions on file shares/applications. The MOM software for the network and servers provide the first layer of security for the MRMFS. There is a completely separate and proprietary implementation of monitoring including security/intrusion detection and performance operated by the MRMFS Application Service Provider, USINet.

   MMS concurs that a comprehensive security policy is needed. MMS has focused extensive resources on formally documenting physical security policies, although we recognize that these policies are not maintained within a single collective reference source. MMS has numerous documented policies addressing all significant security concerns to include: Roles and Responsibilities; Emergency Contact and Numbers; Rules of Behavior; Identification Badges; Hours of Operation; Hiring Procedures; Termination Procedures; Physical Access to the Building; Emergency Procedures; Visitor Registration; Security Violation Reporting; and Restricted and/or Sensitive Areas of the Building. We will begin the process of consolidating these directives/areas into a comprehensive publication with a target completion date of March 30, 2004.

In regards to the certification and accreditation program, MMS has completed the initial assessment of ABACIS. We have resolved the vulnerabilities identified from the initial assessment and have been granted an Interim Authority to Operate (IATO). The IATO was granted by the CIO in September 2003. We expect the system to be accredited sometime in FY 2004.

2. Access Controls: Procedures are in place for the system manager to periodically review the VEAUDIT/3000 report. These reports will be scheduled to run every 90 days. The System Manager will be required to review the reports and address violations. Additionally, a report will be generated for user profiles for periodic reviews to validate that user access rights are appropriate and to ensure terminated employee's accounts are deactivated.

3. Software Development and Change Controls: MMS has long standing established policies and procedures addressing testing of application changes. As documented in the "MMS Software Development, Testing & Release Policy," MMS addresses the following related to the documentation of application testing prior to implementation of software changes: the development of plans and required test case scenarios; tracking of test plan by identification number; coordination of test plan with other ABACIS bureaus and walkthrough of test plans to include testing responsibilities; development of detailed test scripts and execution of test scripts; documentation of test errors and followup steps; documentation of final test results. We will continue to review and improve these policies and controls.

4. Service Continuity: As noted, MMS has a documented Continuity of Operations Plan. To ensure the Plan fully addresses all facets of Service Continuity, MMS is currently performing the following:

   - Hardware and Software Inventories - As part of the certification and accreditation (C&A) process MMS has completed an inventory of all current hardware, peripheral equipment, and software associated with the ABACIS system, as well as an asset valuation.

   - Recovery Prioritization - The prioritization of systems and application recovery in the event of a disaster will be addressed upon completion of a Business Impact Analysis (BIA) for the MMS Net (WAN/LAN). The BIA will be conducted prior to developing a disaster recovery plan. The BIA will consist of detailed questionnaires to survey each business area and provide detailed information regarding IT system needs, recovery timeframes, and operational requirements. The information gathered will be evaluated to prioritize system and application recovery in the event of a disaster. The ABACIS COOP will be updated to include the system recovery schedule and priority.

- Insurance - Because the U.S. Government is self insured, MMS does not maintain insurance coverage to mitigate losses incurred as a result of loss of system continuity.

- Back-Up Policies and Procedures – MMS maintains an automated process on the Hewlett-Packard minicomputer to execute backup procedures. In addition, procedures had previously been developed for emergency submission of backup jobs if the automated process does not work. These procedures have been expanded in response to the need for critical system recovery. These procedures have been inserted into the HP reference manual.

B. Transactions and Balances with Trading Partners

MMS does not fully reconcile its intra-departmental transactions and balances, in accordance with the OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements,* and Treasury's *Federal Intragovernmental Transactions Accounting and Policies Guide* in a timely manner. Specifically, MMS and the other Interior components did not start the reconciliation process until the third quarter of the fiscal year. In addition, MMS is dependent upon other Interior components to provide information and these components do not consistently respond to MMS. As a result, MMS expended a significant amount of time after month end reconciling and adjusting transactions and balances.

Recommendation

We understand that the Department of the Interior is developing an automated process to facilitate the reconciliation of intra-Departmental transactions. We recommend that MMS work with the Department to complete and implement the automated process to facilitate the reconciliation of intra-Departmental transactions and balances. Until the automated process is implemented, we recommend that MMS work with other Interior components to identify and reconcile the intra-Departmental transactions and balances. The reconciliation process should be completed at least quarterly and include procedures to resolve any differences identified in a timely manner.

<u>MMS Response</u>

MMS concurs with the finding and recommendation and will implement the Department's automated process as soon as it becomes available.

C. Accounts Receivable

MMS does not consistently analyze and adjust accounts receivable balances related to royalties, bonuses, rents and other transactions. Specifically, MMS needs to improve controls over accounts receivable as follows:

1. Royalties – Although MMS has reserved all accounts receivable balances over one year old and a portion of receivables over six months old, MMS has aged royalty and negative royalty receivables, open invoices, and credits dating back to 1986.

2. Rents and Bonuses – MMS's royalty system does not enable MMS to efficiently match bonus and rent receivables with the payments MMS has received. As a result of our observations, MMS analyzed and adjusted the unmatched receivables and payments.

Recommendations

We recommend that MMS perform the following to improve controls over accounts receivable:

1. Royalties – We recommend that MMS analyze and resolve the aged and unusual accounts receivable balances. This includes monitoring delinquent accounts, resolving credit balances, and writing off older balances when appropriate.

2. Rents and Bonuses – We recommend that MMS improve the configuration of the royalty system to minimize unmatched rent and bonus receivables with the related payments. In addition, MMS should configure the royalty system to provide MMS with a monthly report of any unmatched items. MMS should investigate and resolve the unmatched item report on a monthly basis.

MMS Response

MMS agrees with the recommendation and has a plan in place to analyze and resolve aged and unusual accounts receivable balance issues during FY 2004. In addition, we plan to write off uncollectible receivables older than 2 years if they are not in bankruptcy or other administrative hold status. Recent software enhancements have improved the configuration of the royalty system to address the issue of matching rent receivables and payments. Minor payment matching and residual data cleanup are slated to be completed in FY 2004.

D. Customer Orders

MMS does not effectively reconcile customer orders from the sub ledger to the general ledger. In addition, MMS does not consistently record modifications to customer orders. As a result of our observations, MMS analyzed and adjusted the customer orders.

Recommendation

We recommend that MMS reconcile the customer orders from the sub ledger to the general ledger on a monthly basis. In addition, we recommend that MMS require supervisors to review and approve customer orders sent from the sub ledger to the general ledger suspense records before posting the customer orders to the general ledger.

MMS Response

MMS will initiate a month-end procedure to review all agreements downloaded into ABACIS between the last IPAC date and the end of the month and will cancel any duplicate agreements prior to closing the accounting records for the month. These procedures will be included in the Financial Management's quality assurance plan, and proper documentation will be prepared and retained to support completion of the monthly procedure.

COMPLIANCE WITH LAWS AND REGULATIONS

The results of our tests of compliance with certain provisions of laws and regulations described in the Responsibilities section of this report, exclusive of those referred to in FFMIA, disclosed no instances of noncompliance that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 01-02.

The results of our tests of FFMIA disclosed instances, described below, where MMS's financial management systems did not substantially comply with Federal financial management systems requirements and the United States Standard General Ledger at the transaction level. The results of our tests of FFMIA disclosed no instances in which MMS's financial management systems did not substantially comply with the Federal accounting standards.

E. Federal Financial Management Improvement Act of 1996 (FFMIA)

1. Federal Financial Management System Requirements – As discussed in the section of our report entitled "Internal Control over Financial Reporting," MMS needs to improve its EDP security and general control environment. MMS needs to improve its entity-wide security program, strengthen access controls, improve software change and development controls, and enhance its service continuity policies. As a result, MMS does not substantially comply with the security and general control requirements of OMB Circular A-130, *Management of Federal Information Resources*.

2. U.S. Standard General Ledger at the Transaction Level – In accordance with OMB Circular A-127, *Financial Management Systems*, MMS is required to record financial events consistent with the applicable account descriptions and attributes reflected in the United States Standard General Ledger (SGL) at the transaction level. However, we noted that MMS does not substantially comply with the SGL at the transaction level as the royalty accounting system does not

have all the appropriate posting models and does not allow MMS to track trading partners. In addition, certain posting models are not consistent with Treasury's guidance. As a result, MMS expended a significant amount of time and resources analyzing and manually adjusting its trial balances to ensure the amounts were fairly stated.

Recommendations

We recommend that during fiscal year 2004, MMS perform the following:

1. Federal Financial Management Systems Requirements –Improve the application and general controls over its financial management systems in accordance with requirements set forth in OMB Circular A-130.

2. U.S. Standard General Ledger at the Transaction Level –Modify its royalty accounting system to ensure that royalty activity is recorded consistent with requirements set forth in OMB Circular A-127.

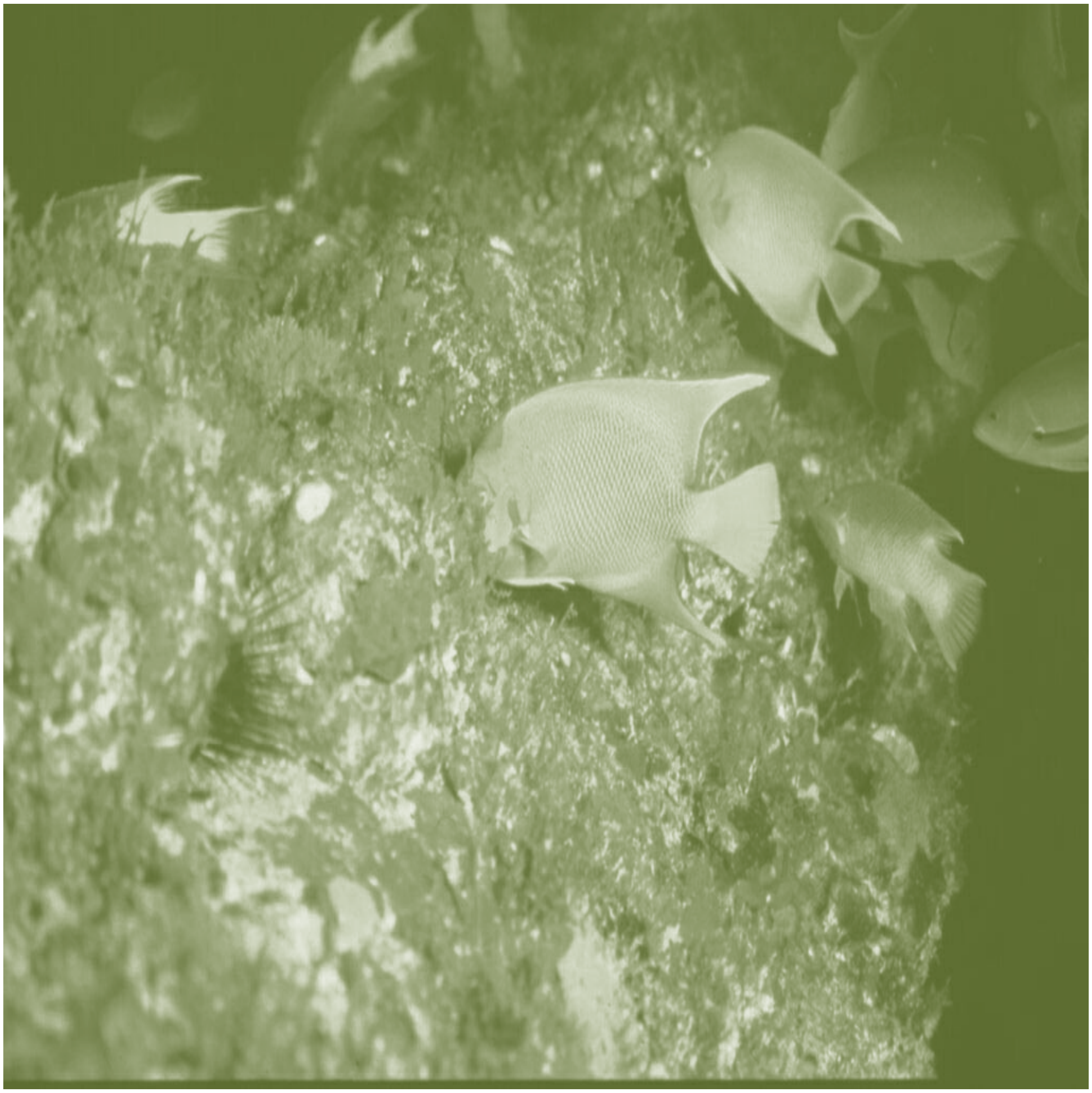
MMS Response

1. As discussed in our response to the section of your report entitled "Internal Control over Financial Reporting," MMS concurs with the recommendations and will develop and implement a formal action plan to improve the general and application controls over its financial management systems.

2. MMS agrees with the recommendation and believes that the implementation of the current round of MRM financial system software changes will resolve the majority of issues and place MRM in substantial compliance with FFMIA. The software improvements will:

    - Reduce the number of nonstandard journal vouchers.
    - Enhance system capability to properly post trading partner information.
    - Align our accounting models to be more consistent with the U.S. Standard General Ledger and Department of the Interior chart of accounts.

    In addition, we continue to revise and update posting models to prepare a timely and accurate trial balance. The software changes to the royalty accounting system were implemented prior to a software freeze that began in October 2003 and will extend through most or all of Fiscal Year 2004. This freeze is necessary to allow a mandatory upgrade of the PeopleSoft financial software platform. Any other necessary enhancements to meet FFMIA requirements will be addressed as priority pending completion of the PeopleSoft upgrade during FY 2004.



Angel fish feed on the lush growth covering the legs of a platform.

The Department of the Interior Mission

As the Nation's principal conservation agency, the Department of the Interior has responsibility for most of our nationally owned public lands and natural resources. This includes fostering sound use of our land and water resources; protecting our fish, wildlife, and biological diversity; preserving the environmental and cultural values of our national parks and historical places; and providing for the enjoyment of life through outdoor recreation. The Department assesses our energy and mineral resources and works to ensure that their development is in the best interests of all our people by encouraging stewardship and citizen participation in their care. The Department also has a major responsibility for American Indian reservation communities and for people who live in island territories under U.S. administration.

The Minerals Management Service Mission

As a bureau of the Department of the Interior, the Minerals Management Service's (MMS) primary responsibilities are to manage the mineral resources located on the Nation's Outer Continental Shelf (OCS), collect revenue from the Federal OCS and onshore Federal and Indian lands, and distribute those revenues.

Moreover, in working to meet its responsibilities, the **Offshore Minerals Management Program** administers the OCS competitive leasing program and oversees the safe and environmentally sound exploration and production of our Nation's offshore natural gas, oil and other mineral resources. The MMS **Minerals Revenue Management** meets its responsibilities by ensuring the efficient, timely and accurate collection and disbursement of revenue from mineral leasing and production due to Indian tribes and allottees, States and the U.S. Treasury.

The MMS strives to fulfill its responsibilities through the general guiding principles of: (1) being responsive to the public's concerns and interests by maintaining a dialogue with all potentially affected parties and (2) carrying out its programs with an emphasis on working to enhance the quality of life for all Americans by lending MMS assistance and expertise to economic development and environmental protection.